

# Nonprofit Observer

Don't cross the line  
Inurement can catch the unwary

Strengthening your grant  
management framework

Now arriving: New charitable  
deduction limits in 2026

How to reduce risk  
associated with volunteers



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# Don't cross the line

Inurement can catch the unwary

**T**he IRS recently updated its technical guide addressing, among other things, the concept of impermissible inurement in Section 501(c)(3) organizations. The guide offers useful reminders on how the agency identifies inurement in nonprofit audits and the potential consequences of crossing the line.

## Inurement vs. private benefit

Nonprofits, of course, must be operated exclusively for one or more tax-exempt purposes. According to federal tax regulations, an organization fails this requirement if its net earnings “inure in whole or in part to the benefit of private shareholders or individuals.”

While the terms “private inurement” and “private benefit” are sometimes used interchangeably, the IRS distinguishes between them. “Inurement” refers to improper benefits received by so-called “insiders” (whether individuals or entities) who control the organization. “Private benefit” casts a wider net, applying to insiders as well as “outsiders” who don’t belong to a charitable class. In other words, all inurement is private benefit, but not all private benefit is inurement.

Additionally, inurement involves the taking of a nonprofit’s *net earnings* in a manner that benefits an insider. The private benefit doctrine, however, looks at the organization’s *primary activities* and who benefits from them.

The consequences of violating the two principles differ as well. The IRS says any degree of inurement is fatal to a nonprofit’s tax-exempt status, regardless of the quality of the organization’s charitable activities. Insubstantial private benefit may be permitted in some cases, though.



## The “net earnings” umbrella

Notably, the IRS defines the term “net earnings” broadly, extending well beyond the typical accounting definition. The agency reads it as encompassing almost any use — other than an arm’s-length transaction or payment of reasonable compensation — of an organization’s assets by an insider.

According to the updated guide, examples of inurement include:

- Unreasonable compensation paid to insiders,
- Payment of excessive rent to insiders,
- Receipt by the nonprofit of less than fair market value in a sale to or exchange of property with an insider,
- Unsecured, inadequately secured or interest-free loans to insiders,
- Provision of capital improvements to property owned by insiders, and
- Copyrights and royalties benefiting insiders.

It's irrelevant if the transaction at issue ultimately proves profitable for the organization; the test isn't whether there's profit or loss. Instead, the question is whether, at every stage of the transaction, those controlling the organization guarded its interests and dealt with the parties involved at arm's length.

### Evidence of inurement

According to the guidance, IRS auditors will examine a variety of areas for indicators of inurement, including:

**Salary information.** Auditors will evaluate the salaries paid to those who control the organization and other key employees to determine if the compensation is reasonable. They'll reconcile the salaries the organization paid with the wages reported on Forms W-2, "Wage and Tax Statement," and watch for any unreported payments of expenses for the benefit of an officer or employee. Auditors will also look closely at reimbursements, such as travel expenses, and determine whether the amounts paid were "ordinary and necessary."

**Sales or exchanges of property.** Auditors will determine whether the organization engaged in any sales or exchanges of property involving insiders. If so, were the sales or exchanges compensated at fair market value?

**The composition of the nonprofit's assets.** As noted above, "net earnings" is defined broadly for inurement purposes, so IRS auditors will analyze an organization's assets to determine if an insider had personal use of them. For example, did an insider use a vehicle owned by the nonprofit for personal travel? If so, was the personal use included on that individual's Form W-2?

**Fundraising agreements.** Any fundraising agreements involving insiders must be an arm's-length transaction. Auditors will also consider the method of raising funds and whether the income is subject to unrelated business income tax.

### Look before you leap

With your tax-exempt status on the line, you can't afford to take inurement risks lightly. So, make sure all compensation paid to insiders is reasonable. If your organization has engaged in any transactions with insiders — or is planning to — also ensure they'll be able to withstand IRS scrutiny. We can help. ●

#### REDUCE YOUR INUREMENT RISK

Inadvertent inurement could jeopardize your nonprofit's tax-exempt status. Fortunately, you can take some steps to mitigate that risk, including:

##### **Establishing and enforcing appropriate policies.**

If you don't already have them, your board should implement strong policies on conflicts of interest and compensation. It's also advisable to have a well-publicized whistleblower policy to encourage the reporting of suspected violations.

**Educating employees and leaders.** Make sure they understand not just the ins and outs of the relevant policies but also the reasoning behind them. Including discussions about inurement and similar risks to nonprofits in board training and employee onboarding can help foster a culture of compliance and accountability.

**Documenting decisions.** Make sure you properly document the rationale and decision-making processes regarding areas that could pose inurement concerns. For example, keep minutes of board or other meetings where compensation packages are considered and collect evidence that transactions are for fair market value.

**Mitigating missteps.** If you realize inurement has occurred, don't delay. It's vital that you take timely corrective measures.

# Strengthening your grant management framework

**W**hile nonprofit organizations often rely on grants as a critical funding source, economic uncertainty has prompted many nonprofits to pursue them more aggressively. Whether your organization is new to grant funding or looking to refine an existing process, building a strong grant management framework takes time and intention. The payoff, however, can be significant. The following strategies can help nonprofits enhance their grant management:

**Treat grant management as a team effort.** A grant touches more than one department, so managing it in silos is a costly, albeit common, mistake. Development, program and finance teams should all be involved throughout the grant's life cycle, from proposal development through final reporting.

Collaboration is especially important during the proposal phase. Program staff define activities, timelines, outcomes, and personnel and expenditure needs, while the finance department helps shape a realistic and compliant budget. Development staff can then integrate this information into a

compelling proposal that aligns expectations across the organization.

Once a grant is awarded, collaboration shouldn't stop. Regular communication among departments about program progress and spending helps identify issues early, when adjustments are still possible. This shared responsibility reduces compliance risks and increases the likelihood of meeting funder expectations.

**Design monitoring systems with the grant proposal in mind.** This makes grant management far smoother. Accounting, reporting and tracking tools should be developed in line with grant requirements before a proposal is submitted, not after funds arrive.

For example, if your organization plans to track grant expenses through its accounting system, the proposal budget should align with your chart of accounts. When budgets and systems don't align, staff often resort to manual reporting — a time-consuming process that increases the risk of errors and inconsistencies.

Taking a systems-aware approach from the outset helps ensure accurate, timely reporting and reduces administrative strain over the life of the grant.

**Formalize policies and procedures.** Grant management should never be ad hoc. Clear, documented policies and procedures provide consistency, accountability and continuity.

Administratively, standardized processes help coordinate resources and create efficiency. Many organizations benefit from maintaining a centralized "grant repository" that includes commonly required documents, proposal language, templates



and frequently asked questions. Keeping these materials up to date saves time and reduces duplication of effort.

From a financial perspective, policies should focus on compliance with grantor requirements. Funders place a high value on compliance, and a strong track record can enhance your reputation and improve future funding prospects. Clear procedures also support timely data collection and accurate reporting.

Operational policies should emphasize outcome tracking and program effectiveness. This data not only supports grant reporting but also can be repurposed for marketing/communications and donor engagement.

**Use a comprehensive grant calendar.** A shared grant calendar is one of the most practical tools for strong grant management. It should include

key dates such as application deadlines, reporting requirements and internal review periods.

The calendar should also account for staff vacations, audits, board meetings and other resource-intensive activities. Building in adequate lead time for reviews and approvals reduces last-minute stress and missed deadlines. While unexpected challenges will arise, proactive planning greatly improves your ability to meet grantor expectations.

As nonprofits grow, a well-structured grant management framework is no longer optional — it's essential. By fostering cross-department collaboration, aligning proposals with internal systems, formalizing policies and planning proactively, nonprofits can reduce errors and inconsistencies, improve efficiency and strengthen funder relationships. Now is the time to assess whether your current approach is setting your organization up for long-term success. ●

## Now arriving: New charitable deduction limits in 2026

**B**eginning in 2026, changes to federal tax law governing charitable contribution deductions will affect many itemizers.

While charitable giving remains beneficial under the tax code, two new limitations may influence donor behavior. Nonprofit leaders and development professionals should understand these changes and consider proactive strategies to sustain giving momentum.

### 0.5% AGI floor on charitable deductions

Starting in 2026, taxpayers who itemize deductions will be able to deduct charitable contributions only to the extent those gifts in total exceed 0.5% of their adjusted gross income (AGI).

For example, a taxpayer with \$200,000 of AGI who contributes \$10,000 to charity in 2026 will be able to deduct only \$9,000 [ $\$10,000 - (.005 \times \$200,000)$ ]. While the floor is relatively modest, it may cause some donors to rethink their charitable giving strategy.

### 35% cap on the tax benefit of itemized deductions

A second change affects taxpayers in the top income tax bracket of 37% (individuals with taxable income above \$640,600 and married couples filing jointly with taxable income above \$768,700). Beginning in 2026, the tax benefit of itemized



deductions, including charitable contributions, will generally be capped at 35%.

In practical terms, this means that while a donor in the 37% bracket can still deduct charitable gifts, each dollar deducted will reduce tax liability by 35 cents instead of 37 cents. This seemingly small difference can be meaningful for donors making large contributions, particularly those accustomed to maximizing tax efficiency in their philanthropic planning.

Importantly, this change doesn't limit the amount a donor may give or deduct; it only limits the rate at which the deduction reduces taxes. Nonetheless, some donors may perceive charitable giving as slightly less advantageous from a tax perspective.

### Encouraging giving despite new limitations

Although these changes may reduce the tax benefit of donations for many donors, nonprofits can take steps to help donors navigate the new rules and remain engaged.

First, education is key. Communication about how the new rules work — and reassurance that charitable giving continues to provide meaningful tax benefits — can help donors make informed decisions. Without a clear and detailed understanding, donors may overestimate the negative impact of these changes.

Second, nonprofits can encourage donors who are concerned about the new AGI floor to consider “bunching” contributions that they'd normally make over two or more years into one year. By

concentrating multiple years of giving into a single tax year, donors can reduce the negative impact of the 0.5% AGI floor and maximize deductions.

In the previous example, if the donor makes \$10,000 in donations in 2026 and another \$10,000 in 2027 and AGI remains at \$200,000 for both years, each year the donor's deduction will be reduced by \$1,000, for a total deduction over two years of \$18,000. But if the donor bunches donations into 2026, the donor's 2026 \$20,000 deduction will be reduced by that same \$1,000.

The donor won't have an itemized charitable deduction for 2027, but the donor's total deduction for the two-year period will be \$19,000. (Without itemizing deductions in 2027, the donor can still make some donations and claim the new charitable deduction for non-itemizers for up to \$1,000 cash contributions, or \$2,000 for married couples filing jointly.)

Third, emphasizing non-tax motivations for giving is increasingly important. Donors consistently cite mission impact, community benefit and personal values as primary drivers of generosity. Highlighting measurable outcomes, success stories and long-term impact can reinforce giving decisions independent of tax considerations.

Finally, planned giving strategies — such as gifts of appreciated assets, charitable remainder trusts or qualified charitable distributions from IRAs (for eligible taxpayers) — remain powerful tools that may offer donors valuable tax advantages beyond charitable deductions.

### Looking ahead

While the 2026 changes introduce new considerations for donors and nonprofits alike, they don't diminish the essential role charitable organizations play in communities. By understanding the latest rules and adapting fundraising strategies accordingly, nonprofits can continue to build strong donor relationships and advance their missions well into the future. ●

# How to reduce risk associated with volunteers

**V**olunteers contribute heavily to a nonprofit's success in achieving its mission, yet few give much thought to the legal or tax risks that can arise from their service. Likewise, organizations often assume volunteer work carries little liability. Overlooking these risks, however, can leave both volunteers and nonprofits vulnerable. Understanding where liabilities may arise — and how to mitigate them — is an important part of responsible nonprofit management.

## What to consider from a legal perspective

Volunteers can face legal liability for actions or omissions that occur while performing services for an organization. Risks are heightened for nonprofits that provide medical services or work with vulnerable populations, but even routine activities such as driving can result in lawsuits.

The federal Volunteer Protection Act of 1997 provides some protection for volunteers acting within the scope of their assigned duties. Many states have enacted similar statutes, but the extent of protection varies widely.

Some states offer broad immunity, absent willful or reckless misconduct, while others impose strict conditions. For example, certain states protect volunteer directors and officers only if the organization explicitly assumes liability in its governing documents. Because state laws differ significantly, organizations shouldn't rely on statutory protection alone.

Importantly, volunteer protection laws don't eliminate the need for insurance. In fact, some states require nonprofits to carry insurance as a condition of limiting volunteer liability.

## Ways to minimize exposure

In addition to having directors and officers liability insurance, nonprofits should maintain

comprehensive general liability insurance that expressly covers volunteers. If volunteers operate vehicles on behalf of the organization, auto insurance coverage should be reviewed carefully, and volunteers added as insureds if necessary. Larger organizations may also consider including indemnification provisions for volunteers in their bylaws to address claims that exceed insurance limits.

Risk management practices are equally important. Screening and training volunteers, clearly defining roles, and limiting certain high-risk activities to employees can significantly reduce the likelihood of injury or harm.

## Tax risks for volunteers

Tax liability is another often-overlooked risk. Volunteers generally shouldn't receive compensation beyond reimbursement for actual out-of-pocket expenses. Payments or benefits that exceed documented expenses may be treated as taxable income by federal or state taxing authorities.

Your organization should require receipts for reimbursed expenses and clearly communicate these requirements, both in writing and verbally. While this may feel burdensome, it protects both volunteers and the organization.



## Safeguarding what matters most

By proactively addressing legal and tax risks, nonprofits can better protect their volunteers and the organization itself. Consulting legal and insurance advisors is a smart first step toward ensuring that those who give their time and talents can do so with confidence. ●