

To: Our Clients and Friends

December 3, 2009

## New Rules Governing Combinations of Nonprofit Organizations

Two recent changes have been introduced with respect to mergers and acquisitions of nonprofit corporations.

First, the Internal Revenue Service recently issued publication 4779, which sets forth steps that an organization recognized as exempt under section 501(c)(3) of the Internal Revenue Code ("Code") should take when it merges out of existence or otherwise ceases its existence.

- File the appropriate form 990 within four months and 15 days of termination.
- Organizations must check the termination box on the form they file and answer any termination-related questions in the form or schedule.
- Private foundations must also follow the existing rules for terminating private foundation status set forth in section 507 of the Code.

In addition, the surviving entity should provide notice to the IRS describing the merger either as part of its 990 or in a separate letter.

Second, the Financial Standards Accounting Board ("FASB") has promulgated a Statement of Financial Accounting Standards No. 164 ("FAS 164") regarding accounting for mergers and acquisitions of nonprofit organizations. Until now, nonprofit organizations have accounted for mergers and acquisitions by analogizing to FASB rules developed for for-profit organizations, but FAS 164 reflects a recognition that different rules are required for nonprofits.

FAS 164 provides different accounting rules for mergers than acquisitions. Thus, the first step is to determine if a given transaction is a merger or acquisition:

- A merger occurs when two or more nonprofit organizations cede control of such nonprofit organizations to create a new entity.
- An acquisition, on the other hand, occurs where a nonprofit organization acquirer obtains control of one or more other nonprofit activities or businesses.

FAS 164 requires use of the “carryover method” of accounting to account for a merger of nonprofit organizations. Under the carryover method, the combined entity’s initial set of financial statements carry forward the assets and liabilities of the combining entities, measured at their carrying amounts in the books of the combining entities at the merger date. An entity applying the carryover method recognizes neither additional assets or liabilities.

FAS 164 requires the use of the “acquisition method” of accounting to account for an acquisition by a nonprofit organization. This acquisition method is similar to that used for for-profit organizations. The largest difference between the acquisition method for nonprofit and for-profit organizations pertains to accounting for goodwill. Generally, goodwill may be accounted where the organization merging out of existence is *not* “predominantly supported by” contributions and returns on investment (such as a nonprofit hospital that is predominantly supported by fees for services) but is not accounted for otherwise. “Predominantly supported by” means that contributions and returns on investments are expected to be significantly more than the total of all other sources of revenues.

FAS 164 is effective for (a) mergers for which the merger date is on or after the beginning of an initial reporting period beginning on or after December 15, 2009 and (b) acquisitions for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2009.

To discuss this issue further, please speak to your Bryan Cave contact, or to:

Nathan Boyce  
(314) 259-2257  
[nathan.boyce@bryancave.com](mailto:nathan.boyce@bryancave.com)

Keith J. Kehrer  
(314) 259-2063  
[kjkehrer@bryancave.com](mailto:kjkehrer@bryancave.com)