

May 8TH, 2013 3:00 CPE

5/8/2013

Stanfield & O'Dell
*Beyond Numbers
To Solutions* PC
www.stanfieldodell.com
Consultants and CPAs

Taxation of Nonprofits and Religious Organizations

Presented by Dan Skerbitz, CPA

2013

Stanfield & O'Dell
*Beyond Numbers
To Solutions*
Consultants and Certified Public Accountants

Over 60 years of quality service to the
Tulsa business and nonprofit
community.

3211 S. Lakewood
Tulsa, OK 74135
(918) 628-0500

dans@stanfieldodell.com

Stanfield & O'Dell

Tax Exempt Sector

- ▶ Currently about 1.6 million tax exempt organizations registered with the IRS
- ▶ About 18,400 registered in Oklahoma
- ▶ In addition, it is estimated that there are over 327,000 churches in the U.S. (not required to register, but some register voluntarily)
- ▶ Total revenues to registered tax exempts about \$2 trillion per year.

Stanfield & O'Dell

Types of Tax Exempts

- ▶ Internal Revenue Code provides tax exemption for over 30 types of organizations.
- ▶ The largest category is 501(c)(3) public charities & private foundations.
- ▶ Other common types are :
 - 501(c)(4) civic leagues & social welfare
 - 501(c)(6) business, chamber of commerce
 - 501(c)(7) social & recreational clubs
 - 501(c)(8) fraternal society

Stanfield & O'Dell

Tax Exempt Sector

- ▶ Hospitals comprise of the largest portion of revenue – about 48%.
- ▶ Higher education follows with about 12%.
- ▶ Donations from individuals represent about 15% of the total tax exempt revenue (about \$305 billion).

Stanfield O'Neil

Obtaining Tax Exempt Status

- ▶ See IRS website – “Life Cycle of a Public Charity”
<http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Life-Cycle-of-a-Public-Charity>
- ▶ IRS provides general information on the steps involved in forming a nonprofit and obtaining tax exempt status

Stanfield O'Neil

The First Step – Formation

- ▶ Create legal entity by filing documents with Secretary of State. Most are organized as corporations or trusts. Establish bylaws, governing board, mission and vision, FEIN, bank account, etc.
- ▶ May immediately begin operating, but with caveat that IRS approval not yet obtained.

Stanfield O'Neil

The Second Step – IRS Approval

- ▶ Most tax exempts will need IRS approval. This is obtained by filing Form 1023 or 1024 – Application for Recognition of Tax Exempt Status.
- ▶ Articles of incorporation / formation, bylaws and governing body must conform to requirements.
- ▶ The mission and activities must qualify as tax exempt activity.

Stanfield  Dell

When to File Application

- ▶ Form 1023 or 1024 must be filed within 27 months from the end of the month it was formed.
- ▶ Form 1023 is used by organizations seeking 501(c)(3) status, which allows for tax deductible contributions.
- ▶ Form 1024 is used for other types of tax exempt status.

Stanfield  Dell

IRS Processing of Application

- ▶ After filing Form 1023 / 1024, IRS should respond within 30 – 60 days with a letter verifying they have received the application and that they will begin processing within 90 days.
- ▶ Applications are assigned to review in 3 categories:
 - ▶ 1. Immediate processing;
 - ▶ 2. Additional information needed; or
 - ▶ Those needing revision

Stanfield  Dell

IRS Processing of Application

- ▶ Questions from the IRS about the application are not unusual. They often ask for clarification or further information.
- ▶ Revisions to the application often relate to the exempt activities, governance & bylaws, unrelated business activities, and conflicts of interest.

Stanfield O'Dell

Requirement to File Application

- ▶ Most organizations seeking tax exemption under Section 501(c)(3) must file Form 1023 (organizations with less than \$5000 gross receipts and churches not required).
- ▶ 501(c)(4), (5) & (6) organizations are not required to file an application (Form 1024); however, it is recommended.

Stanfield O'Dell

Group Exemptions

- ▶ Recognition of tax exempt status can be granted from a parent organization that has a group exemption. The IRS provides the parent with a group exemption number.
- ▶ There are reporting and compliance procedures for maintaining status under a group exemption.

Stanfield O'Dell

Exemption from Income Tax

- ▶ Upon approval of the application, the IRS will issue a determination letter specifying the section of the IRC under which the organization is exempt and what type of annual filing is required.
- ▶ The exemption is from federal income tax on the revenue derived from the organization's tax exempt activities and contributions.

Stanfield O'Dell

Exemption from Income Tax

- ▶ The organization will be subject to income tax (at corporate rates) on unrelated business income and certain other income. This income is reported on Form 990-T, Exempt Organization Business Income Tax Return.
- ▶ 501(c)(3)'s are exempt from FUTA.

Stanfield O'Dell

IRS Revocation of Status

- ▶ In June 2011, the IRS revoked the status of approximately 275,000 tax exempt organizations for failure to timely file annual reports (tax return) for 3 consecutive years.
- ▶ Reinstatement of tax exempt status requires re-filing of exempt application.
- ▶ Organization is a taxable entity until reinstatement is effective.

Stanfield O'Dell

Annual Tax Reporting

- ▶ Nonprofit organizations are required to submit an annual information report to the IRS using the Form 990 series of returns.
- ▶ 990-N (e-Postcard). Technically not a tax return, but an email to the IRS notifying them that the organization is still in existence, but its gross receipts average less than \$50,000.

Stanfield O'Dell

Annual Tax Reporting, cont'd.

- ▶ 990-EZ, Short Form Return of Organization Exempt From Income Tax. For organizations with over \$50,000 of gross receipts, but less than \$200,000, and total assets under \$500,000.
- ▶ 990 (long form), for organizations with over \$200,000 gross receipts or assets over \$500,000.

Stanfield O'Dell

Annual Tax Reporting, cont'd.

- ▶ 990-PF, Return of Private Foundation. Used by 501(c)(3) organizations that are classified as private foundations.
- ▶ Subject to excise tax on net investment income (1% or 2%).
- ▶ Required to distribute a certain amount each year for charitable purposes (usually 5% of assets).

Stanfield O'Dell

Form 990 / 990-EZ Due Date

- ▶ Due on the 15th day of the 5th month following the end of the tax year (May 15 for calendar year organizations).
- ▶ A 3-month automatic extension may be filed (Form 8868).
- ▶ A second 3-month extension may also be requested using Part II of Form 8868.

Stanfield O'Dell

Form 990-N Due Date

- ▶ Due by 15th day of the 5th month after end of tax year (May 15 for calendar year organizations).
- ▶ Must be submitted online at epostcard.form990.org
- ▶ No extension is available, but online submission normally available until the system resets for the next tax year.

Stanfield O'Dell

State Tax Reporting

- ▶ Many states also require some form of annual reporting for nonprofits.
- ▶ Oklahoma requires Form 512E, return of organization exempt from income tax, a 1-page form for reporting taxable income (if any). A copy of the federal 990 must be attached.

Stanfield O'Dell

State Charitable Registration

- ▶ 39 states and the District of Columbia require nonprofits that solicit contributions to register with the state attorney general or secretary of state.
- ▶ Oklahoma requires an annual Charitable Registration with the secretary of state, along with a \$65 fee (\$15 if contributions are less than \$10,000).

Stanfield O'Dell

State Charitable Registration

- ▶ Religious organizations, educational institutions, fraternal organizations, and certain others may be exempt.
- ▶ If contributions are solicited from other states (e.g. on your website), those states may also require annual registration. Some states also require audited financial statements.
- ▶ Use of professional fundraiser generally requires state registration.

Stanfield O'Dell

State Tax Exemption

- ▶ Organizations that are recognized as exempt from federal income tax are generally also exempt from Oklahoma income tax.
- ▶ 501(c)(3) organizations with less than 4 employees exempt from state unemployment tax.
- ▶ Only certain nonprofit organizations are exempt from Oklahoma sales tax or property tax.

Stanfield O'Dell

Oklahoma Sales Tax Exemption

- ▶ Some of the types of organizations exempt from payment of sales on purchases tax are:
- ▶ Boy Scouts & Girl Scouts;
- ▶ State, local & county government entities;
- ▶ Churches;
- ▶ Charitable Health Organizations;
- ▶ Accredited Museums;
- ▶ Indian tribes;
- ▶ And others as specified in Title 68-1356 of the Oklahoma Statutes.

Stanfield O'Dell

Oklahoma Sales Tax Exemption

- ▶ Oklahoma Statutes 68-1356 provides exemption from collection of sales tax for:
- ▶ Dues paid to fraternal, religious, civic, charitable, or educational organizations that are nonprofit;
- ▶ Sales by churches, except sales made in the course of business for profit;

Stanfield O'Dell

Okla Sales Tax Exemptions, cont'd

- ▶ Sales of tangible personal property made by public & private elementary & secondary schools;
- ▶ Sales of tangible personal property by 4-H clubs for fundraising purposes;
- ▶ And certain other exemptions as specified in the statutes.
- ▶ Be aware of nexus rules for sales made outside of Oklahoma.

Stanfield O'Dell

Property Tax Exemption

- ▶ Oklahoma statutes 68-2887 provide exemption from property taxes for:
- ▶ Nonprofit colleges & schools;
- ▶ Free public libraries & museums;
- ▶ Fraternal or religious use property;
- ▶ All property of any charitable institution organized in Oklahoma;
- ▶ All property used exclusively for charitable purposes;

Stanfield O'Dell

Property Tax Exemption, cont'd

- ▶ All property of any nonprofit hospital;
- ▶ All libraries and office equipment of ministers of the Gospel;
- ▶ All fraternal orphan homes and other orphan homes; and
- ▶ Certain others.
- ▶ Application generally must be made to obtain charitable exemption followed by annual certification to county assessor.

Stanfield O'Dell

Health Insurance Tax Credit

- ▶ The Affordable Care Act enacted on March 23, 2010 created a tax credit for small employers that pay at least half of health insurance premiums for employees.
- ▶ "Small employer" - less than 25 full-time equivalent employees.
- ▶ Seasonal workers who worked less than 120 days can be excluded.

Stanfield O'Dell

Health Insurance Tax Credit

- ▶ Average annual wages must be less than \$50,000 (total wages / FTE's).
- ▶ Credit for 2010 - 2013 is 35% of health insurance premiums (25% refundable credit for nonprofits).
- ▶ Increases to 50% & 35% in 2014.
- ▶ Phase out begins when FTE's exceed 10 and average wages exceed \$25,000.

Sanfield O'Dell

Health Insurance Tax Credit

- ▶ Limited to amount of required payroll taxes for nonprofit organizations (Medicare withheld and matched, and federal withholding).
- ▶ Minister's wages are excluded from calculation of average wages. Thus, churches may qualify even though ministers are paid over \$50,000.
- ▶ File 990-T and attach Form 8941 to claim credit.

Sanfield O'Dell

Unrelated Business Income

- ▶ Section 511 of the tax code imposes a tax on unrelated business income (UBI).
- ▶ UBI is defined as:
 - ▶ "any trade or business"
 - ▶ "which is not substantially related to charitable purposes" and
- ▶ Which is regularly carried on

Sanfield O'Dell

“Trade or Business”

- ▶ Any activity carried on for the production of income from the sale of goods or performance of services.
- ▶ Reg. Sec. 1.513-1(b) An activity retains its identity as a trade or business even when carried on within the larger context of the other exempt activities of the organization.

Stanfield O'Dell

Trade or Business, cont'd.

- ▶ Example: Publishing a magazine may be a necessary function of the nonprofit organization, but commercial advertising within the magazine may be UBI.

Stanfield O'Dell

“Not Substantially Related”

- ▶ Reg. Sec. 1.513-1(d)(2) Any activity which contributes importantly to the accomplishment of the organization's exempt purposes is “related”. This is a facts and circumstances test.
- ▶ Assets used for exempt purposes may also generate UBI. For example, vehicles owned by a school that are leased to a commercial business on the weekends.

Stanfield O'Dell

Exploited Activities

- ▶ Exempt activities often create goodwill or publicity that can be exploited in a commercial manner.
- ▶ The exploitation will normally be considered UBI even though the income is dependent upon the exempt activity (e.g. commercial advertising in the nonprofit organization's magazine)

Stanfield COLUge

Examples of Unrelated Business

- ▶ Selling of membership mailing lists to commercial businesses. Sharing the list with other nonprofits is excluded.
- ▶ Services provided with lease. Renting property along with providing substantial services is UBI. Note: fees for using parking lot are usually UBI.
- ▶ Museum gift shop. Items sold that are not related to its artistic endeavors are UBI.

Stanfield COLUge

Exempt Activity Business

- ▶ Selling of products that result from the performance of exempt functions is a related activity.
- ▶ Example: An organization has a program for rehabilitating handicapped persons, and as part of their training, produces arts and crafts which are sold to the public.

Stanfield COLUge

Specific Exclusions from UBI

- › Section 513(a) of the tax code provides for certain exceptions:
- › Activities which are performed substantially all by volunteers;
- › Activities carried on for the convenience of members, students or employees;
- › Sales of items which have substantially all been donated to the organization;

Stanfield O'Dell

Specific Exclusions, cont'd

- › Qualified sponsorship payments;
- › Bingo games, where legal and not conducted by for-profit organizations;
- › Distribution of low cost articles incidental to soliciting contributions; and
- › Convention or trade show activity.

Stanfield O'Dell

Specific Exclusions, cont'd.

- › Section 512(b) exempts dividends, interest, annuities, royalties, capital gains and losses, and real property rents from the tax on UBI, except for:
- › Income from debt-financed property (including capital gains). The amount of taxable income is proportionate to the debt on the property.

Stanfield O'Dell

Debt-Financed Property

- ▶ 85% Rule. If substantially all (85% or more) of the property is used for exempt purposes, its income is not taxable, even if debt-financed.
- ▶ Neighborhood land rule. Real property acquired with intention to use if for exempt purposes within 10 years, will not be treated as debt-financed (restrictions apply).

Stanfield CO Dept

“Regularly Carried On”

- ▶ An activity normally considered unrelated could still be exempt from income tax if it is not regularly carried on.
- ▶ Must show frequency and continuity and be pursued in a manner similar to comparable activities of for-profit organizations.

Stanfield CO Dept

Calculation of Taxable Income

- ▶ In determining the amount of unrelated business taxable income, the organization is allowed to deduct expenses directly connected with the trade or business which are allowable tax deductions.
- ▶ Expenses may need to be allocated between exempt and non-exempt activities.
- ▶ Charitable contribution deduction allowed.

Stanfield CO Dept

Net Income From Exploited Activity

- ▶ Exploited activity income (such as commercial advertising in periodicals) is first reduced by direct costs (but not below zero); then by costs allocated to the exploited activity.
- ▶ The allocated costs may reduce UBTI from any other unrelated business activity, but not below zero.

Stanfield & DeJell

Net Operating Losses

- ▶ NOL's can be deducted as provided in Section 172 of the tax code, including carry backs and carryovers.
- ▶ Activities determined to lack a profit motive cannot generate NOL's that can be used to offset income from other unrelated activities.

Stanfield & DeJell

Tax Return for UBI

- ▶ Nonprofit organizations with gross unrelated business income of \$1,000 or more must file Form 990-T, Exempt Organization Business Income Tax Return.
- ▶ Tax is paid on net UBTI at corporate rates.
- ▶ This return is filed in addition to the normal annual report (Form 990)

Stanfield & DeJell

Effect of UBI on Exempt Status

- ▶ UBI will not harm an organization's tax exempt status so long as the trade or business does not constitute more than an insubstantial part of its activities.
- ▶ "Insubstantial" could be in relation to the overall activities, not necessarily the income from those activities.

Stanfield & O'Neil

Religious Organizations and Churches

- ▶ Charitable religious organizations and churches generally fall under the same regulations as 501(c)(3) charitable organizations.
- ▶ Thus, in order to maintain public charity status and allow donors to deduct contributions, churches & religious organizations must comply with 501(c)(3) regulations.

Stanfield & O'Neil

Church Tax Reporting

- ▶ Churches and qualified church auxiliary organizations are exempt from filing Form 1023 and 990.
- ▶ Some churches elect to file Form 1023 to obtain IRS recognition of exemption.
- ▶ Voluntary filing of Form 1023 does NOT trigger 990 filing requirement. Church is still exempt from 990 filing.

Stanfield & O'Neil

State Registration for Churches

- ▶ Many states provide an exemption from the charitable registration requirement to religious 501(c)(3) organizations and churches; however,
- ▶ 15 states require registration if Form 990 is required to be filed; and
- ▶ Arizona provides no exemptions (financial information not required from churches).

Stanfield O'Neil
