Are you feeling like the IRS might be watching you a little bit more closely these days. Sometimes your intuition is right. A new report from the IRS’s division of Tax Exempt and Government Entities confirms your suspicions. Lois Lerner, Director, Exempt Organizations Division, recently released the accomplishments of the prior fiscal year and gives us some insights into what to expect in the fiscal year of 2011. The 29-page report shows the priorities she has outlined that may affect you. The entire report is good reading, but I’ve highlighted some of the major points of importance to you.
PLAN

Nonprofits vs. the IRS
What Happened in Fiscal Year 2010?

The IRS increased the monitoring of nonprofit organizations. The numbers show that the Service has stepped up its efforts to check on charity compliance. For example:

- Audits of exempt organizations increased from 7,861 in FY 2008 to 10,187 in FY 2009 (a 30 percent rise) and to 11,449 in FY 2010 (another 12 percent). This is a significant three-year trend in audits of nonprofit organizations that appears will continue into the future. If you’ve been playing what I call ‘audit roulette’ and think you won’t be audited, your chances at the table just went up. This is a game you don’t want to play and really don’t want to win.

- IRS compliance checks (in which they ask about a specific item on a Form 990 or for more information on an organization’s operations by mail) are also being used extensively. They require fewer resources and as the report states, the checks will enable the IRS to “touch more organizations than by using an exclusively exam-based strategy.” It’s important to take these letters seriously and ensure you respond to them in a timely manner. I suggest you involve your accountants or your Audit Committee and even an outside consultant to help you draft your response. Often times your response can lead to more inquiries from the IRS and has the potential to lead to an audit of your organization. Many organizations show me this letter from the IRS, sometimes unopened, six months after they have received it.

- The IRS is working more closely with the Social Security Administration and all the states to identify nonfilers and noncompliant organizations more effectively so that the cases selected for exams are more likely to result in finding significant issues. This means they are focusing their efforts on those examinations that will most likely uncover issues and possibly result in assessments of tax, interest and penalties.

- The IRS is putting its money where its mouth is. There has been a growth in the Exempt Organizations staffing. There are more people in EO filling more jobs. The total number of employees has grown from 837 positions in 2008 to 910 in 2009, with another increase to 942 in 2010. Specifically and more informative is that 100 of these new positions over the two-year period were in the Examinations area. In comparison, staffing in all other major areas (Rulings & Agreements, Customer Education & Outreach, and Director’s Office) only increased by a total of five from FY 2008 to FY 2010. They are beefing up the resources needed to make more examinations of nonprofit organizations.

What Else is Happening?

The revised Form 990 was first used for filing in 2008, so the first full year of filings using the revised form is close to complete, and the second well underway. Have you noticed there is more media coverage of nonprofit organizations because of the amount of disclosure on the new Form 990. Not all of it is positive, with many revelations making the newspapers.

There are some indications of improvements in compliance in the second year of the new form’s use. With the use of the new form, all Form 990 filers are required to complete some information on Schedule O. In 2008, about 79 percent of the filers included it. That figure increased to 90 percent for those filing in 2009.

More organizations are e-filing (about 13 percent e-filed Forms 990 and 990-EZs in 2007; that figure grew to 19 percent in 2008). Only the largest organizations are typically required to e-file, but many others are discovering the ease and cost savings of doing so. Additionally, the threshold for filing Form 990 and the Form 990-N is changing. Do you know which form to file?

### 2011 Filing Requirements

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<th>Form</th>
<th>Gross Receipts</th>
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<tr>
<td>990-N</td>
<td>Less than or equal to $50,000</td>
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<td>990-EZ or 990</td>
<td>Greater than $50,000 and less than $200,000, and total assets less than $500,000</td>
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<td>990</td>
<td>Equal to or greater than $500,000, and total assets equal to or greater than $500,000</td>
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What’s Planned for FY 2011?
Nationally, the IRS has announced that over the next three years it will perform exams on employment tax issues. The Exempt Organization Division gets to play in this sandbox too. The EO Division’s share of this national program is 500 focused audits of exempt organizations per year for the next three years. My advice is to brush up on the fringe benefit rules and get into compliance.

Part of the reasoning for the revised Form 990 (besides Congressional attention to nonprofit organizations) was to collect the data that the IRS needed to ensure compliance. My experience has been that the IRS collects a lot of data, employs a lot of people to review and analyze that data and then develops programs that are targeted to improve compliance. This means, as the Director stated, the effort moves from project to process, meaning you’ll see more focus on issues the IRS believes are critical to its role as the administrator of tax laws. Now the IRS will be using the information to focus its limited resources.

The IRS will now begin cross checking compensation reporting with the Social Security Administration. The time frame for reporting compensation is the same as W-2 reporting now, thus the information can be compared to what was reported to the SSA. The IRS will be looking for differences between what is reported on Form 990 and what has been reported on the Form W-2 or 941, or if there are other reporting discrepancies.

Supporting organizations, typically set up to benefit one charity, are also targeted for special review of their charitable purpose. Other nonprofits will also be reviewed to determine if they really have been established for a charitable purpose or if they are primarily self-serving.

The IRS has an interest in the reporting of loans to officers, directors, trustees and key employees over the past several years. This has resulted in tax assessments of over $5.5 million and over $480,000 in employment taxes. The IRS also found many errors in reporting that needed adjustments, and it plans to continue its review of these loans. We just went through an election year and the IRS investigated allegations of prohibited political activity by exempt entities. They are developing better processes to handle these issues.

What Nonprofits Should Do
The IRS will be continuing its efforts to ensure that the nonprofit sector complies with the requirements that come with being a tax-exempt organization. Nonprofits can take some simple steps to lessen the likelihood of receiving an inquiry from the IRS in the coming year.

- Increase awareness of tax compliance throughout your organization.
- Send employees with tax responsibilities to some training.
- Can’t afford that? Bring training in house. Think you can’t afford that? Collaborate with another nonprofit to share the cost and arrange joint training.
- Make sure that what’s reported in compensation on Form 990 matches what is reported to other federal agencies, such as the Social Security Administration.
- Confirm that income taxes and other payments related to employees, such as Social Security and unemployment compensation (if required), are correctly reported and transmitted to the appropriate agencies.
- If loans have been made to executives, trustees, and other key employees, be aware that the IRS will be reviewing them, so be sure to report accurately. It’s an issue they have been investigating.
- Check out what political activity is allowed and what is prohibited—an updated IRS publication is now available on www.irs.gov.
- File Form 990 completely, accurately and on time. The threshold levels for organizations allowed to file the Form 990-EZ have changed significantly in the past several years, allowing the phase-in of the revised Form 990. Many organizations that have been filing Form 990-EZ for two years may now have to change to the full Form 990. Verify which form is required.

Steve Hoffman, MsT, EA, CFP® is an experienced tax resource for nonprofit organizations. He is available to present seminars and workshops in your area. He has 15 years of employment experience with the IRS and has held director of taxation positions at major nonprofit organizations. He specializes in nonprofit taxation, finance, and board development and provides advice to start up nonprofit organizations. For more information, send an email to StevenWHoffman@gmail.com, follow him on Twitter at stevenwhoffman, or read his blog at http://yourmostvaluableasset.blogspot.com.
De Minimis Fringe Benefits: What’s taxable and what’s not?

We’ve all hear the term “De Minimis” fringe benefits and we tend to think that they are not subject to any taxes at all. But that is not the case. So, what is a de minimis fringe benefit after all?

In general, a de minimis benefit is one for which, considering its value and the frequency with which it is provided, is so small as to make accounting for it unreasonable or impractical. De minimis benefits are excluded under Internal Revenue Code section 132(a)(4) and include items which are not specifically excluded under other sections of the Code. These include items such as:

- Controlled, occasional employee use of photocopier
- Occasional snacks, coffee, doughnuts, etc.
- Occasional tickets for entertainment events
- Holiday gifts
- Occasional meal money or transportation expense for working overtime
- Group-term life insurance for employee spouse or dependent with face value not more than $2,000
- Flowers, fruit, books, etc., provided under special circumstances
- Personal use of a cell phone provided by an employer primarily for business purposes

In determining whether a benefit is de minimis, you should always consider its frequency and its value. An essential element of a de minimis benefit is that it is occasional or unusual in frequency. Thus, a regular meeting that occurs every Friday with lunch provided is considered to be offered regularly. And the value of the food would be subject to taxation.

Further a fringe benefit must not be a form of disguised compensation. For example, the provision of an employer cell phone to an employee because we ‘really can’t afford to give you a raise right now’.
Whether an item or service is *de minimis* depends on all the facts and circumstances. In addition, if a benefit is too large to be considered *de minimis*, the entire value of the benefit is taxable to the employee, not just the excess over a designated *de minimis* amount. The Internal Revenue Service (IRS) has ruled previously in a particular case that items with a value exceeding $100 could not be considered *de minimis*, even under unusual circumstances.

This means, it is generally accepted to provide items of value to an employee up to 100.00 per year to employee. However, if the value is 101.00 the entire amount of fringe benefits provided are subject to taxation, not just the 1.00. (NOTE: It is wise to check with your state ethics commission as well. In one state, an employer could only provide 25.00 per year to employee.)

**Cash Benefits**

Cash is generally intended as a wage, and usually provides no administrative burden to account for. Cash, therefore, *cannot* be a *de minimis* fringe benefit. An exception is provided for occasional meal or transportation money to enable an employee to work overtime. The benefit must be provided so that employee can work an unusual, extended schedule. The benefit is not excludable for any regular scheduled hours, even if they include overtime and the employee must actually work the overtime. Meal money calculated on the basis of number of hours worked is not *de minimis* and is taxable wages.

**Gift Certificates/Gift Cards**

Gift cards are traditionally provided during holiday periods to employees. The IRS considers gift cards the same as cash provided to an employee and are always considered taxable by the IRS.

Cash or cash equivalent items (such as a gift card/certificate) provided by the employer are never excludable from income. An exception applies for occasional meal money or transportation fare to allow an employee to work beyond normal...
hours. Gift certificates that are redeemable for general merchandise or have a cash equivalent value are not *de minimis* benefits and are taxable.

A certificate that allows an employee to receive a specific item of personal property that is minimal in value, provided infrequently, and is administratively impractical to account for, may be excludable as a *de minimis* benefit, depending on facts and circumstances.

Achievement Awards

Special rules apply to allow exclusion from employee wages of certain employee achievement awards of tangible personal property given for length of service or safety. These awards

- Cannot be disguised wages
- Must be awarded as part of a meaningful presentation
- Cannot be cash, cash equivalent, vacation, meals, lodging, theater or sports tickets, or securities.

In addition, there are other requirements specific to achievement and safety awards and there are dollar limitations that must be met. See the Taxable Fringe Benefits Guide or Publication 535 for more information on www.irs.gov.

How are *de minimis* Fringe Benefits Reported?

It is necessary to coordinate with the payroll department to ensure correct reporting of fringe benefits.

If the benefits qualify for exclusion, no reporting is necessary. If they are taxable, they should be included in wages on Form W-2 and subject to income tax withholding at both the federal and state level. If the employees are covered for social security and Medicare, the value of the benefits is also subject to withholding for these taxes. You may optionally report any information in box 14 of Form W-2.
Author Bio

Steve Hoffman, The Tax Translator is a nationally known expert in taxation. Often called "Tax with Personality," Steve translates complex tax law into easily understood English. He is a published author and frequent presenter to many associations and organizations about how tax impacts them.
Visit www.thetaxtranslator.com
Follow @TaxTranslator

This article was published on HR.com and can be seen at this link:
Fraud on your Campus – How and Why?

I’m sitting here at my desk reading the Boston Globe newspaper and getting ready to create another great Newsletter for you. I see an interesting article about a case of fraud at the University of Massachusetts Medical School that generated the following discourse on fraud at colleges and universities.

The culprit was a $46,000 year financial analyst in an obscure department who somehow managed to drive a Porsche, collect Salvador deli paintings and build a palatial home for himself. He siphoned off nearly $3.4 million from payments intended for the state Medicaid insurance program over the last five years. The Globe reports this may be maybe the biggest theft by a state employee in more than a decade. Really? In only ‘more than a decade’ – I would have thought in more than a century. So, fraud appears to be a continual problem.

Here’s how he was caught. Not through continuous attention to procedure or monitoring of policies, but the fraud was only discovered after he died in a one car accident and a review of his work found all kinds of discrepancies. They eventually learned he had set up a dummy corporation to which he had been diverging state funds for years.

I did some more research into fraud at universities and found are many other examples:

- University executive embezzled $60,000 through extra payroll
- University accountant embezzled $30,000 through fictitious vendor
- University executive embezzled $600,000 over seven-year period by manipulating institutional accounts
- University project manager embezzled $2 million over five-year period through phony construction company
- University president/CEO/trustee embezzled $1.5 million over five year period through various fraudulent reimbursement schemes
- University resident life employee embezzled $300,000 over seven year period through cash payments made by students

Conclusion: It appears that fraud can and does appear at all levels –employees, executives, students, Board Members and Presidents too.

I have little doubt there were written policies and procedures designed to prevent and detect fraud. Most universities and colleges have these policies in place. However, written policies and procedures are inherently ineffective in themselves.
One reason for this is they are seldom monitored or reviewed. Sure, human resources may give a new employee a stack of papers to sign that says they have read and acknowledged receipt of the policies on fraud and what might happen to them and how it might impact them (termination) and the fact that they might face criminal prosecution. But the fact of the matter is we don’t do several items that would help to reduce fraud. I say ‘reduce’ as I believe we will never eliminate fraud at colleges and universities.

1. We don’t discuss fraud with employees. We simply don’t like to talk about it. It’s unpleasant to us and the employees. It takes more than just a written policy or procedure to prevent and detect fraud. How are you, as a Vice President communicating to your employees in the business and finance division and other divisions in the University that fraud is not acceptable and will be punished?
2. “Trust is not a control”. Sure we know that Sam has been working here for 25 years. He’s a good guy, knows his ‘stuff’ and is always willing to help out. What is needed is constant monitoring of procedures, checks and balances, reconciliations.
3. Annual review of written policies to insure they are current. That’s right, every year the policies are reviewed and updated. I see many policy statements that are ‘more than a decade’ old.
4. It’s not my job. It is not the sole job of Internal Audit to detect fraud. It takes a village to deter and detect fraud. Your role in the village is that of the “town crier”. I know it’s not in your job description to be a ‘town crier’ however when all is said and done, I believe they will look to the business and finance division to correct and deter fraud from occurring in the future. After all, we’re talking about money and that is what the Business and Finance Division is all about.
5. Culture will eat controls for breakfast. Everytime. Set the tone at the top.

It’s not easy to determine who might be or where fraud happens and one survey shows the ‘median’ losses of fraud at universities is between $100,000. and $125,000. Even if detected and convicted over 50% of universities recover nothing from the legal action. Normal background checks don’t always flag an individual as having potential commit fraud because most employees who commit fraudulent acts are first-time offenders. It is the long-term employees that typically cause greater losses along with high-ranking or executive positions. Makes sense right? They know how the system runs.

There are business areas to watch where fraud occurs most often and these include:

- accounting
- operations
- purchasing
- payroll

Steve Hoffman, The Tax Translator
Steve@TheTaxTranslator.com
732.853.4721
And let’s not forget executive management.

The most common fraud cases reported are billing scams followed by check tampering and fictitious expense reimbursement. Strangely enough these transactions are recorded in financial records such as an employee creating a fictitious vendor account and then sends the bill to be paid. Or an employee on a business trip decides to use university credit card for some personal expenses. So there is no need to ‘physically’ take cash or merchandise in order to commit fraud.

There are basically only two approaches to help eliminate fraud on campus: Deterrence and detection. Obviously the best approach is deterrence. As Vice President it is you who is responsible for ensuring that university funds are safeguarded from loss. It must be accepted reality that a fraud is possible in your University. Don’t fall into thinking that fraud symptoms are simply administrative errors because you can’t conceive of the existence of fraud in your organization, Ask yourself, “If assets or money were fraudulently obtained how would I know?”. Make sure there is an adequate system of internal controls in your organization. The major tenets of an internal control system include:

- separation of duties
- physical safeguarded over assets
- proper documentation
- proper approval
- adequate supervision
- physical inventories
- independent validation of transaction accuracy

How is most fraud detected?

Initially they are detected by

- A ‘tip’ = 43% (do you have an anonymous tip line in place?)
- Management review = 14%
- Internal audit = 14%
- By accident = 7%
- Account reconciliation = 4.8%
- Document examination = 4%
- External audit = 3%

What are some weaknesses of Controls you may have in place?

Steve Hoffman, The Tax Translator
Steve@TheTaxTranslator.com
732.853.4721
Surveys have shown these weaknesses:

- Lack of Management Review = 19%
- Override of existing internal controls = 19%
- Poor tone at the top = 9.3%
- Lack of competent personnel in oversight roles = 7.5%
- Lack of independent checks in on its = 3.4%
- Lack of employee fraud education 2.6%
- Lack of clear lines of authority 1.8%
- Lack of internal controls = 36.3%

Let's do the math.

- Increasing your internal controls gains you a 36% advantage
- Setting the tone at the top and you gain another 9.3%.
- Educate your employees and gain another 2.6%.
- Let's really test the override of the existing internal controls increase the odds by 19.8%

To sum up, fraud is not going to disappear because I wrote this. We have seen that it has been happening for ‘more than a decade’. That fraud can occur at all levels. That even though policies were in place, fraud still will happen on your campus, what we can do to reduce fraud and why we don’t do them, business areas to watch for fraud, how it is detected, weaknesses of controls in place and some math to know where to go to work first in detecting and reducing fraud.

See my other articles on LinkedIn:

Three Predictions about the Future of Higher Education

When is a ‘Stipend’ Really Not?

Student Athletes: Payments for Services?

Is the President and the Finance Department on the Same Page?

Game Plan: Non-Profits vs. the IRS

Tax Happens, But It Doesn’t Have to be Hard
What the Internal Revenue Service Discovered

Steve Hoffman, aka, ‘The Tax Translator”, has many years of experience and education and is dedicated to providing education and consulting to colleges and universities. With 15 years’ experience at the IRS and 12 years in higher education, he is uniquely qualified to see issues from ‘both sides of the desk’. His focus while making presentations is on audience learning. Known as the The Tax Translator, he makes tax law easily understood and has been called ‘Tax with Personality’. His first book, “Taxation for Universities and Colleges: Six Steps to a Successful Tax Compliance Program” was recently published by Wiley Publishing. His second book, ‘Resources from The Tax Translator” is over 400 pages of samples of policies related to tax, questionnaires, flowcharts, decision trees and other helpful articles to implement the six steps of a successful tax compliance program at your school. Contact Steve at Steve@TheTaxTranslator.com
In Audit Roulette, the House Always Wins

The IRS will be taking a closer look at independent schools’ Form 990s, employee fringe benefits and more in the 2015-2016 school year. By Steve Hoffinan

With myriad changes every year in federal, state and sometimes even local tax laws, independent schools can find themselves in a precarious position without keeping careful oversight of tax reporting duties. Of notable concern is that the Exempt Organizations Division (EOD) of the IRS is increasing its enforcement efforts involving nonprofits, where noncompliance is believed to be significant. For that reason and others, I suggest that independent schools pay particular attention to several major areas of federal tax law for the school year beginning in August.

In essence, nonprofits are more likely than for-profit organizations to be audited. Schools that do not set out to become compliant are playing a game of "audit roulette" with the IRS—and the house always wins this game.

Stepped-up Scrutiny in 2015-2016

- Form 990: In its new plan for the fiscal year beginning October 1, the EOD has indicated that it will continue to select nonprofits for audits based on potential indicators drawn from their Form 990s. Schools should be as complete and transparent as possible in completing the Form 990. Also be aware that during an audit, the IRS will ask to see a school’s written policies. The Tax Toolkit on NBOA’s website includes a list of the 10 policies every school should have, along with sample written policies, sample whistle blower policies and more (http://nboa.org/TaxToolkit/).

- Meals for employees: The IRS is intensifying scrutiny of free meals provided to employees, an emphasis prompted by audits of major software companies and since expanded to all organizations, including nonprofits. In order to be considered a reasonable fringe benefit, meals provided to employees must meet certain requirements. For instance, they must be for the convenience of the employer, not for employees. Schools that provide free meals without being able to demonstrate this could face large tax liabilities.

- UBT: The IRS continues to focus on unrelated business income tax as a result of an EOD compliance project that resulted in large assessments. The concern is whether organizations are accurately reporting their sources of unrelated business income—for instance, facility rentals and school merchandise—and whether they are correctly allocating and deducting expenses associated with them.

- Political activities: Coming into an election year, the IRS will almost certainly focus on "political activity by nonprofits." Certain actions can even result in the revocation of an organization’s tax-exempt status. For instance, schools may conduct voter education activities but are prohibited from endorsing candidates for public office or placing signs on their property that show support for a particular candidate.

Ongoing Areas of Focus

Independent contractors: The IRS believes that vast sources of income are not being reported through payroll withholding. The issue of independent contractor vs. employee is a "gray area" of taxation for independent schools, yet it arises in virtually every audit and often results in assessments, penalties and interest. For instance, a school may have a counselor who works at its summer camp as an independent contractor when, depending on the facts and circumstances, he or she should be paid through the payroll process. When in doubt, I suggest taking a conservative approach and paying independent contractors through the payroll system to protect the school from financial and reputational harm.

I also recommend that schools review how they classify whether to treat an independent contractor or employee, and then compare that to published guidance from the IRS (available at http://www.irs.gov/pub/irs-pdf/p1775.pdf). Another tip is to complete the questionnaire in the NBOA’s Tax Toolkit (http://www.nboa.org/TaxToolkit/) to determine whether someone should be considered an independent contractor. Finally, schools should have a clearly written policy covering payments to independent contractors.

For more on independent contractor relationships, see Legal Matters, page 42.

- Fringe benefits: These can be taxable or nontaxable, depending on the circumstances. In the context of independent schools, the IRS assesses particularly interest in housing and meals provided to employees. Penalties and awards can also be taxable unless certain conditions are met.

- State sales tax: Looking to increase revenue, states have become more sophisticated and aggressive in collecting sales tax. Some independent schools hold the mistaken belief that their tax-exempt status means they do not need to collect sales tax on items sold or services performed. But students and parents are not exempt from sales tax, so if a school has annual sales of $175,000 or more on goods or services, for example, it may have to collect sales tax.

Finally, be advised that states might change their rules on sales taxes at any time of the year. Check your state’s tax authority to be sure your school is in full compliance.

Help Is Available

The complexity and changing nature of tax laws make it incumbent on independent schools to take advantage of educational opportunities to stay compliant. Many free webinars are archived on the IRS video portal (http://www.irs.gov/professionals/). Another tip is to complete the questionnaire in the NBOA’s Tax Toolkit (http://www.nboa.org/TaxToolkit/) to determine whether someone should be considered an independent contractor. Finally, schools should have a clearly written policy covering payments to independent contractors. For more on independent contractor relationships, see Legal Matters, page 42.

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