
MOSHERLAW NONPROFIT UPDATE

SERVING THE NONPROFIT COMMUNITY FOR OVER 25 YEARS

Compliments of Mosher & Associates

1st Quarter, 2007

LEGAL ISSUES AFFECTING NONPROFIT AND TAX-EXEMPT ORGANIZATIONS

INSIDE THIS ISSUE:

Danger Ahead: Charitable Organizations Participating or Intervening in Political Campaigns

Pension Protection Act Carries Host of Charitable Reforms

Learning to Recognize and Manage UBIT

Recent Publications

Real Estate Tidbit: Annual \$1,000 Water Exemptions

Office News

Mission Statement

The legal professionals of Mosher & Associates are dedicated to serving the legal needs of both small and large charitable, religious, educational, and human service organizations and the larger philanthropic community.

Danger Ahead: Charitable Organizations Participating or Intervening in Political Campaigns

Section 501(c)(3) organizations are absolutely prohibited under the Internal Revenue Code from participating or intervening in any political campaign regarding candidates for public office. In response to a perceived increase in abuses by nonprofits, the IRS has stepped up scrutiny of reported violations and has issued guidance designed to foster compliance. As we approach the November election, it is well to be aware of these prohibitions.

The stakes are quite high. Penalties for violating these prohibitions include loss of exempt status and/or taxes imposed of 10% of each political expenditure, and under certain circumstances 2 ½% on the organization manager personally, (maximum \$5,000). An additional penalty of 100% of the political expenditure on the organization, and 50% (maximum \$10,000) on the manager if the violation is not corrected within the taxable period.

According to IRS official guidance, nonprofit organizations should avoid the following to comply with the prohibitions:

- Distributing diverse printed materials that encourages their members to vote for a preferred candidate;
- Religious leaders using the pulpit to endorse or oppose a particular candidate;
- Criticizing or supporting a candidate on their website or through links to another website;

- Disseminating biased voter guides or candidate ratings;
- Placing signs on their property that show they support a particular candidate;
- Giving improper preferential treatment to certain candidates; and
- Making cash contributions to a candidate's political campaign.

It is apparent from the list of prohibited activities that many 501(c)(3) organizations may either unwittingly violate the prohibition or intentionally seek to push the limits of permissible activities. A political campaign may be an important forum for debating significant issues that are vital to many nonprofits' goals and activities. For some organizations, requiring them to refrain from political involvement at the critical juncture of an impending election may seem repugnant and contrary to foundational democratic principles. To participate meaningfully, and without violating the legal prohibition, may pose quite a challenge. For many other organizations, compliance may simply entail an awareness of applicable guidelines and care in following them.

The prohibitions contained in this article do not apply to personal statements by leaders of exempt organizations, as long as the context is clear, that the opinions are not those of the organization. The IRS will look to the facts and circumstances of each individual case. As of now no "bright-line test" exists which can apply in every situation.

Pension Protection Act Carries Host of Charitable Reforms

On August 17, President Bush signed into law the Pension Protection Act of 2006. This massive Act contains several provisions regarding religious and charitable organizations – including changes in charitable contribution donations and reporting requirements – that may directly affect our nonprofit clients' operations. The Act reflects the government's response to an increased perception of charitable abuses and therefore imposes more accountability from tax exempt entities, including additional reporting requirements and penalties for non-compliance.

Perhaps most notably, organizations that repeatedly fail to file Form 990s or newly-required notices (for non-church organizations with less than \$25,000 in annual gross revenues) with the IRS face automatic revocation of their tax-exempt status. In addition, cash contributions in any amount must be properly documented in order to be deductible.

Of the Act's numerous provisions, the following are highlights of those generally affecting smaller nonprofit organizations.

New Notice Requirements. If your organization has been exempt from the Form 990 information return requirement because it has less than \$25,000 in gross annual receipts, it must now electronically file an annual notice with the IRS. This notice must include the following organizational information: (a) legal name; (b) any other name under which the organization does business; (c) mailing address and website, if any; (d) tax identification number; (e) principal officer's name and address; and (f) evidence of the continuing basis for exemption from the Form 990 information return filing requirements. This annual notice will be subject to public disclosure requirements. No monetary penalty may

be imposed for failure to file the annual notice, but the IRS can revoke the organization's tax exempt status (see below). This provision is effective for annual periods beginning after 2006.

Revocation of Tax Exempt Status. If your organization fails to file its Form 990 information returns or its newly required notices – whichever is required – for three consecutive years, then the IRS will **automatically** revoke its tax exempt status. The organization must then file anew for tax exempt status. Reinstatement will be allowed only upon a showing of "reasonable cause" for failure to file the returns or notices (i.e., a very good excuse). This is a drastic change from previous law, under which penalties could be imposed but tax exempt status generally was not revoked. Nonprofits thus must now be extremely conscientious about keeping up with the proper annual IRS paperwork.

Federal Disclosure to State Officials. Under the Act, the IRS now will have its own freedom to share information such as revocation of tax exempt status, applications for tax exempt status, and annual informational returns and notices. This may provide state officials with improved ability to monitor nonprofits' charitable registrations and fundraising activities, although the latter categories of information are already subject to public disclosure. The upshot? Be sure to have your state charitable solicitations and registrations properly in order, including multi-state filings as needed.

Record-Keeping Requirements. For deductibility of **all** charitable contributions of cash, the donor must maintain a cancelled check, bank record, or receipt from the donee organization showing the name of the donee organization, the date of the contribution, and the amount of the contribution. This provision is effective immediately. Donors should thus check that they are providing appropriate written acknowledgments of contributions to all donors.

Recent Publications

Working in collaboration with the Charitable Advisory Council's Public Education Committee, Associate Attorney Ryan Oberly recently prepared "General Questions For Starting A Nonprofit Organization" as a public service project for the Illinois Attorney General's Office. The document provides smaller nonprofit organizations with answers to several of the fundamental legal questions that typically arise in the first few years of a nonprofit organization's operation. The document is available on the Attorney General's website and in the "Featured Articles" section of www.moshierlaw.com. It is our hope at Moshier & Associates that this and all of the publications on our website will serve as helpful resources for the nonprofit community.

Pension Protection Act Carries Host of Charitable Reforms – continued

Public Disclosure of Unrelated Business Income. The Act now requires that organizations with unrelated business income, for which they file Form 990-T returns, to make such returns available for public inspection. This provision is effective for all returns filed after the Act's enactment.

Tax-Free IRA Distributions. The Act provides that certain distributions of up to \$100,000 from a traditional individual retirement account (IRA) or a Roth IRA may qualify for charitable contributions.

Food Inventory. Trades and businesses may be entitled to enhanced deductions for donations.

Clothing and Household Items. The Act tightens up the deductibility of such donations to be permissible only for items that are in "good used condition or better," effective immediately.

Church Terminology. The Act clarifies that a "convention or association of churches" may include individuals and individuals with voting rights.

Donor-Advised Funds and Supporting Organizations. The Act effectively eliminates the use of DAFs for tax-free distributions to individuals by imposing substantial, prohibitive taxes on such distributions. Accordingly, people who have utilized the convenience of DAFs as a vehicle to fund their charitable and other tax-exempt activities may now need to form new organizations to continue such work. The Act further provides that the Treasury Secretary undertake a year-long study of DAFs and supporting organizations, to further scrutinize whether they operate consistently with charitable principles. It thus appears likely that the government will further curtail the usefulness of these tax exempt entities within the charitable community.

Private Foundations. The Act doubles the penalty excise taxes for improper self-dealing, undistributed income, excess business holdings, investments that jeopardize the foundation's exempt purposes, and taxable expenditures. Accordingly, private foundations must be more diligent than ever in carrying out their purposes.

Learning to Recognize and Manage Unrelated Business Income Tax

As the year ends, remember to report unrelated business income over \$1,000.00, and pay state and federal taxes (referred to as "UBIT") on any profits received. What constitutes unrelated business activity? The activity must the following three factors.

Trade or Business. When examining whether activities will create unrelated business income, responsible directors should first ask the following two questions: 1) Is your organization's primary motive for participating in this activity to gain a profit? 2) Is the activity being conducted in a commercial manner? The focus of these questions is on the activity itself and not on the organization's need for such profits or how they will be used.

Regularly Carried On. If the answers to these two questions are yes, directors should determine whether the organization will "regularly carry on" the particular activity. Is the activity carried on once or twice a year, conducted seasonally, year-round? While no definitive line exists for when an activity becomes "regularly carried on", directors should keep this dichotomy in mind.

Not Substantially Related. Finally, the organization should examine if the activities will be substantially related to the organization's tax-exempt functions. As organizations move outside the generally accepted methods of soliciting funds and into more business-like ventures, the organization must make sure its activities are "substantially related" to accomplishing its exempt purposes.

Consider a school, organized to train children in performing arts, that sells tickets to monthly performances by the children. The ticket sales would not be subject to UBIT because the events are furthering the school's exempt purpose. What if the same school ran a concession stand during each of the performances? While there are several other factors that might change the analysis, the concession stand does not appear to be substantially related to accomplishing its exempt purposes and the proceeds will therefore be subject to UBIT.

Learning to Recognize and Manage UBIT— continued

Thankfully, federal and state laws provide several exemptions to these rules. Furthermore, simply because an activity will result in unrelated business activity does not necessarily mean that an organization should avoid it. However, too much unrelated business activity can jeopardize an organization's tax-exempt status. While no set limit exists, as a general rule, organizations generating more than 20% of their gross revenues should consider setting up a subsidiary to conduct such business activities. Organization managers who plan to develop business-type activities that might result in UBIT should be sure to obtain skilled legal counsel as there are many methods for conducting business activities that legally avoid UBIT.

For further information on unrelated business income taxes, see, "A Basic Study of Unrelated Business Income Taxation Under IRC Section 512" which is available in the Featured Articles Section of www.moshierlaw.com.

Office News

Attorney **Charles Hogren** has recently joined Moshier & Associates after a dedicated and lengthy legal aid career serving the poor. As the co-founder and former executive director of the Cabrini-Green Legal Aid Clinic, Chuck is intimately familiar with the daily challenges of running a nonprofit organization, working with Boards of Directors, and fund-raising. Moshier & Associates is very pleased to have Chuck as part of our professional team.

Attorney Michael Moshier has recently agreed to serve as an adjunct professor for **DePaul University's Public Services Graduate Program**. He will be teaching a course on law and nonprofit organizations during the School's Winter Quarter.

MOSHERLAW NONPROFIT UPDATE

Moshier & Associates

19 South LaSalle Street, Suite 1400
Chicago, IL 60603

Phone: 312-220-0019

Fax: 312-220-0700

Email: info@moshierlaw.com

We're on the web!
Visit us at
www.moshierlaw.com
