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Non-Profit Series

SESSION 1: TAX ISSUES

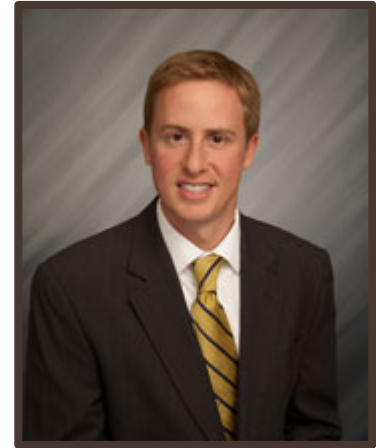
PRESENTERS



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TOPICS COVERED



Tax Exempt Requirements



Federal Tax Exempt Restrictions



Unrelated Business Taxable Income

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Tax Exempt Requirements



TAX EXEMPT REQUIREMENTS



Federal Requirements

- Organization must be organized and operated exclusively for exempt purposes, such as: charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sport competition, and preventing cruelty to children or animals.
- 501(c)(3) organizations are divided into Public Charities and Private Foundations

TAX EXEMPT REQUIREMENTS



Federal Requirements

Types of 501(c)(3) Organizations

Public Charity

- Classifications
 - 509(a)(1) Publicly Supported Organizations
 - Churches
 - Schools
 - Hospitals
 - Substantially Publicly Supported
 - 509(a)(2) Service Provider Organizations
 - 509(a)(3) Supporting Organizations
- Donor Limits = 50% AGI
- Annual Return = Form 990, 990-EX, or 990-N

Private Foundations

- Classifications
 - Any 501(c)(3) that is not a public charity
- Donor Limits = 30% AGI
- Subject to excise taxes
 - Self Dealing
 - Failure to distribute income
 - Excess business holdings
 - Jeopardizing investments
 - Taxable expenditures
- Annual Return = Form 990-PF

TAX EXEMPT REQUIREMENTS



Federal Requirements

Two Common Types of Public Charities

Donative Organizations

(509(a)(1) & 170(b)(1)(a)(iv))

- Substantial part of support from government or public contributions
- 33 1/3% OR 10% + Facts and Circumstances

Service Provider Organizations

(509(a)(2))

- More than 1/3 support from gifts, grants, contributions, membership fees, and gross receipts from sales/services/admissions
- Not more than 1/3 support from gross investment income and UBTI

TAX EXEMPT REQUIREMENTS



Federal Requirements

Maintenance of 501(c)(3)

Areas that can jeopardize your tax-exempt status:

1. Engaging in private benefit/inurement
2. Substantial lobbying
3. Political campaign activity
4. Substantial unrelated business income
5. Failure to meet annual reporting obligations
6. Failure to operate in accordance with stated exempt purpose

Inspection Requirements

- Any organization that files a Form 990 (including Form 990-EZ, Form 990-PF, etc.) must make its three most recent Form 990's and its Form 1023 available for public.

TAX EXEMPT REQUIREMENTS



State Requirements

Exemption from State Sales and Use Taxes

- 501(c)(3) tax exemption under the Internal Revenue Code does not automatically entitle tax exemption from Nebraska sales and use tax.
- Only those organizations that are specifically listed in the Nebraska Sales and Use Tax Regulations as exempt entities qualify for state tax exemption.
- Examples of organizations specifically listed in Nebraska Sales and Use Tax Regulations:
 1. Nonprofit organizations created exclusively for religious purposes;
 2. Several types of nonprofit medical facilities; and
 3. Political subdivisions of the State.

TAX EXEMPT REQUIREMENTS



County Requirements

County Property Taxes

- 501(c)(3) tax exemption under the Internal Revenue Code does not automatically entitle tax exemption from Douglas County property tax.
- Only organizations who meet a five-part test may qualify for property tax exemption.
- The test requires the property:
 1. be owned by a religious, educational, charitable, or cemetery organization;
 2. be used exclusively for religious, educational, charitable, or cemetery purposes;
 3. not be used for gain or profit for the owner or user;
 4. not be used for the sale of alcoholic liquor for more than 20 hours a week; and
 5. not be owned or used by an organization which discriminates in membership or employment based on race, color, or national origin.

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Federal Tax Exempt Restrictions



Engaging in Political Activity



Lobbying



Ballot Initiatives



Excess Benefit Transactions

FEDERAL TAX EXEMPT RESTRICTIONS

Engaging in Political Activity

Prohibition on Political Activity

- Rule: All 501(c)(3) organizations are absolutely prohibited from directly or indirectly participating in, or intervening in, any political campaign on behalf of—or in opposition to—any candidate for elective public office.
- Trigger: any and all activities that favor or oppose one or more candidates for public office
- Threshold: Entirely prohibited; no "de minimis" allowance
- Reporting: Form 990, including Schedule C

FEDERAL TAX EXEMPT RESTRICTIONS



Engaging in Political Activity

Examples

- Distributing printed documents supporting a candidate
- Candidates speaking during organization's event
- Distributing improper voting guides or candidate ratings
- Posting a sign on property endorsing a candidate
- Endorsing a candidate on the organization's website or through online links
- Entity officials making statements during organization's events
- Contributing funds to a political campaign
- Allowing a non-candidate to endorse a candidate during a speech at organization's event

Caution

- Avoid "coded language" as a substitute for referencing an identifiable candidate
- Taking positions on public policy issues during elections may be impermissible if it is deemed to favor a candidate, regardless of motivation
- Train organizational leaders regarding individual opinions (appropriate time/place/disclaimers)

FEDERAL TAX EXEMPT RESTRICTIONS

Engaging in Political Activity

Voter Education & Registration:

- Voter education activities are permissible if carried out in a non-partisan manner
 - Public Forums
 - Voter Education Guides
- Voter registration drives are permissible if carried out in a non-partisan manner
 - Cannot be biased to favor or oppose any candidate(s)
 - Non-Partisan Requirements
 - Candidates are treated equally
 - Voters are treated equally
 - Questions are fairly prepared and presented



FEDERAL TAX EXEMPT RESTRICTIONS

Engaging in Political Activity

- IRS Scrutiny: Political Activities Compliance Initiative (2008) found more than half of exempt organizations engage in prohibited campaign intervention
 - Examined 250+ organizations
 - Based on 2004, 2006, and 2008 elections
 - Generally resulted in IRS warnings
 - Can result in excise taxes on the organization (10% + 100%) and management (2.5% + 50%)
 - Seven organizations lost their exemption

FEDERAL TAX EXEMPT RESTRICTIONS

Lobbying

Restriction

- “No substantial part of the activities” of a § 501(c)(3) organization can include “carrying on propaganda, or otherwise attempting to influence legislation” except as expressly permitted by statute.

Definition of Attempting to Influence Legislation

- When an organization contacts, or urges the public to contact, members or employees of a legislative body for the purpose of proposing, supporting or opposing legislation.
- When an organization advocates the adoption or rejection of legislation.

Requires Legislation

- Legislative body can be federal, state, or local
- Specific legislation introduced into the legislative body

FEDERAL TAX EXEMPT RESTRICTIONS

Lobbying

Substantial Part Test

- Default test (applies unless and until election)
- Based on all of the pertinent facts and circumstances
- "The political efforts of an organization must be balance in the context of the objectives and circumstances of the organization to determine whether a substantial part of its activities is to influence, or is an attempt to influence, legislation."
- No precise definitions or exceptions
- No defined acceptable percentage
- Consider both time and money involved
- Little IRS guidance is available = Significant uncertainty

FEDERAL TAX EXEMPT RESTRICTIONS

Lobbying

Expenditure Test

- Election under IRC § 501(h)
- Must file Form 5768 to elect
- Advantages
 - Provides definitive, mathematical amount that can be spent
 - Has broader exceptions for what constitutes lobbying
 - Violations lead to excise taxes rather than immediate loss of exemption
 - Lobbying time donated by volunteers is excluded
 - Lower IRS audit risk
- Limits
 - Total Lobbying Limit (Direct + Grass Roots)
 - Grass Roots Lobbying Limit

<p>Form 5768 (Rev. August 2013) Department of the Treasury Internal Revenue Service</p>	<p>Election/Revocation of Election by an Eligible Section 501(c)(3) Organization To Make Expenditures To Influence Legislation (Under Section 501(h) of the Internal Revenue Code)</p> <p>► Information about Form 5768 and its instructions is at www.irs.gov/form5768.</p>
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FEDERAL TAX EXEMPT RESTRICTIONS

Lobbying

Under The Expenditure Test, Lobbying Does NOT Include:

- Providing technical advice or assistance to legislative body or committee in response to a written request
- Making available results of nonpartisan analysis, study, or research
- Providing examinations and discussions of broad, social, economic, and similar problems that does not address the merits of specific legislation
- Communicating with legislative body regarding matters which might affect the existence of the organization, its powers and duties, its tax exempt status, or the deduction of contributions to the organization
- Updating the members of your own organization on the status of legislation, without a call to action



EXPENDITURE TEST TABLE

If the exempt purpose expenditures are...	The lobbying nontaxable amount is...
Less than or equal to \$500,000	20% of the exempt purpose expenditures
Over \$500,000 but not over \$1,000,000	\$100,000, plus 15% of the excess of the exempt purpose expenditures over \$500,000
Over \$1,000,000 but not over \$1,500,000	\$175,000 plus 10% of the excess of the exempt purpose expenditures over \$1,000,000
Over \$1,500,000	\$225,000 plus 5% of the excess of the exempt purpose expenditures over \$1,500,000

**Total amount is always capped at \$1 million*

***Grass roots amount is equal to 25% of the direct lobbying nontaxable amount. Grass Roots lobbying occurs if there is communication (1) urging the recipient to contact a legislator or other government official, (2) states the contact information of such an official, (3) provides a petition or similar material, or (4) specifically identifies any legislator who will vote on the legislation as opposing or being undecided, or as the recipient's representative.*

FEDERAL TAX EXEMPT RESTRICTIONS

Lobbying

Penalties under the Substantial Part Test

- Potential immediate loss of exemption (all income taxed)
- Additional excise tax equal to **5%** of lobbying expenditures in the year the exemption is lost
- Potential **5%** tax of lobbying expenditures against organizations managers

Penalties under the Expenditure Test

- If the organization exceeds its lobbying expenditure dollar limit in a particular year, it must pay an excise tax equal to **25%** of the excess.
- If the organization engages in excessive lobbying activity over a 4-year period, it may lose its tax exempt status, and all of its income over that period is subject to tax (150% ceiling amount)

FEDERAL TAX EXEMPT RESTRICTIONS



Ballot Initiatives

- A 501(c)(3) may proactively campaign or contribute to a ballot initiative committee or on behalf of a ballot initiative.
- A 501(c)(3) which chooses to campaign or contribute on behalf of a ballot initiative committee may need to file reports with the Nebraska Accountability and Disclosure Commission depending on the type of contribution:
 - Form B-7 (Report of Political Contributions) (if contribution is more than \$250).
 - Form B-10 (Agent's Expenditure Report)
 - Form B-6 (Report of Independent Expenditure)

FEDERAL TAX EXEMPT RESTRICTIONS

Excess Benefit Transactions



Excess Benefit Transaction Defined

- Transaction in which an economic benefit is provided by an applicable tax-exempt organization, directly or indirectly, to or for the use of a disqualified person, in which the value of the economic benefit exceeds the value of the consideration received by the organization.

Disqualified Person Defined

- Any person who was in a position to exercise substantial influence over the affairs of the applicable tax-exempt organization
- Includes any family members or affiliated organizations of a disqualified person

FEDERAL TAX EXEMPT RESTRICTIONS

Excess Benefit Transactions

Examples of Excess Benefit Transactions

- Excessive compensation to disqualified persons
- Excessive expense accounts for personal use, travel, etc.
- Personal use of nonprofit property: car or dwelling
- Charging the non-profit excessive rent to lease property
- Selling goods or services at above FMV, or allowing non-profit to sell you goods or services at below FMV
- Loans at below market interest rates

FEDERAL TAX EXEMPT RESTRICTIONS

Excess Benefit Transactions

Correcting an Excess Benefit Transaction:

- Make immediate good faith efforts to correct it by:
 - Undoing the excess benefit
 - Take any additional measures necessary to place the organization in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards
- Efforts to correct excess benefit transactions are considered by the IRS in cases of revoking tax exemption due to excessive excess benefit transactions.

FEDERAL TAX EXEMPT RESTRICTIONS

Excess Benefit Transactions



Intermediate Sanctions:

- Because only the most egregious excess benefit transactions result in loss of a nonprofit exemption, the IRS has introduced “Intermediate Sanctions” to act as a further deterrent
- Under IRC § 4958, the disqualified person who benefits from an excess benefit transaction is liable for an excise tax of 25% on the excess benefit.
 - If the excess benefit is not returned / corrected within the taxable period, a tax of 200% of the excess benefit involved is imposed.
- A 10% excise tax (not to exceed \$20,000) will be personally imposed on an organization manager (officer, director, trustee, etc.) if their participation was willful and without reasonable cause.

FEDERAL TAX EXEMPT RESTRICTIONS

Excess Benefit Transactions

Rebuttable Presumption Procedure

If an organization meets the following 3 procedure requirements, payments made to a disqualified person under a compensation arrangement are presumed reasonable, and a transfer of property or right to use property is presumed fair market value:

1. Advance approval of transaction by an authorized body composed of individuals who do not have a conflict of interest;
2. Ensure that the authorized body obtains and relies upon appropriate comparability data; and
3. Ensure that the decision is appropriately documented.



Unrelated Business Taxable Income



What is "Unrelated"?



Exclusions

UNRELATED BUSINESS TAXABLE INCOME

What is "Unrelated"?

Basic Rule

- A 501(c)(3) is not taxed on its income from an activity substantially related to its exempt purpose.
- An activity is "substantially related" if there is a causal relationship between it and the accomplishment of an exempt purpose.
 - Example: Local school hosts an after-hours art class for students.
- Regularly engaging in trade or business NOT substantially related to the exempt purpose leaves the organization subject to tax, at corporate rates, on its income from that unrelated trade or business.
- **Note:** The fact that the income was used to further charitable purpose does NOT make it substantially related.

UNRELATED BUSINESS TAXABLE INCOME

What is "Unrelated"?

Parsing the Definition:

Trade or Business

- Revenue is not generated in a passive manner
- Does the activity compete with for-profit businesses?

Regularly Carried On

- Is the activity conducted with a frequency and continuity generally similar to comparable commercial activities of nonexempt organizations"? Reg. § 1.513-1(c)(1).
- While there is no threshold, isolated incidents may not trigger UBTI.

Substantially Related

- Income derived by an exempt organization is not taxed if the income-generating activity contributes importantly to the tax exempt purposes of the organization. IRC § 513(a)

UNRELATED BUSINESS TAXABLE INCOME

What is "Unrelated"?

Common Unrelated Business Income Activities



Sale of advertising space



Sale of merchandise



Rental income from debt-financed property



Income from parking lots opened to the general public

UNRELATED BUSINESS TAXABLE INCOME

Exclusions

Exclusions

- Activities specifically excluded from the definition of unrelated trade or business income include:
 - Volunteer Labor
 - Activities conducted for the convenience of members (cafeteria; employee parking, etc.)
 - The sale of donated merchandise (thrift shops)
 - Distribution of low-cost articles in soliciting contributions (2014 threshold was \$10.40)
 - Income from convention or trade show participation
 - Bingo proceeds

UNRELATED BUSINESS TAXABLE INCOME

Exclusions

Passive Income Generally Excluded:

- Dividends
- Interest
- Certain other investment income
- Royalties
- Certain rental income
- Certain income from research activities
- Gains/losses from the disposition of property

Deductions:

- Additionally, in calculating any UBTI tax due, a 501(c)(3) may take deductions for (1) trade or business expenses, (2) losses, and (3) charitable contributions. Such deductions may mitigate any tax due.



QUESTIONS?



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