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## US TAX GUIDE

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### Non-Profits Operating Abroad

Filing Forms 990-EZ and 990  
**(for the first time)**

# Table of Contents

**Introduction** .....3

**Chapter 1: Form 990-EZ**.....4

**Chapter 2: Form 990**.....8

## Introduction

*Hola Expat Tax Services was founded to provide tax services to US expats living around the world. Our clients work across a wide range of industries, including for non-profits. As a result of our clients referring us to their organizations, we have begun assisting an increasing number of non-profits with their IRS filings. The organizations (public charities) that we assist are engaged in activities outside the United States.*

**The purpose of this tax guide is to help non-profit organizations file Form 990-EZ or Form 990 for the first time.** There are two chapters to this tax guide. Chapter 1 examines Form 990-EZ, while Chapter 2 covers Form 990. The focus of both chapters is primarily on those sections that require **reporting of financial activities**.

Many non-profit organizations start out by filing Form 990-N (e-Postcard), which is a very simple filing. Unfortunately, Form 990-N can only be used when gross receipts are \$50K or less. When the gross receipts of a non-profit exceed this threshold, the reporting requirements increase significantly. The following table specifies the financial thresholds for the three 990 informational returns.

990 Informational Returns	Financial Thresholds
<b>Form 990-N (e-Postcard)</b>	Annual gross receipts of \$50K or less
<b>Form 990-EZ</b>	Annual gross receipts between \$50K and \$200K <u>and</u> Total assets less than \$500K
<b>Form 990</b>	Annual gross receipts of \$200K or more <u>or</u> Total assets of \$500K or more

Note: Gross proceeds, as defined by the IRS, include: (1) contributions, gifts and grants; (2) revenue derived from program services; (3) **gross revenue** from sale of assets and inventory; and (4) **gross revenue** derived from fundraising activities.

## Chapter 1: Form 990-EZ

Let's begin with an examination of Form 990-EZ. At this point, it may be a good idea to have the actual form close-at-hand. There are 6 sections to Form 990-EZ, three of which relate to financial activities. Per the focus of this tax guide, we will explore the first 3 sections only.

1. Revenue/Expenses and Change in Net Assets
2. Balance Sheet
3. Program Services
4. Officers, Directors, Trustees, and Key Employees
5. Other Information
6. Other Information (only for 501c3 organizations)

### Form 990-EZ – Part I

**Revenue, Expenses and Change in Net Assets** – This section is basically an income statement. One reports all the sources of revenue and expenses to calculate net income. Then net income is added to the net assets or fund balance (at the beginning of the year) to derive the year-end net assets or fund balance.

Let's slow down, and expand upon the important line items that fall under Revenue, Expenses, and Change in Net Assets. The following table describes the most **common revenue line items**:

Revenue – Line Items	Key Points
<b>Contributions, gifts, grants</b>	<ul style="list-style-type: none"><li>• The majority of non-profits will have a significant portion of their revenue on this line item;</li><li>• Includes cash and non-cash amounts, the latter being valued at the time of the donation</li></ul>
<b>Program service revenue</b>	<ul style="list-style-type: none"><li>• Program service revenue is income received through the programs offered by the organization (e.g., payments received by a health clinic)</li></ul>
<b>Membership dues</b>	<ul style="list-style-type: none"><li>• For the purpose of this line item, membership dues must be equivalent or comparable to the value of the benefit received by the purchaser Example: John Smith buys a membership that provides a discount on museum visits. If the cost of the membership is greater than the value of the</li></ul>

## US Tax Guide – Non-Profits Operating Abroad

	discount, the difference should be reported under contributions.
<b>Fundraising events (line 6b)</b>	<ul style="list-style-type: none"> <li>• Fundraising events include: dinners, auctions, etc.;</li> <li>• For the purpose of this line item, gross income must be equivalent or comparable to the value of the benefit received by the purchaser Example: Jane Smith buys a ticket to a fundraiser dinner</li> </ul>
<b>Sale of Inventory (line 7a)</b>	<ul style="list-style-type: none"> <li>• Relevant for non-profits that sell products as a revenue source</li> </ul>

Most of the **expense line items** are straightforward. The table below describes the two expense categories that warrant some explanation:

Expenses – Line Items	Key Points
<b>Grants paid</b>	<ul style="list-style-type: none"> <li>• Grants can be made to individuals and organizations (affiliated with the non-profit making the payment);</li> <li>• Grants include scholarships, fellowships, and research grants</li> </ul>
<b>Benefits paid to or for members</b>	<ul style="list-style-type: none"> <li>• Insurance premiums paid on behalf of members (not employees)</li> <li>• Generally not relevant for 501c3 organizations</li> </ul>

The **Change in Net Assets** is a reasonably simple calculation. Based on the revenue and expenses for the year, an organization has net income or loss for the year (excess or deficit), which appears on line 18. The net income figure is added to the beginning-of-year net assets or fund balance (line 19). Net assets come off the balance sheet, and represents the difference between the assets and liabilities of the organization. By adding net income to net assets at the beginning-of-year, one derives net assets for end-of-year (line 21).

To be able to align the income statement with the balance sheet, accurate bookkeeping is an absolute must.

## US Tax Guide – Non-Profits Operating Abroad

### Form 990-EZ – Part II

**Balance Sheets** – The required balance sheet information on Form 990-EZ is straightforward. The most important thing to keep in mind is that the beginning-of-year figures must equal the end-of-year figures from the prior year. Otherwise, the discrepancies must be explained.

### Form 990-EZ – Part III

**Statement of Program Service Accomplishments** – According to the IRS, a program service is a major (usually ongoing) objective of an organization. In this section, the non-profit describes the accomplishments of its top three program services. Along with the description, the expenses associated with each program service must be provided if the non-profit is a 501c3. Presumably, total program service expenses (line 32) would be a significant portion of the total expenses, as reported under Part I.

### **Form 990-EZ – Schedule A**

501c3 organizations are generally required to file Schedule A with either Form 990-EZ or 990. This schedule is used by non-profits to validate its status as a **public charity**.

Why is public charity status important? The answer is that if a non-profit fails to maintain its public charity status, it would then be classified as a private foundation, and thus subject to complex and restrictive legal requirements.

**Reason for Public Charity Status** (Part I) – The majority of 501c3 organizations select **option 7** or **option 9** as their reason for public charity status.

- Option 7 represents an organization that normally receives a substantial part of its support from a governmental unit or from the general public. By selecting this option, one is required to complete Part II of Schedule A.
- Option 9 is typically the option for non-profits that sell a substantial amount of goods and/or services. With this option, one is required to complete Part III of Schedule A.

**Public Support Test** (Part II and III) – The public support test is the most common means of qualifying as a public charity. During the first 5 years of a non-profit's existence, the IRS waives the test (i.e., an organization does not need to pass the test to maintain public charity status). However, the public support test becomes active in Year 6, requiring that a non-profit receive a certain percentage of its revenue from the general public.

## US Tax Guide – Non-Profits Operating Abroad

**While there are 3 public support tests, most non-profits utilize one of 2 tests.** Both require calculating a fraction, where the numerator is the non-profit's "public support," and the denominator is its "total support."

1. The **One-Third Test** requires that a non-profit derive at least one-third of its total support from public support (i.e., the fraction must equal one-third or greater).
  - Total support excludes revenue from charitable activities and capital gains.
  - Public support excludes contributions from any source other than a governmental unit or public charity that exceed 2% of total support received over the 5-year period.
  - For example: ABC Organization had \$100,000 in total support during the 5-year period. Two percent of \$100,000 is \$2,000 (the limitation). If ABC Organization had received \$5,000 in contributions from one particular individual, then \$3,000 of that amount would not count toward public support.
2. The **One-Third / One-Third Test** is composed of 2 parts. The first part requires that a non-profit derive at least one-third of its total support from public support. The second part requires that not more than one-third of its total support is derived from gross investment income and unrelated business income (i.e., not related to the organization's exempt purpose).

Definitions for total support and public support are different than the One-Third Test:

- Total support excludes only capital gains
- In calculating the figure for public support, the non-profit can include revenue from charitable activities.
- Public support excludes contributions from a "disqualified person," which includes: (1) officers, directors or other insiders of the non-profit; (2) "substantial contributors" – defined as any individual or organization who has given more than \$5,000 to the organization, if such gift constituted more than 2% of total contributions that the organization has received over the entire period of its existence; (3) any person holding more than 20% interest in an entity that is a substantial contributor; (4) a family member of any of the preceding persons; and (5) any corporation, partnership, or other organization owned more than 35% by any of the preceding persons.
- Public support also excludes receipts from charitable activities that exceed the greater of \$5,000 or 1% of the non-profit's total support for each tax year (calculated for each individual or entity).

## US Tax Guide – Non-Profits Operating Abroad

With both tests, large contributions can negatively impact the calculation for public support. That is because of the limitations in calculating public support (as already described).

- 2% Limitation (One-Third Test)
- Substantial Contributors (One-Third / One-Third Test)
- \$5,000 or 1% Limitation (One-Third / One-Third Test)

If a non-profit fails to qualify under either test (for the most recent year), it can still maintain its public charity status provided it qualified in the prior year. A single year of below-threshold public support will not necessarily disqualify an organization from public charity status.

Lastly, there is a 3rd public support test called “10%-facts-and-circumstances,” which we do not cover in this tax guide (more complicated).

### Form 990-EZ – Concluding Remarks

Form 990-EZ is a big jump from Form 990-N. Therefore, it is clearly advantageous to have good record keeping and financial controls in-place before a non-profit exceeds the \$50K threshold (annual gross receipts). Accounting software will likely be a good idea so that the non-profit can keep track of contributions, account for fund-raising events, record sales, assist with budgeting, and manage the balance sheet. For the needs of a small non-profit, most online application costs roughly \$200-300 per year.

The filing due date for Form 990-EZ is the 5<sup>th</sup> month after the non-profit’s accounting period. For an organization that is a calendar-year filer, May 15<sup>th</sup> is typically the due date. Failure to file by the due date carries a penalty of \$20 per day, not to exceed the lesser of \$10,000 or 5% of the gross receipts for the year.

### Chapter 2: Form 990

This chapter is focused on the transition from Form 990-EZ to Form 990. Specifically, the following sections and Schedule are highlighted:

- Form 990, Part VIII – detailed breakdown of revenue
- Form 990, Part IX – detailed breakdown of expenses
- Form 990, Part X – detailed balance sheet
- Schedule F – activities outside the United States

#### Form 990 – Part VIII (detailed breakdown of revenue)

On Form 990, the filer is required to provide a more detailed breakdown of revenue sources. Specifically, revenue sources need to be separated into those that are related to the organization's exempt purpose and those that are unrelated. Generally speaking, a non-profit's related revenue will be mainly derived from program services.

#### Form 990 – Part IX (detailed breakdown of expenses)

Similar to revenue, Form 990 requires a detailed breakdown of expenses. Expenses need to be separately categorized into: (a) program service expenses; (b) management and general expenses; and (c) fundraising expenses.

#### Form 990 – Part X (detailed balance sheet)

The level of detail required with respect to the balance sheet is significant. Most of the assets should be valued at cost or adjusted basis. Depreciation should be calculated based on GAAP.

## US Tax Guide – Non-Profits Operating Abroad

### Form 990 – Schedule F (Charitable Activities in a Foreign Country)

Non-profits that have a certain level of activity in a foreign country are required to complete one or more sections on Schedule F. The financial thresholds are summarized below:

- Part I – required if a non-profit had revenue or expenses of more than \$10K outside the United States. If the non-profit's activities are solely in a foreign country or region, then the information in this section will mostly be the same as the information provided in Part III of Form 990;
- Part II – required when a non-profit has provided grants or other assistance directly or indirectly to a **foreign entity** of more than \$5,000. Non-cash assistance should be based on fair market value (if possible). Each applicable entity is listed separately;
- Part III – required when a non-profit has provided grants or other assistance to **foreign individuals (in aggregate)** of more than \$5,000. Each type of grant/assistance per region is listed separately.

### Form 990 – Concluding Remarks

A non-profit that is required to file Form 990 should absolutely utilize accounting software (ideally one that is designed for non-profit organizations). Detailed financial reporting, including those highlighted above, would be extremely challenging otherwise.

The filing due date for Form 990 is the 5<sup>th</sup> month after the non-profit's accounting period.

## US Tax Guide – Non-Profits Operating Abroad

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