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Exempt Organizations Update

Allegheny Tax Society

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I. IRS Fiscal Year 2012 Exempt Organizations Work Plan – Highlights

a. Self-declaring tax-exempt organizations

- i. Some organizations are required to receive a determination letter from the IRS to be recognized as exempt from federal income tax
 - i. **Form 1023** - Section 501(c)(3) organizations
 - ii. **Form 1024**
 - a. Section 501(c)(4) credit counseling organizations
 - b. Section 509(c)(9) voluntary employee benefits associations (“VEBAs”)
 - c. Section 501(c)(17) trusts forming a part of a plan providing for the payment of supplemental unemployment compensation benefits
 - d. Section 501(c)(20) qualified group legal services plans
- ii. Other organizations (e.g., Section 501(c)(7) social clubs) may declare themselves to be tax-exempt without receiving a determination from the IRS (Form 1024 optional)
- iii. Using Form 990 data, the IRS plans to assess whether such organization are being appropriately classified
- iv. The IRS also plans to send a comprehensive questionnaire to such organizations

b. Impermissible political intervention

- i. Permissible political activity depends on the organization type
 - i. Section 501(c)(3) organizations
 - a. “No substantial part of the activities of which is carrying on propaganda, otherwise trying to influence legislation”
 - i. Facts and circumstances test to determine whether “substantial”
 1. 5% threshold – *Seasongood v. Comr.*, 227 F.2d 907 (6th Cir. 1955)
 2. Primary reliance on 5% threshold rejected – *Christian Echoes Nat’l Ministry v. U.S.*, 470 F.2d 849 (10th Cir. 1972)
 3. **Section 4912** Excise Taxes
 - ii. **Section 501(h)** election – substitutes “substantial” test for statutory limitations
 1. **Form 5768**

- 2. Sliding scale capped at \$1,000,000 of expenditures per year
 - 3. **Section 4911** Excise taxes
 - iii. **Form 990, Schedule C, Part II**
 - b. "does not participate in, or intervene in (including publishing or distributing of statements) any political campaign on behalf of (or in opposition to) any candidate for public office"
 - ii. Section 501(c)(4) social welfare organizations
 - a. **Section 501(c)(4)-1(a)(2)(ii)** - Lobbying activities considered to promote social welfare
 - i. **Form 990, Schedule C, Part III**
 - b. **Section 501(c)(4)-1(a)(2)(ii)** – the promotion of social welfare does not include participation in political campaigns
 - i. **Rev. Rul. 81-95, 1981-1 C.B. 332** – a Section 501(c)(4) organization may engage in political campaign activities so long as the organization is primarily engaged in activities that promote social welfare
 - iii. Section 527 Political Organizations
 - a. May be subject to Federal Election Commission reporting
 - b. **Form 8871**
 - c. **Form 8872** – open to public inspection
- c. Unrelated business income tax – Section 511
- i. The IRS plans to review Form 990 and Form 990-T data
 - ii. The IRS will focus on organizations that report high unrelated business income but do not pay any unrelated business income tax
 - i. **Section 1.512(a)-1(a)** – deductions allowed against unrelated business income if allowed by chapter 1 of the Code and directly connected with the carrying on of the unrelated trade or business
 - ii. **Portland Gold Club v. Comr., 497 U.S. 154 (1990)** – profit motive requirement
- d. Exempt Organization Governance
- i. The IRS plans to review Part VI, *Governance, Management, and Disclosure*, of the Form 990
 - ii. This IRS' goal is to determine the relationship between certain governance practices and tax compliance
- e. Overseas activities
- i. **Rev. Rul. 71-460, 1971-2 C.B. 231** – charitable activities retain their character as charitable if conducted outside of the U.S.
 - ii. **Form 990, Schedule F**

- iii. The IRS EO division plans to cooperate with other IRS divisions and foreign tax authorities
- iv. The IRS' goal is to verify that organizations with overseas activities are fulfilling their tax-exempt mission

f. Group Rulings

- i. **Rev. Proc. 80-27, 1980-1 C.B. 677** – Procedures for obtaining and maintaining a group ruling
- ii. **IRS Publication 4573** – “Group exemptions are an administrative convenience for both the IRS and organizations with many affiliated organizations.”
- iii. In June of 2011, the Advisory Committee on Tax Exempt Organizations and Government Entities (“ACT”) recommended that the IRS disallow the ability of organizations with a group ruling to file a group Form 990
- iv. The IRS plans to send a questionnaire to a variety of group ruling holders to gather information on how such organizations are meeting the requirements of Rev. Proc. 80-27

g. Exempt Organization Select Check

- i. New IRS database to search for organizations that have had their tax-exempt status revoked
- ii. The Pension Protection Act of 2006 added provisions that provide that exempt organizations that fail to file an annual return for three consecutive years will have their tax-exempt status revoked (there are a few exceptions to this rule – e.g. certain religious organizations)
 - i. **Section 6033(j)(1)**
 - ii. **IRS Notice 2011-44** – IRS will grant retroactive reinstatement of exemption under certain limited circumstances
- iii. 990 Filing Thresholds
 - i. Form 990 – Gross receipts of \$200,000 or greater or total assets of \$500,000 or greater
 - ii. Form 990-EZ – Gross receipts less than \$200,000 and total assets less than \$500,000
 - iii. Form 990-N – Gross receipts of \$50,000 or less

II. **2011 Form 990, Return of Organization Exempt from Income Tax, and Schedules**

- a. This is the 4th version of Form 990 following major revision in 2008

- b. Partnership reporting has been changed for 2011
 - i. Organizations must now report partnership information (e.g. income, balance sheet information) based on the partnership's Schedule K-1 filed for the tax year ending with or within the organization's tax year
 - ii. Previously, such information was to be reported based on the organization's books
- c. Schedule H, *Hospitals*

- i. Whether an organization is considered a "hospital facility" for Schedule H purposes depends on state law licensing requirements (For Pennsylvania, see **28 Pa. Code Part IV**)
- ii. In addition to other general hospital information, Schedule H asks questions regarding the requirements of Section 501(r) – "*Additional Requirements for Certain Hospitals*", which was implemented by the Patient Protection and Affordable Care Act (see **Form 990, Schedule H, Part V-B**)
 - a. **Section 501(r)(3)** – Provides that hospitals must conduct a community health needs assessment ("CHNA") every 3 years and adopt an implementation strategy to meet the needs identified by the CHNA
 - i. Section 501(r)(3) is applicable for tax years beginning after March 23, 2012
 - ii. **Section 4959** imposes an excise tax penalty of \$50,000 on each hospital that fails to satisfy the CHNA requirement for any taxable year
 - iii. **IRS Notice 2011-52**
 - 1. Describes the anticipated proposed regulations related to the Section 501(r)(3) CHNA requirement
 - 2. Taxpayers may rely on provisions of this Notice until the proposed regulations are released
 - b. **Section 501(r)(4)** – Provides that hospitals must establish a written financial assistance policy that is widely publicized
 - c. **Section 501(r)(5)** – Provides that hospitals must limit the amount that is charged to those who are eligible for financial assistance to no more than the amount billed to individuals with health insurance
 - d. **Section 501(r)(6)** – Provides that hospitals must forego extraordinary collection practices before making reasonable efforts to determine whether an individual is eligible under the organization's financial assistance policy

III. Issues Related to Contributions to Section 501(c)(3) Organizations

- a. Section 509(a) - Private Foundation vs. Public Charity
 - i. Private Foundation – Files **Form 990-PF**
 - a. Subject to distribution requirements (**Section 4942**)
 - b. Subject to numerous excise taxes
 - i. **Section 4940** – Taxes on investment income
 - ii. **Section 4941** – Taxes on self-dealing
 - iii. **Section 4943** – Taxes on excess business holdings

- iv. **Section 4944** – Taxes on investments that jeopardize charitable purpose
 - v. **Section 4945** – Taxes on taxable expenditures
- ii. **Public Charity – Files Form 990**
 - a. **Section 509(a)(1)** – Based on activities of the organization (e.g., hospitals and universities)
 - b. **Section 509(a)(2)** – Publicly Supported Organizations
 - c. **Section 509(a)(3)** – Supporting Organizations
 - i. Type I – Controlled by supported EO
 - ii. Type II – Controlled in connection with supported EO
 - iii. Type III
 - 1. Functionally Integrated
 - 2. Other
- b. **Functionally Integrated Supporting Organization (Type III)**
 - i. **Current Regulations – Section 1.509(a)-4(i)**
 - a. An organization is “functionally integrated” if the “activities engaged in for or on behalf of the publicly supported organizations are activities to perform the functions of, or to carry out the purposes of, such organizations, and but for the involvement of the supporting organization, would normally be engaged in by the publicly supported organizations themselves”
 - b. This definition would seem to include fundraising and grant making activities
 - ii. **Proposed Regulations – Prop. Reg. Section 1.509(a)-4(i)(4)(ii)**. Specifically excludes fundraising and grant making activities from the definition of “functionally integrated activities”
- c. **The Pension Protection Act added Section 4942(g)**
 - i. **Section 4942(g)** provides that grants made by private foundations to Type III – “Other” organizations are not considered qualifying distributions for the purpose of Section 4942
 - ii. In light of Prop. Reg. Section 1.509(a)-4(i)(4)(ii), many private foundations have implemented policies that prohibit grants to Type III – “Other” supporting organizations (some go as far as to prohibit grants to any Section 509(a)(3) organizations)
- d. **Donor reliance on IRS resources**
 - i. **Publication 78**
 - ii. **Rev. Proc. 2011-33, 2011-1 C.B. 887**
 - iii. **SOI Tax Stats – Exempt Organizations: IRS Master File Data**

IV. New Form 8940, Request for Miscellaneous Determination

- a. **Form 8940** may be used by Section 501(c)(3) organizations to obtain various miscellaneous determinations
- b. A user fee is required for many determinations covered by Form 8940
- c. Determinations available through Form 8940 include:
 - i. Advance approval of certain set-asides – **Section 4942(g)(2)**
 - ii. Advance approval of voter registration activities – **Section 4945(f)**
 - iii. Advance approval of scholarship procedures – **Section 4945(g)**
 - iv. Exemption from Form 990 filing requirements – **Sections 1.6033-2(g) and (h)**
 - v. Advance approval that a potential grant or contribution constitutes an “unusual grant” – **Section 1.170A-9T(f)(6)(ii) or Section 1.509(a)-3T(c)(3)**
 - vi. Change in type (or initial determination of type) of Section 509(a)(3) organization
 - vii. Reclassification of foundation status, including a voluntary request from a public charity for private foundation status – **Section 509(a)**
 - viii. Termination of private foundation status under **Section 507(b)(1)(B)** – advance ruling request
 - ix. Termination of private foundation status under **Section 507(b)(1)(B)** – 60-month period ended

V. Other Exempt Organization Topics