

IN A NUTSHELL: Tax-Exempt Law for Nonprofit CAAs

Webinar Four
CAA Leaders' Legal Boot Camp
 Eleanor Evans, Esq. and Veronica Zhang, Esq.
 CAPLAW
 April 14, 2016

APRIL 5, 2016 Uncle Sam's Money: Fundamentals of Federal Grant Law

APRIL 7, 2016 The Nuts and Bolts of the Federal CSBG Act

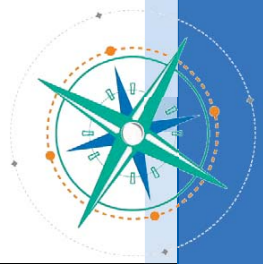
APRIL 12, 2016 Dollars & Sense: Federal Grant Financial Management Rules

APRIL 14, 2016 In a Nutshell: Tax-Exempt Law for Nonprofit CAAs

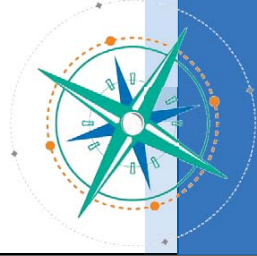
APRIL 19, 2016 Public CAA Essentials

Miss a webinar? View it On Demand

www.caplaw.org/conferencesandtrainings/webinars.html

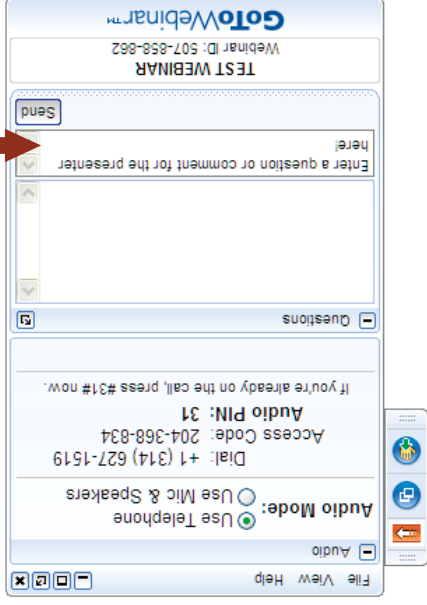


This Webinar Series is part of the Community Services Block Grant (CSBG) Legal Training and Technical Assistance (T/TA) Center. It was created by Community Action Program Legal Services, Inc. (CAPLAW) in the performance of the U.S. Department of Health and Human Services, Administration for Children and Families, Office of Community Services Cooperative Agreement – Grant Award Number 90ET0441-01. Any opinion, findings, conclusions, or recommendations expressed in this material are those of the author(s) and do not necessarily reflect the views of the U.S. Department of Health and Human Services, Administration for Children and Families.

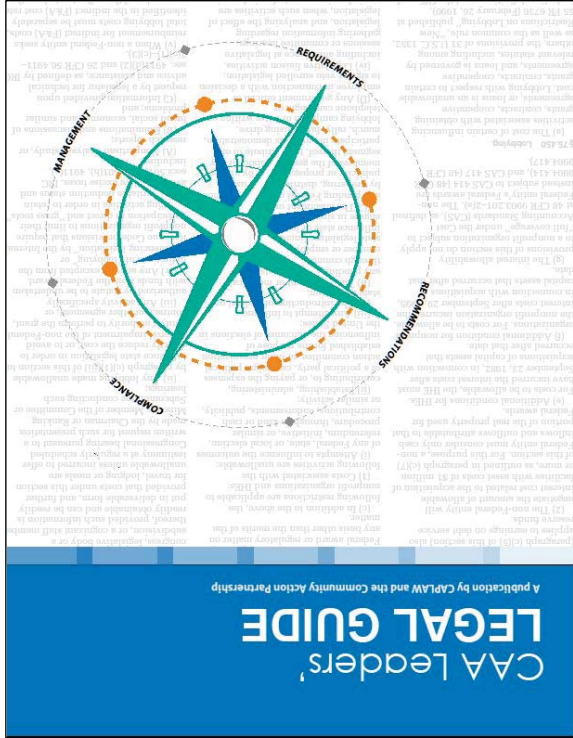


Webinar Control Panel

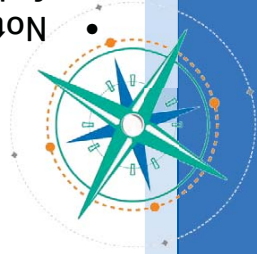
Enter questions & comments here



CAA Leaders' Legal Guide



Federal Tax-Exempt Organizations

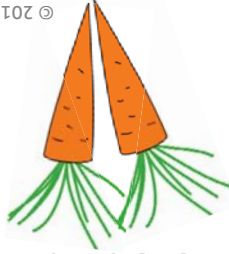


- Not all nonprofit corporations are tax-exempt organizations under federal tax law
- Organizations eligible for federal tax exemption under section 501(c) of the Internal Revenue Code include:
 - 501(c)(2): Title-Holding Corp. for Single Exempt Parent Organization
 - 501(c)(3): Religious, Educational, Charitable Organizations
 - 501(c)(4): Civic Leagues, Social Welfare Organizations
 - 501(c)(5): Labor, Agricultural, or Horticultural Organizations
 - 501(c)(6): Business Leagues, Chambers of Commerce
 - 501(c)(7): Social and Recreational Clubs
 - 501(c)(8): Fraternal Beneficiary Societies and Associations
 - 501(c)(10): Domestic Fraternal Societies and Associations
 - 501(c)(19): Veterans' Organizations
 - 501(c)(25): Title-Holding Corp. for Multiple Exempt Parent Organizations
- Generally, must file **Form 1023** with the IRS to be recognized as tax-exempt under section 501(c)(3)

Benefits of 501(c)(3) Tax Exemption

Carrots

- **Income related to exempt purpose** is exempt from federal income tax
 - May be eligible for exemptions from other taxes, including employment, state income, sales, and/or property taxes
- **Contributions made to organization** are deductible on the donor's federal income tax return



Restrictions on 501(c)(3) Orgs

Sticks

- Must be organized and operated **exclusively** for **exempt purposes**
 - “Exclusively” = primarily
- May not conduct **lobbying activities** as a **substantial** part of overall activities
- Restricted from participating in **political campaigns**
- May not allow **earnings** to **inure to the benefit** of private individuals
- Required to disclose certain information (including compensation) on **Form 990**



Agenda

Since 501(c)(3) status is one of a nonprofit CAA's most valuable assets, how does the CAA protect that status?

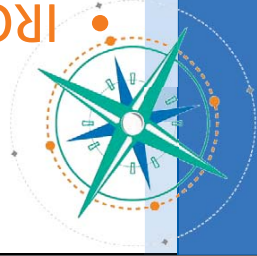
1. Which activities might subject a nonprofit CAA to federal **unrelated business income tax (UBIT)**?
2. What does a nonprofit CAA need to do when it receives **charitable contributions**?
3. Can nonprofit CAAs **lobby** or get involved in **political campaigns**?
4. What are the rules against **private inurement** and **private benefit** transactions?
5. When does a nonprofit CAA need to file its **Form 990** and how does it comply with the **public inspection** and **copying** requirements?

Unrelated Business Income Tax (UBIT)



- Must be organized and operated **exclusively** for **exempt purposes**
- **Permissible 501(c)(3) exempt purposes:**
 - Religious, charitable, scientific, literary, educational, etc.
 - “Charitable” includes relief of the poor or underprivileged, lessening the burdens of government, and promotion of social welfare
- Engaging in unrelated trade or business (UTB) may result in **federal/state income tax**
 - Too much UTB may result in **losing 501(c)(3) status**
 - How much is **too much**?

UBIT Overview



IRC §511

- **Tax imposed** on income generated from any “unrelated trade or business” conducted by a 501(c)(3) tax-exempt organization
 - **Unrelated Business Taxable Income (UBTI)**
 - UBTI = gross income derived from UTB, less any business deductions directly connected with carrying on UTB
 - Income taxed at corporate income rates or trust rates, depending on form (15% - 35%)
- **Why UBIT?**
 - To prevent unfair competition with for-profit entities

It All Started With Macaroni!



VS.



Three Elements of UBTI

Income from:

(must meet All three requirements)

1. A trade or business

2. Regularly carried on

3. Not substantially related to the organization's exempt purpose

(IRC 511(a)(1))

Three Elements of UBTI

1. A trade or business

(26 CFR §1.513-1)

- Any activity carried on for the production of income from the sale of goods or the performance of services
- No exception simply because the activity is carried on within a larger group of exempt purpose activities
- Characteristics
 - Key: Profit motive (Treasury Reg. 1.183-2(b))
 - Commercial manner
 - Unfair competition
 - Extensive use of organization resources

Three Elements of UBTI

2. Regularly carried on

(26 CFR §1.513-1)

- Look at the frequency and continuity of the activity
 - Is it similar and comparable to commercial operations of a for-profit entity?
- Factors to consider:
 - Year-round?
 - Seasonally?
 - Infrequently or intermittently?

Three Elements of UBTI

3. Not substantially related to the organization's

exempt purpose (26 CFR §1.513-1)

- **Relationship:** What is the relationship of the activity to the accomplishment of the exempt purpose?
 - Does it **contribute importantly** to accomplishing that purpose (other than providing financial support)?
 - Consider the **size and extent** of the activity
 - Simply using income to support exempt purpose does not make the business "related"

Products from Exempt Activities

Dual-Use Activities

Key Exceptions to "Unrelated Trade or Business"

- **Volunteer Exception (IRC §513(a)(1))**
 - Substantially all of the work is performed by volunteers without pay

- **Convenience Exception (IRC §513(a)(2))**
 - Activities conducted for convenience of members, students, employees

- **Donated Goods Exception (IRC §513(a)(3))**
 - Substantially all merchandise sold has been donated (e.g., thrift shop)

*Activities not considered an "unrelated trade or business"



Key Exclusions to UBTI

- **Convention and Trade Show Activity (IRC §513(d))**
 - If one of org's purposes is to promote/stimulate interest in the industry and the exhibits are designed to achieve this purpose

- **"Passive" Investment Income (IRC §512(b)(1))**
 - Dividends, interest, royalties, rents, annuities
 - E.g., partnership investments with "pass-through" tax treatment

- **Qualified Sponsorship Payments (IRC §513(i)(1))**
 - No arrangement or expectation of "substantial return benefit" other than the use or acknowledgment of name/logo/product

**Activities considered "unrelated trade or business" but income not taxable as UBTI*

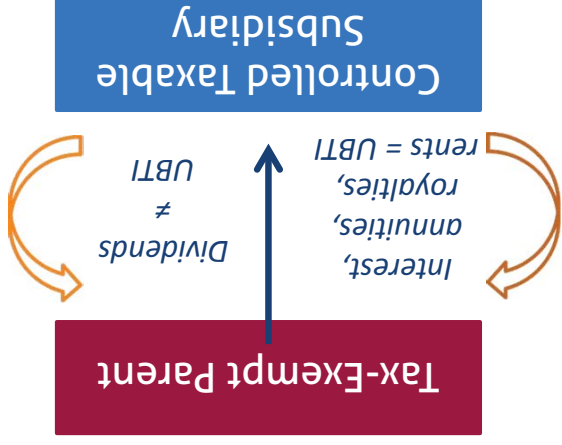


UBIT Pitfalls: Exceptions to the

Exceptions

Counts as UBTI and Subject to UBIT

- Rent from **debt-financed property**
 - Unless substantially all of the use (85%) of the property is substantially related to exempt purpose
- Rent where **substantial services** are provided
- Interest, annuities, royalties, rents from **taxable controlled entities**
 - To the extent entity receives a tax benefit
 - Single-member LLC activities attributed to tax-exempt parent



Reporting UBTI



- **Federal filing requirement: Form 990-T**
 - Must file Form 990-T if organization generates more than \$1,000 in gross income from unrelated trade or business
 - Must file by 15th day of 5th month after organization's tax year
 - Form 990-T must be made available for public inspection

- Check **state laws** and filing requirements

UBIT Takeaways



Purpose is to prevent unfair competition

- Consider whether activity competes with for-profit entities

- **Remember the fragmentation rule**

- IRS can divide an activity into "related" and "unrelated" pieces

- **If activity is unrelated and taxable, but *insubstantial***

- Activity may still be worthwhile to undertake

- **If activity is unrelated, taxable, and *substantial***

- Be sure activity is not conducted on a scale that threatens exempt status

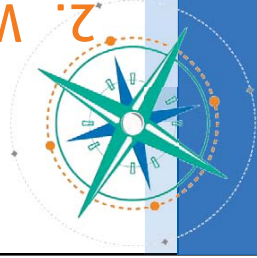
Quiz #1: UBIT



1. Which of the following does **NOT** generate UBIT for a nonprofit CAA?

- a. Selling tickets to its annual fundraising gala
- b. Renting the first floor of 10-floor mortgaged building to a law firm
- c. Income from an unrelated trade or business (UTB) operated by its single-member LLC subsidiary
- d. A donation from a bank for an ad in its conference booklet

Quiz #2: UBIT



2. Which of the following statements about a nonprofit CAA's income-generating activity is **TRUE**?

- a. It is "substantially related" if income supports the CAA's programs
- b. Regular sales of donated goods won't jeopardize 501(c)(3) status
- c. If CAA doesn't owe any UBIT, no need to file a Form 990-T
- d. Dividends subject to UBIT if paid from controlled sub to CAA

Receiving Charitable Contributions



• Deductible contributions

- May deduct contributions of **money or property** to or for the use of a qualified organization
 - Only to the extent it exceeds fair market value of any goods/services received in return
 - Special rules for certain types of property, such as clothing and household items, vehicles, inventory
- Cannot deduct the value of **a person's time or services**
 - But may be able to count these towards matching requirements for certain federal funds
 - May deduct **unreimbursed expenses** directly connected with providing services
- Cannot deduct **less than donor's entire interest in property** (e.g., rent-free space, vacation home)

Charitable Contributions



• Donor responsibilities

- Must have a **bank record or written communication** from a charity for all contributions
- Must obtain a **contemporaneous written acknowledgment** from a charity for any single contribution of \$250 or more
 - Including contributions in the form of unreimbursed business expenses
- Charities typically send no later than January 31 of following year
- No prescribed format - may have one for each contribution or for all contributions in the year

Goods and Services Provided



- Contemporaneous written acknowledgment must describe **any goods or services provided by the organization to the donor**
 - Includes cash, property, services, benefits, or privileges
- **Token exception** for “insubstantial” goods or services, which do not need to be described
 - Fair market value ≤ 2% of donation (or \$106*), **or**
 - Donation is at least \$53* and the only items provided bear the organization’s logo and do not exceed \$10.60* (for all items received during the year)

**2016 amounts; adjusted annually for inflation*

Contemporaneous Written Acknowledgment



- **Include in the statement:**
 - the **name** of organization;
 - the **amount** of cash contribution;
 - a **description** (but not the value) of non-cash contribution;
 - a statement that **no goods or services were provided by the organization** in return for the contribution, if that was the case; and
 - a **description and good faith estimate of the value** of goods or services, if any, that an organization provided in return for the contribution.

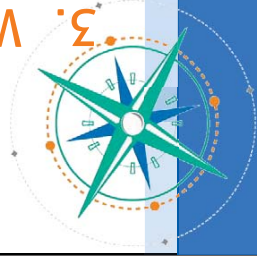
Charitable Contributions



• Organization responsibilities

- Quid pro quo contribution: Charitable organizations must provide a **written disclosure** to a donor who receives goods or services in exchange for a single payment > \$75
- Must inform donor that the amount that is deductible for federal income tax purposes is limited to the **excess over fair market value** of goods/services
- Must provide a **good-faith estimate of the fair market value** of goods/services given to donor in connection with either the solicitation or the receipt of the quid pro quo contribution
- Not required for **token exception** goods
- **Penalty: \$10/contribution; \$5,000/event**

Quiz #3: Charitable Contributions



3. What must a CA do when it receives a charitable contribution?

- Verify contribution is deductible to donor before accepting it
- Provide donor an estimated fair market value of donated goods
- Tell donor the amount deductible for a \$100 quid pro quo donation
- Collect the donor's Social Security Number

Can Tax-Exempt Orgs. Lobby or Get Involved in Political Campaigns?



Lobbying Issues + Legislation

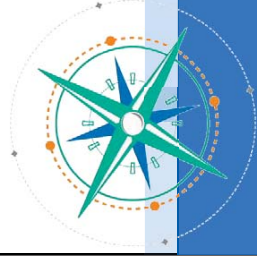


Political (Campaign) Activity

Candidates



Can Tax-Exempt Orgs. Lobby or Get Involved in Political Campaigns?



Can Tax-Exempt Orgs. Lobby or Get Involved in Political Campaigns?

- Chapter 4 of the Leaders' Guide *only* addresses the **federal tax law** restrictions on lobbying and political activities
 - These apply **ONLY** to **nonprofit CAAs**

- Chapter 1 of the Leaders' Guide discusses **additional federal grant law** restrictions on lobbying and political activities
 - These apply to **BOTH public and nonprofit CAAs**

- **Public CAAs** should check their local laws on lobbying and political activities

Tax Law Restrictions on Lobbying



- **IRC § 501(c)(3):** Lobbying cannot be a **substantial part** of organization's activities
 - "Substantial part" test
 - 501(h) election/expenditure test
 - BOTH tests:
 - Must report lobbying on Form 990
 - Must keep track of money spent on lobbying
 - Violation may result in:
 - Loss of tax exemption
 - Punitive tax on organization and its managers

Tax Law Restrictions on Lobbying



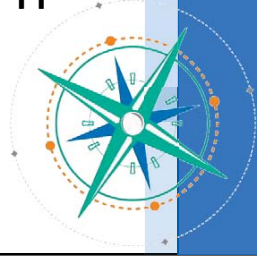
- **Substantial part test (default test)**
 - Subjective, facts and circumstances analysis
 - Volunteer lobbying counted (time/expenses)
 - Must provide detailed description of **lobbying activities and expenses** on Form 990
- **Expenditure test**
 - Objective, specific dollar limits (% of org.'s exempt purpose expenditures)
 - Must opt in by filing 501(h) election on Form 5768
 - No limit on lobbying activities that do not incur expenses (e.g., unreimbursed lobbying by volunteers)
 - Must report **lobbying expenses (only)** on Form 990

Not Lobbying: Four Exceptions



- **Nonpartisan analysis, research, or study**
 - Full presentation/detailed, available to public
- **Examinations and discussions of broad social, economic, and similar problems**
 - E.g., community meetings with state legislators (but cannot refer to specific legislation)
- **Written request for technical advice**
 - Must provide to full legislative body
- **Self-defense communications**
 - Actions that could jeopardize organization's existence, powers, duties, tax-exempt status
 - Lobbying on appropriations bills do **not** constitute self-defense

Lobbying Practice Tips



- **Use non-federal, unrestricted funds** to lobby
 - Track time spent by employees lobbying
 - Don't include lobbying costs as part of the indirect cost pool
- **Lobby using board members or other volunteers**
 - Do not need to track volunteer time if making 501(h) election
- **Lobby on personal time**, without using CAA resources
 - Be careful when asking **non-exempt employees** to volunteer to lobby
- **Keep records of lobbying costs**

Political Campaign Activities



IRS: Federal Tax Law

501(c)(3) tax-exempt organizations may NOT:

Directly or indirectly participate or intervene in any political campaign on behalf of or in opposition to a candidate for public office (local, state or federal)

(IRC § 501(c)(3))

Political Activity Do's and Don'ts IRS Revenue Ruling 2007-41



Voter Education/Voter Registration

- Ok so long as conducted in a nonpartisan/unbiased manner; don't mention parties
- Can't use CSBG/Head Start funds to pay; no identification with CSBG

Organization Leaders' Own Activities

- Ok if speaking as *individuals*, rather than on behalf of the organization

Candidate Appearances

- Ok if all candidates invited and have equal opportunity to speak; no identification with CSBG
- Don't invite in a *non-candidate capacity* close to election time

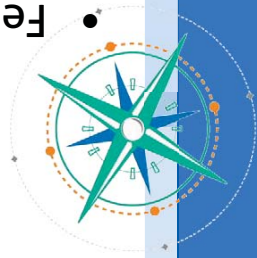
Websites

- CAA is responsible for the content of website and links to other sites

Issue Advocacy

- May take positions on public policy issues, but *cannot* favor or oppose a candidate

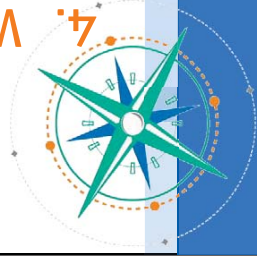
Political Activities – Hatch Act



- Federal law that applies mainly to federal, state, or local employees and NOT employees of nonprofit organizations
- However, applies to **certain employees of nonprofit CAAs** who are paid out of CSBG and/or Head Start funding (42 U.S.C. § 9918(b); 42 U.S.C. § 9851(a))
- Limits activities of **employees**, not the CAA
 - Restrictions apply regardless of whether activity is conducted at the workplace or on work time
 - Restrictions apply even when employee is on unpaid or paid leave

Covered in Webinars #1 and #2 in this series and in CAA Leaders' Legal Guide Chapters 1 and 4

Quiz #4: Lobbying/Political Activity



4. Which of the following **MAY** jeopardize a private CAA's tax-exempt status?

- Making the 501(h) election but not counting volunteer lobby time
- Inviting mayor (running for reelection in 2017) to poverty summit
- ED sends a candidate endorsement on CAA letterhead
- Lobbying without making the 501(h) election

Private Inurement / Private Benefit

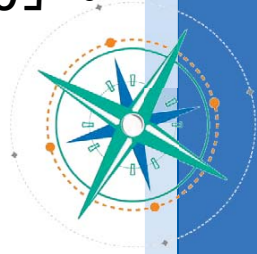
Private Inurement	Private Benefit
<p>What is covered by the restriction?</p> <p>Insiders (directors, officers, key employees, etc.)</p>	<p>All persons and entities</p>
<p>What is it?</p> <p>Transactions where insiders receive a "disproportionate" share of the benefits of the exchange relative to the exempt purpose served</p>	<p>Transactions that serve a private interest rather than a public purpose</p>
<p>What amount is prohibited?</p> <p><i>Any</i> private inurement</p>	<p>More than an <i>incidental</i> amount of private benefit (de minimis ok)</p>
<p>What are some examples?</p> <p>Executive compensation, employee benefits, loans, rental arrangements</p>	<p>Programs/activities that have an extremely narrow class of beneficiaries</p>
<p>What are the penalties?</p> <p>Intermediate sanctions (excise taxes on insiders/managers); revocation of 501(c)(3) status (26 U.S.C. § 4958 – Taxes on Excess Benefit Transactions)</p>	<p>Denial or loss of 501(c)(3) status</p>
<p>Is there a safe harbor?</p> <p>Rebuttable presumption: (i) transaction approved by independent board members; (ii) board obtained in advance and relied on comparability data; and (iii) adequate, contemporaneous documentation</p>	<p>No</p>

43

Annual Report: Form 990

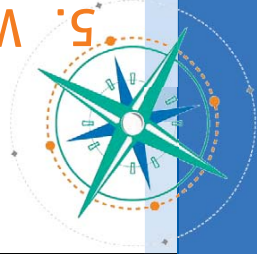
- All 501(c)(3) organizations required to file an annual report with the IRS on Form 990
- Must file Form 990-T if at least \$1,000 in UBTI
- Due on the 15th day of the 5th month after fiscal year end
- 3 month automatic extension (6 months for FY 2016 and beyond)
- Monetary penalties for failure to file
- Must file electronically; failure to file for 3 consecutive years leads to automatic revocation of tax-exempt status

Public Disclosure and Copying Requirements



- 501(c)(3) organizations must **provide copies of** and make the following available for **public inspection**:
 - Annual Return (Form 990)
 - UBIT Tax Returns (Form 990-T)
 - Tax-Exemption Application (Form 1023)
 - Including IRS determination letter
- Can satisfy obligation to provide copies by **making documents widely available**
 - Posting on own website or in a public database in a format meeting IRS guidelines
 - But still must make available for **public inspection**

Quiz #5: Wrapping It All Up



5. Which of the following statements is **TRUE**?
- All nonprofit organizations are exempt under federal tax law
 - IRS automatically revokes 501(c)(3) status for private inurement
 - CAA must allow inspection of Form 990 even if it posts it online
 - 501(c)(3) tax-exempt organizations are not required to pay any federal income taxes
 - IRS won't challenge deal with insider if board approves first



Questions



- APRIL 5, 2016 Uncle Sam's Money: Fundamentals of Federal Grant Law
- APRIL 7, 2016 The Nuts and Bolts of the Federal CSBG Act
- APRIL 12, 2016 Dollars & Sense: Federal Grant Financial Management Rules
- APRIL 14, 2016 In a Nutshell: Tax-Exempt Law for Nonprofit CAAs
- APRIL 19, 2016 Public CAA Essentials

Miss a webinar? View it On Demand
www.caplaw.org/conferencesandtrainings/webinars.html



Join Me in
FT. LAUDERDALE
FLORIDA

CAPLAW
National Training Conference
June 22-24, 2016
Ft. Lauderdale Marriott Harbor Beach Hotel