Exempt Organization Tax Update

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Real-Life Tales From the Briar Patch

Oklahoma Tax Credit for Contributions to Scholarship Granting Organization

Okla. Admin. Code Sec. 710:50-15-114(b)

The credit is generally 50% of the total amount of contributions made during a taxable year, not to exceed $1,000 for each taxpayer or $2,000 for married filing jointly, or $100,000 for any taxpayer which is a legal business entity, subject to the limitation in (e) of this Section. Tax credits which are allocated by a pass-through entity to equity owners are only limited in amount for the income tax return of a natural person based upon the limitation of the total credit amount to the entity from which the tax credits have been allocated, and not limited to $1,000 for single individuals or limited to $2,000 for married persons filing a joint return.

Credit for Contributions to Scholarship Granting Organization, cont'd.

(c) Additional year commitment. For a taxpayer who makes an eligible contribution and makes a written commitment to contribute the same amount for an additional year, the credit shall be 75% of the total amount of the contribution made during the taxable year. The taxpayer shall provide evidence of the written commitment to the Tax Commission when the tax return claiming the credit is filed the first year.

(e) Limitation of credit. (1) If total credits claimed exceed the caps established pursuant to 68 O.S. § 2357.206(D), the credit shall be equal to the taxpayer's proportionate share of the cap for the taxable year.

Credit for Contributions to Scholarship Granting Organization, cont'd.

- Tax deduction for business making contribution to scholarship granting organization:

Section 1.170A-1(c)(5) provided that if the taxpayer's payment or transfer bears a direct relationship to its trade or business, and the payment is made with a reasonable expectation of commensurate financial return, the payment or transfer may constitute an allowable deduction as a trade or business expense under section 162, rather than a charitable contribution under section 170.

In other words – business gets a 100% tax deduction, plus the 50% or 75% tax credit is passed through to the owners, resulting in potential overall tax savings in an amount greater than the original contribution.

Oklahoma Collective

www.1oklahoma.com

“NIL Collectives” (Names, Images, Likenesses). Charitable 501c3 organizations. Dozens have already been established around the U.S.

Recent ruling by the NCAA now allows athletes to profit from the use of their NIL. Collectives formed as charities facilitate opportunities for athletes to get paid for such things as public appearances, posting social media content, licensing rights, autograph signing, etc.

SMLLC's owned by Nonprofit Org.

Church organization created multiple SMLLC's for liability protection purposes. I warned them that certain states do not provide automatic tax exemption for LLC's, and that they would have to submit applications in those states.

They ended up paying franchise tax on several LLC's in Texas and California.

The LLC's had IRS exemption by virtue of being disregarded for federal tax purposes, the states did not recognize the exemption.

Problem further exacerbated because churches are not required to obtain recognition of federal tax exemption. Application in CA & TX is easier with IRS letter of tax exemption.

Crypto Currency, NFT's, etc.

Many of the fundraising firms and consultants offer platforms for charities to accept crypto donations. Charity could also establish their own account on an exchange.

Some charities are also investing in crypto. Like any other alternative investment, proper oversight by the governing board is advised.

Some of my clients have invested in Philcoin and Turncoin, neither of which is on an exchange, making it nearly impossible to sell and recoup the investment.

Private Inurement

Private inurement is a form of private benefit that is specifically for organization insiders (officers, directors, key employees).

- One of my clients was paying its president a percentage of revenue in exchange for the use of the name and trademark, which had been copyrighted by the individual.
- I advised him that revenue sharing is a form of private inurement and that he should determine a fair market value for the licensing of the copyright.
- The organization should pay him a fixed amount based on this determination of reasonableness.

IRC Section 4958, Excess Benefit Transactions

IRC Sec. 4958 provides for excise tax penalties on insiders receiving excess benefits and on the managers who approved it.

https://www.irs.gov/pub/irs-tege/eotopice03.pdf

To reduce the exposure to penalty, the organization can follow 3 steps to achieve a safe harbor when setting compensation for executives: 1) Independent Compensation Committee; 2) Using comparable data; 3) Documents deliberation and approval of compensation.

Excess Benefit Transactions, cont'd.

Charitable organization asked me for a compensation study that would factor in the recent spike in housing costs for their area in Florida. I told them I couldn't do this because the comparable data, while it may be specific to a geographic region, won't be real-time enough to reflect overall wage increases based on inflation.

Furthermore, wages aren't always directly tied to inflation. For example, companies don't usually cut salaries when the housing market collapses.

I advised them to perform the comparable data analysis, then document their reasoning for providing additional relocation benefits on top of the reasonable salary.

Conservation Easement Charitable Contribution

Developer in the Tulsa area obtained a charitable contribution deduction in excess of $1.7 million for conservation easement in a residential neighborhood.

Qualified appraisal showed the following:

FMV of parcel before easement:	$xxx
Less FMV after easement:	($xxx)
Equals FMV of the easement	$xx

This amount was reported on Form 8283, noncash charitable contributions, and attached to 2019 tax return with copy of appraisal.

Conservation Easement Charitable Contribution, cont'd.

IRS Notice 2007-50 Provisions, which were then made permanent in 2015 in the PATH Act (Protecting Americans from Tax Hikes)

* Raised the deduction a donor can take for donating a conservation easement to 50%, from 30%, of his or her annual income;

* Extended the carry-forward period for a donor to take a tax deduction for a conservation agreement to 15 years from 5 years; and

* Allows qualifying farmers and ranchers to deduct up to 100% of their income, increased from 50%.

Conversion of Public Charity to taxable C-Corporation

In 2021, and Oklahoma 501c3 charity (health care related) notified the IRS that they changed their status from nonprofit to for-profit by doing the following:

- Amended Oklahoma articles of incorporation from nonprofit to for-profit;
- Effected a recapitalization under IRC Section 368(a)(1)(E) – tax-free reorganization;
- Issued 100% of its stock to a newly formed LLC.

Conversion of Public Charity to taxable C-Corporation, cont'd

- In exchange for the stock, the newly formed LLC made a cash contribution to another tax-exempt charitable organization in an amount equal to the appraised value of the converting charity.
- The converting charity filed a "Final" Form 990 for the year 2021, and reported the conversion on the 990, including attaching the appraisal and conversion documents.
- The corporation retained its EIN and will now file Form 1120.

In effect, the nonprofit was sold at FMV to the new corporation.

Qualified Charitable Distributions from IRA

- Person age 70 ½ or over can direct IRA to make distribution to a qualified charity up to $100,000. Each spouse must make distribution from his/her own IRA.
- The distribution can satisfy all or part of the required minimum distribution for the year.
- The distribution is reported on Form 1099-R.
- Report on 1040 as a nontaxable distribution with code “QCD”.
- The charity should issue a receipt so that the donor can prove the distribution went to a qualified charity.
- No tax deduction for charitable contribution.

Group Exemption Requirements Proposed Regulations

IRS Notice 2020-36

- Central Organization must be a 501(c), or governmental entity, have at least five (5) subordinates initially, and must demonstrate “supervision and control”. For example:
  - Annual review of subs activity and compliance
  - Send written notice to subs about compliance requirements.
- Subordinates must be of same 501(c) category; cannot be Type III supporting org.; must have similar purpose (i.e. NTEE Code); and must have uniform governing instrument.

Group Exemption Requirements Proposed Regulations, cont’d

There has been substantial opposition to the proposed regulations, especially from religious groups whose beliefs allow subordinate organizations freedom to express their differing religious views and practices in their own governing documents.

The AICPA issued a comment letter on March 1, 2022 with several recommendations for implementation.

https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/56175896-aicpa-group-exemption-letter-3-1-2022.pdf

Unrelated Business Taxable Income Silo Rules

The 2017 Tax Act added Section 512(a)(6) with the requirement to segregate business activities for purposes of calculating UBTI.

NOL generated by one activity cannot offset another.

The final regulations confirmed the use of the two-digit NAICS codes for classifying the unrelated business activities.

“Qualifying Partnership Interests” can be aggregated together.

Mandatory Electronic Filing

Following the Taxpayer First Act in 2019, which required electronic filing of Form 990, starting March 16, 2021 (for tax year 2020), the Form 990-T is also required to be filed electronically.

All Form 990 series are now required electronically (990, 990-EZ, 990-PF, 990-T, and 4720).

UBTI and YouTube Monetization

YouTube Terms of Service Agreement:

Starting November 18, 2020, any payments you may be entitled to receive from YouTube under any other agreement between you and YouTube (including for example payments under the YouTube Partner Program, Channel memberships or Super Chat) will be treated as royalties. If required by law, Google will withhold taxes from such payments.

https://www.youtube.com/static?template=terms#:~:text=Starting%20November%2018%2C%202020%2C%20any,will%20be%20treated%20as%20royalties.

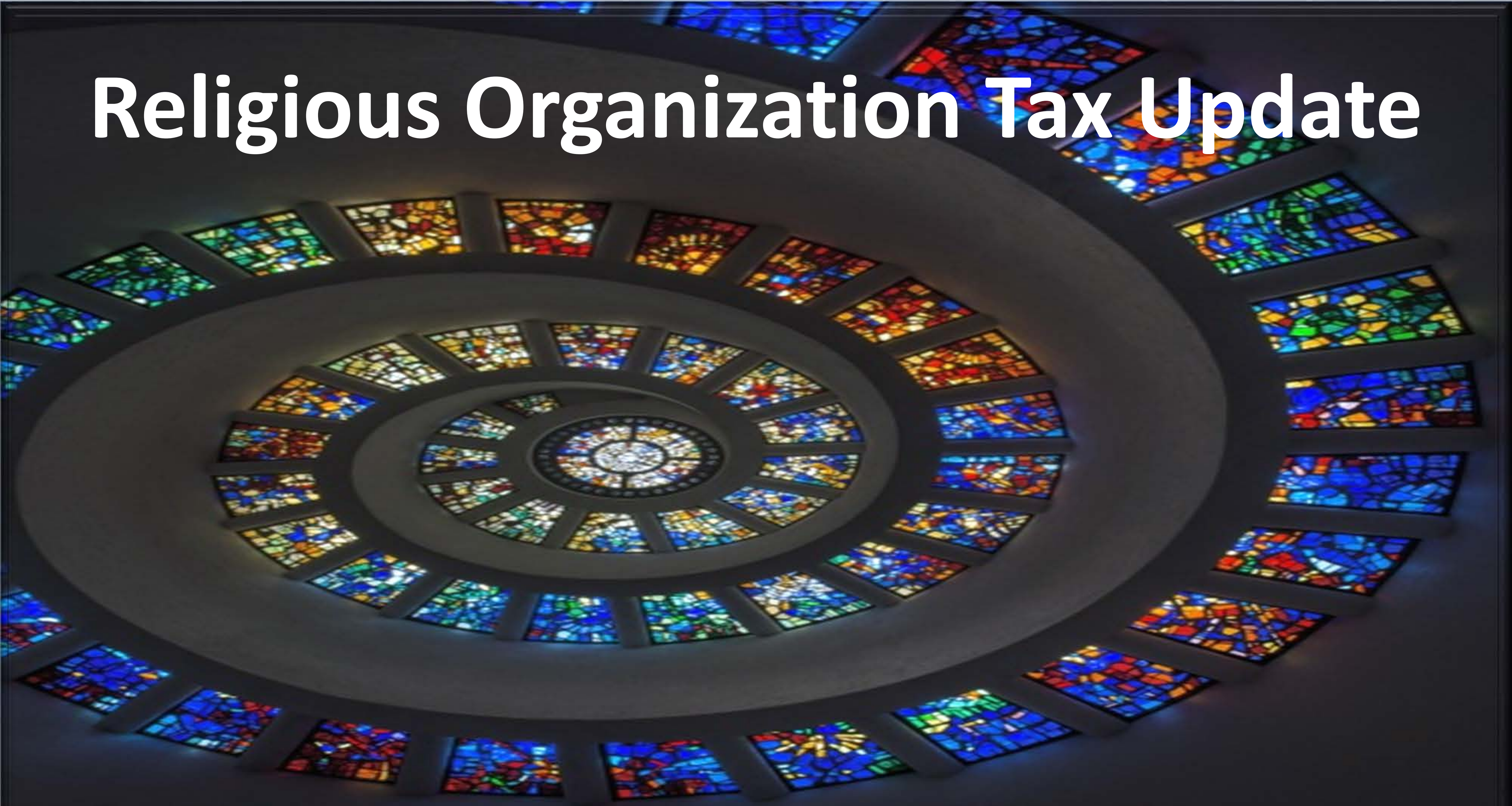
What Would You Do?

Client called about a cell tower lease treated as UBTI. Property is subject to acquisition debt, and tower is on a far corner of property, away from facilities used for exempt purposes.

He proposed assigning lease to a newly formed EO to manage the lease, along with the other leases [which were to another EO], thereby creating a stronger argument for allocating more expense to the overall rental activity.

I objected, saying the related leases (which are not UBTI) cannot be combined with the taxable activity for the purpose of generating additional deductions. He refused to report the activity on Form 990-T because he didn't want to pay the tax.

Religious Organization Tax Update



IRS Audits of Churches

IRC Sec. 7611 restricts IRS inquiries and audits involving church tax exemption status and unrelated business income. The IRS is restricted from initiating church audits without first obtaining approval from a “high-level Treasury official”; sending written notification to the church; and waiting at least 15 days after the notice to begin its inquiry.

Note: The IRS has identified the Commissioner of the Tax Exempt and Government Entities Division as the appropriate high-level Treasury official (currently Sunita B. Lough)

IRS Audits of Churches, cont'd.

A client recently received an IRS Inquiry Letter, which is the initial step in the process of the IRS Church Examination procedures.

Included with the letter was IRS Publication 5328 (2-2019), Statement of Administrative and Constitutional Rights.

After the inquiry, if the IRS decides to open an examination, it must be personally approved the high-level official, the IRS must provide at least 15-days written notice to the church, and the IRS must notify IRS Counsel of the proposed examination.

Reporting of Theft by an Employee

IRS Form 3949-A, Information Referral.

Report as much of the person's information as possible and identify type of misconduct, the tax years involved, and dollar amounts, along with brief comments describing the alleged violations.

Form W-2, 1099-NEC or MISC. Not appropriate because payment was not approved by organization nor does it represent compensation for services.

It's not a "Receivable from the Thief". That implies approval by the organization. The theft is a loss (expense).

IRS Form 13909, Tax-Exempt Organization Complaint (Referral)

This is the whistleblower form used to reported allegations of misconduct by a tax-exempt organization.

Financial misconduct by officers/directors; prohibited political activities; failure to report employment tax or file tax returns, improper fundraising activities, etc.

W-2 For a Minister

- Ministers are self-employed for purposes of Social Security and Medicare tax. Church does NOT withhold FICA from wages.
- Box 1 of W-2 reports taxable wages. Boxes 3 and 5 are blank.
- Housing allowance is not reported on W-2, except maybe in Box 14 as miscellaneous information. The housing allowance is not subject to income tax.
- Not to be confused with churches who have filed Form 4029 and are exempt as an employer from FICA. In that case, ALL employees must pay SE tax on church wages.

Gifts to Minister

- Generally, any payments from church to pastor or minister is treated as taxable compensation (e.g. “love gifts”, “special offering”, etc.)
  - The collection and distribution organized by church and in recognition of the service of the minister makes it compensation.
  - Include on W-2 and be mindful of reasonable compensation limits.
  - Payments from sources outside the church are normally self-employment income

Gifts to Minister, cont'd.

True gifts from individuals to the minister may be nontaxable.

I recommend a gift verification letter for large gifts or circumstances where it could be questioned. The donor signs letter affirming the nature of the gift as personal generosity and not compensation for services rendered.

Note: Increase in the use of cash apps, especially through social media, for electronic gifts and payments to ministers makes this a larger problem.