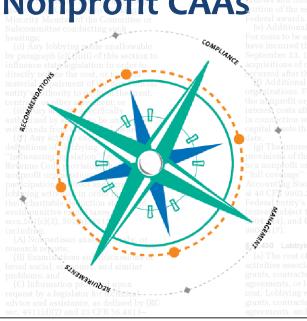
IN A NUTSHELL:

Tax-Exempt Law for Nonprofit CAAs

CAA Leaders' Legal Boot Camp Webinar Four

April 14, 2016 Eleanor Evans, Esq. and Veronica Zhang, Esq. CAPLAW



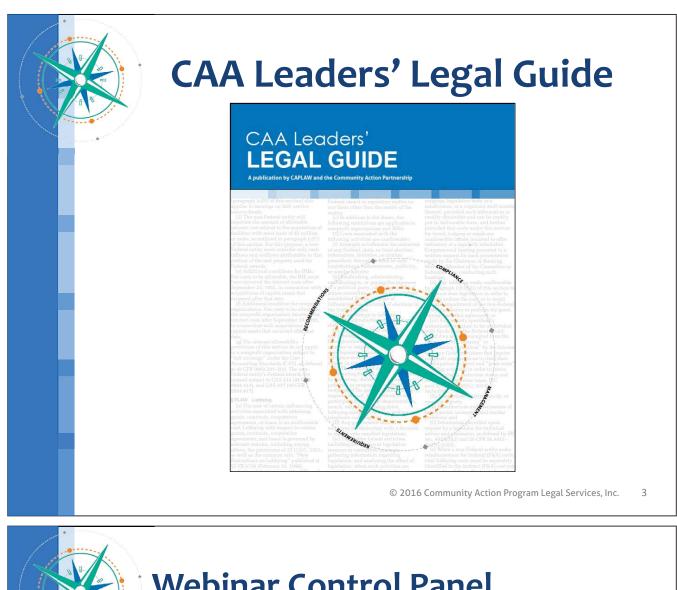


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Federal Tax-Exempt Organizations

- 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 taxexempt under section 501(c)(3)

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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?

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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



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)

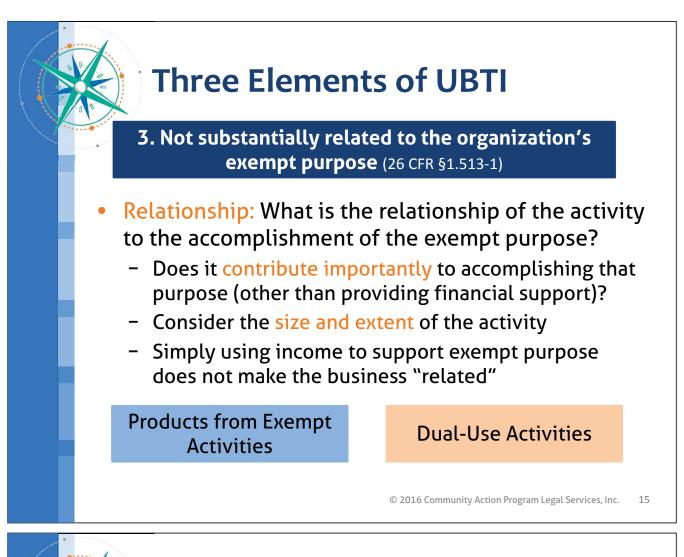
- Any activity carried on for the production of income from the sale of goods or the performance of services
 - No exception simply because the activity is carried on within a larger group of exempt purpose activities
- Characteristics
 - Key: Profit motive (Treasury Reg. 1.183-2(b))
 - Commercial manner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

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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?



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

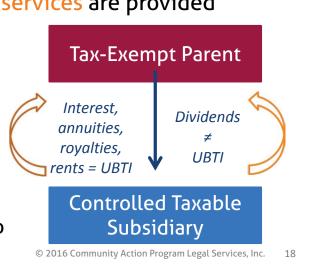
*Activities considered "unrelated trade or business" but income <u>not</u> taxable as UBTI

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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

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Quiz #1: UBIT

- 1. Which of the following does <u>NOT</u> generate UBTI 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

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Quiz #2: UBIT

- 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
 - 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)

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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

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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

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Quiz #3: Charitable Contributions

What must a CAA do when it receives a charitable contribution?

- a. Verify contribution is deductible to donor before accepting it
- b. Provide donor an estimated fair market value of donated goods
- c. Tell donor the amount deductible for a \$100 quid pro quo donation
- d. 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





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

<u>NOTE</u>

 Chapter 4 of the Leaders' Guide <u>only</u> addresses the federal tax law restrictions on lobbying and political activities

These apply ONLY to nonprofit CAAs

- Chapter 1 of the Leaders' Guide discusses <u>additional</u> 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

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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 <u>not</u> constitute self-defense

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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))

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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

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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

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Quiz #4: Lobbying/Political Activity

Which of the following <u>MAY</u> jeopardize a private CAA's tax-exempt status?

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

Private Inurement / Private Benefit

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

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

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Quiz #5: Wrapping It All Up

Which of the following statements is **TRUE**?

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

