

# 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

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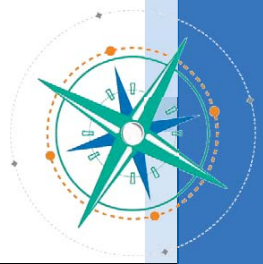
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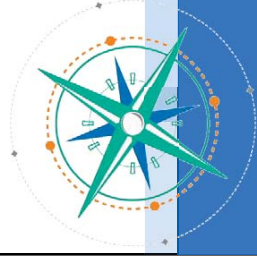
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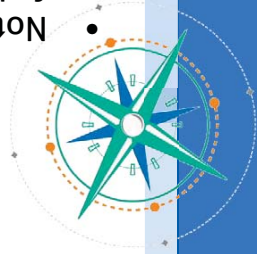
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# CAA Leaders' Legal Guide

# Federal Tax-Exempt Organizations

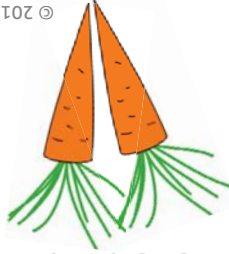


- Not all nonprofit corporations are tax-exempt organizations under federal tax law
- Organizations eligible for federal tax exemption under section 501(c) of the Internal Revenue Code include:
  - 501(c)(2): Title-Holding Corp. for Single Exempt Parent Organization
  - 501(c)(3): Religious, Educational, 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**

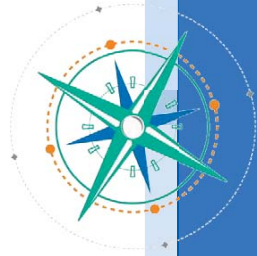


# Agenda

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

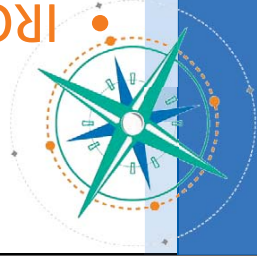
1. Which activities might subject a nonprofit CAA to federal **unrelated business income tax (UBIT)**?
2. What does a nonprofit CAA need to do when it receives **charitable contributions**?
3. Can nonprofit CAAs **lobby** or get involved in **political campaigns**?
4. What are the rules against **private 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*

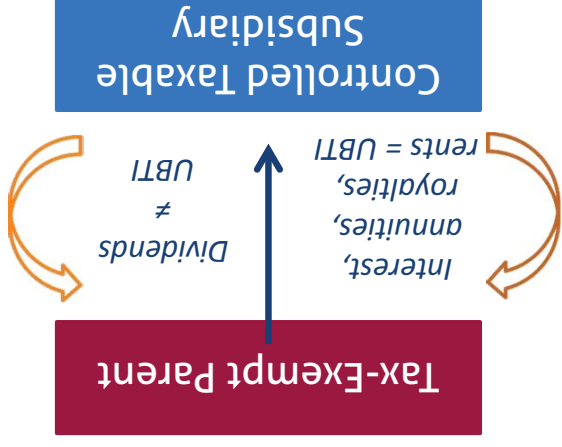


## UBIT Pitfalls: Exceptions to the

### 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 15<sup>th</sup> day of 5<sup>th</sup> 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

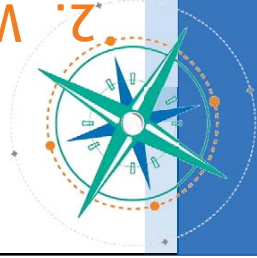
## Quiz #1: UBIT



1. Which of the following does **NOT** generate UBITI 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)

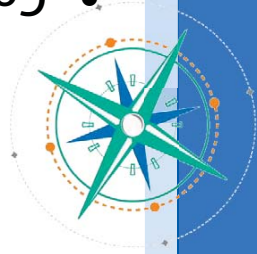
## Charitable Contributions



### • 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.

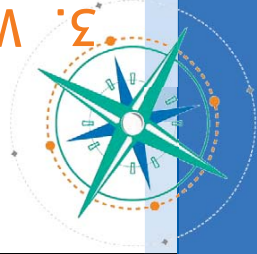
## Charitable Contributions



### • 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

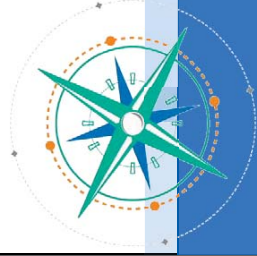


## Political (Campaign) Activity

Candidates



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



- 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**

## NOTE

# 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

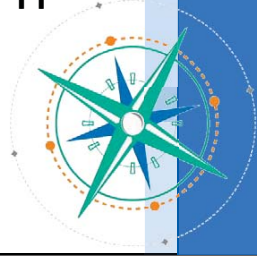


## Not Lobbying: Four Exceptions



- **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

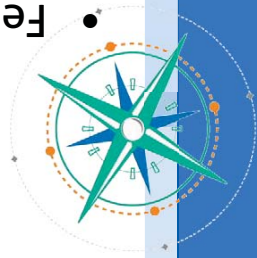
### Websites

- 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

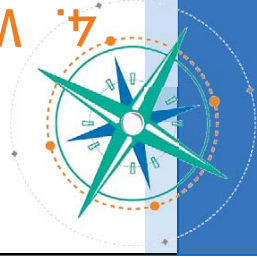
## Political Activities – Hatch Act



- 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*

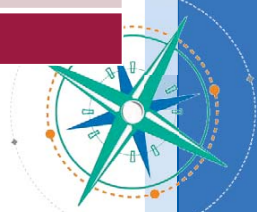
## Quiz #4: Lobbying/Political Activity



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><b>Rebuttable presumption:</b>                      (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>

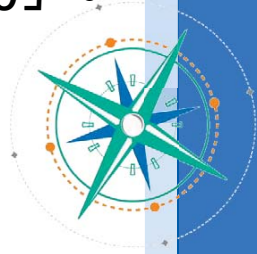
# Annual Report: Form 990



All 501(c)(3) organizations required to file an annual report with the IRS on Form 990

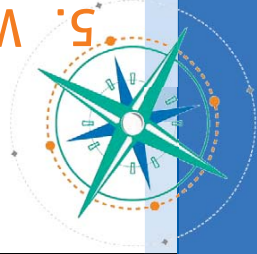
- Must file Form 990-T if at least \$1,000 in UBTI
- Due on the 15<sup>th</sup> day of the 5<sup>th</sup> month after fiscal year end
- 3 month automatic extension (6 months for FY 2016 and beyond)
- Monetary penalties for failure to file
- Must file electronically; failure to file for 3 consecutive 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
  - CA 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



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