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# MOSHERLAW NONPROFIT UPDATE

SERVING THE NONPROFIT COMMUNITY FOR OVER 30 YEARS

Compliments of Mosher & Associates

2nd Quarter, 2007

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## LEGAL ISSUES AFFECTING NONPROFIT AND TAX-EXEMPT ORGANIZATIONS

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### 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.

## The IRS Tightens the Reins on Filing IRS Form 990s

The IRS' Exempt Organizations Compliance Unit is increasingly monitoring exempt organization's annual IRS Form 990 returns, enforcing penalties for failing to file by the deadline, and restricting its willingness to abate the same. As a result, exempt organizations can no longer afford to casually address the annual reporting requirement.

The IRS Form 990 is due on the fifteenth day of the fifth month after the close of the organization's fiscal year. Penalties for late or incomplete filings are \$20.00 a day with a maximum penalty of \$10,000.00. If the organization has greater than one million in annual gross receipts, the penalty increases to \$100.00 a day with a maximum penalty of \$50,000.00.

This recent surge of stricter monitoring and enforcement by the IRS compels organizations to exercise careful forethought and develop a plan to continually monitor its annual reporting. To this end, organizations may consider developing an ad hoc committee to take responsibility for making sure the Form 990 is properly filled out, signed by an authorized representative, and timely filed.

If the organization elects to hire a certified accountant, significant care should be taken to ensure the accountant clearly understands the reporting responsibilities of tax-exempt organizations and is familiar with IRS Form 990. Organizations should request written confirmation that the accountant will file by the deadline and/or take the responsibil-

ity for obtaining an extension. We recommend that the accountant agree to pay for any penalties incurred as a result of his or her failure to finish preparing the Form 990 in a timely manner. However, organizations need to provide the necessary financial information to enable the accountant to complete the IRS Form 990 before the deadline.

If your organization has been exempt from filing Form 990 because it has less than \$25,000 in gross annual receipts, the recent passing of the Pension Protection Act now requires you to electronically file an annual notice with the IRS. This notice must include basic organization information and evidence of the continuing basis for exemption from the Form 990 filing requirements. This annual notice will be subject to public disclosure requirements. While no monetary penalty may be imposed for failure to file the annual notice, the IRS will revoke the organization's tax exempt status if the organization fails to file the information notice for three consecutive years. In other words, this filing requirement is an annual "check-in" that lets the IRS know that small organizations are still operating.

The Form 990 serves as one of the forefront communications between your organization and the public at large covering fundraising, program expenditures, and administrative overhead. As a result, it behooves the organization to approach the Form with great care, integrity, and honesty.

## IRS Issues Inflation Adjustments For 2007

The IRS has issued the 2007 inflation adjustment amounts accompanying various tax laws pertaining to tax exempt organizations (Rev. Proc. 2006-53). The following are a few pertinent items:

- The exception from unrelated business income taxation involving "low-cost articles" is applicable with respect to articles with a cost of no more than \$8.90. [27.2(j)]
- The \$5, \$25 and \$50 guidelines for disregarding the value of insubstantial benefits received from a donor in return for a fully deductible federal income tax charitable contribution are \$8.90, \$44.50 and \$89. [Appendices E-F]
- The annual per-person, -family, or -entity dues limitation to qualify for the reporting exception regarding certain exempt organizations with nondeductible lobbying expenditures is \$95 or less. [20.8(a)]

The IRS also issued the 2007 optional standard mileage rates used to calculate the deductible costs of operating an automobile for business or charitable purposes. (Rev. Pro. 2006-49). Beginning January 1, 2007, the standard mileage rates for the use of a car will be:

- 48.5¢ per mile for business miles driven; and
- 14¢ per mile driven in service to a charitable organization.

## Property Tax Update: New Ideas (Problems) from Dept. of Revenue

Does your nonprofit organization have programs that are entirely government funded? Does it own real estate that is exempt from Illinois property taxes? If so, then in the increasingly narrow perspective of the Illinois Department of Revenue (DOR), your nonprofit may no longer be operating a qualified "charity" but rather be merely conducting a noncharitable "business relationship" with the government that may disqualify your property for exemption from property taxes.

The Illinois DOR is the administrative agency that oversees qualifications for property tax exemption. The DOR's determinations are subject to judicial review, albeit costly to individual litigants. Established Illinois case law provides that property is qualified for a tax exemption if it is owned by a charity and operated for charitable purposes. A hallmark of "charity," as defined in Illinois, may be to relieve a government burden, such as education, welfare, homelessness, or crime. The DOR has narrowed this example of "charity" to mandate that a nonprofit *must* clearly relieve a government burden to qualify for charitable property tax exemptions. According to the new rules at the DOR, if a charitable organization is primarily funded by governmental dollars, it probably does not satisfy this requirement because it does not appear to save the government any money. Moreover, if a significant part of a charitable program, such as rental subsidies for low-income housing, is wholly government-funded, then property is similarly determined to be nonexempt. Likewise, it is not enough that a nonprofit waives fees, if the funds for such fees otherwise come from government dollars. Rather, the nonprofit must make up any shortfalls from waived fees using its own resources raised from "public charity."

This logic ignores the enormous benefits that nonprof

## Recent Publications

Michael Moshier recently finished a revised edition of Chapter One of the Illinois Institute for Continuing Legal Education's *Not-For-Profit Corporations Handbook*. Chapter One, entitled "Organizing an Illinois Not-for-Profit Corporation" provides a brief history of the statutory laws affecting not-for-profit organizations, the principal corporate (non-tax) aspects of starting a not-for-profit corporation, and practical planning suggestions for developing a more effective organizational structure. Mr. Moshier's Chapter One, along with the rest of IICLE's new edition of *Not-For-Profit Corporations*, will be released in June of 2007. For further information, please visit [www.iicle.com](http://www.iicle.com)

## Property Tax Update: New Ideas (Problems) from Dept. of Revenue - continued -

its bring to vital charitable activities, both concretely and intuitively, that government agencies and their dollars simply cannot match. To avoid jeopardizing property tax exemptions in this current adverse climate, we recommend the following measures. First, to the extent possible, nonprofits should establish an endowment fund or other nongovernmental charitable funding for their programs, fees, or other costs, so that they are at least partially funded by nongovernmental sources. Second, nonprofits can join together to seek a legislative adjustment to bring the DOR back into accord with the established case law as well as the current trends allowing for creative partnering between charitable organizations and the government. Please contact Sally Wagenmaker or Michael Mosher in our office for further information.

## Helping the Needy: Benevolence Guidelines

Many churches and other nonprofit organizations regularly provide benevolence, that is, financial assistance to needy individuals. If such help does not conform to IRS requirements, however, contributions may not be deductible and the church's tax-exempt status may even be at risk. Churches must therefore act carefully to preserve contributors' tax deductions, maintain their tax-exempt status and avoid potential penalties.

The Tax Code allows tax deductions for contributions made "to or for the use of" qualified organizations, including churches. Contributions designated for specific individuals, regardless of need, are "personal gifts" and non-deductible. For contributions used ultimately for benevolent purposes, two requirements must be met for deductibility: (1) the church must control the donated funds' uses; and (2) the contributor's intent in making the payment must be to benefit the church, not one individual.

To meet these requirements, we recommend that churches maintain a written benevolence fund policy regarding the purpose and use of the funds, to demonstrate control. Such policy should include enumerated criteria for evaluating benevolence requests, and all requests should be adequately documented. The policy may distinguish between disaster relief, for which

benevolence may be distributed for short-term needs without regard to financial resources, and other long-term needs, for which a financial assessment is vital. In addition, churches should be aware of special rules regarding benevolence given to "insiders", such as employees, board members and their relatives, which may in certain circumstances be treated as taxable compensation or improper private benefits. A key concern in these cases is to avoid conflict of interest.

Helping needy people is an obvious way for churches to live out their religious mission. Doing this correctly, to protect deductibility of contributions and churches' tax-exempt status, is prudent and wise stewardship.

## Chicago Nonprofits: Water Exemption Clarification

In our previous newsletter, we stated that Chicago not-for-profit organizations may be eligible for a \$1000 annual exemption from municipal water charges. This was inaccurate, and we apologize for the error. In fact, most nonprofits are eligible for *entire* exemptions from water bills and partial \$500 annual exemptions from sewer bills. Pursuant to sections 11-12-540(a) and 3-12-020(a) of the Chicago Municipal Code, nonprofit organizations that own and use Chicago property exclusively to provide educational, religious, or charitable services may obtain both the water and sewer exemptions.

To qualify, an organization should file an application stating that the property is used appropriately, provide necessary corporate and real estate documentation, and submit financial information for the past two years to the City of Chicago Department of Water. If any part of the property is used to produce revenue, then the entire property is ineligible for the exemptions. However, the Department may in its discretion grant such applications if separate meters are installed that adequately provide for such distinct uses. The application process takes approximately six months to complete, and all outstanding water and sewer bills must be made before the application will be processed.

For more information and to obtain an application, please contact Sally Wagenmaker or Susan Thomas in our office or the City of Chicago Department of Water, Bureau of Water Services, at 312-747-9090.

## Abuse Allegations: Respond Appropriately

How do you respond when someone at your church or nonprofit organization raises a claim of abuse concerning a child or other vulnerable person? Do you have to report this to local authorities? How do you handle it within your organization? How will you investigate it? And to whom should you disclose this sensitive information?

All allegations of abuse should be taken very seriously. At a minimum, such situation must be handled forthrightly while balancing due respect for people's privacy, confidentiality, legal considerations, and actual and potential harm. At worst, allegations can spell financial and emotional catastrophe for the people and organizations involved.

We recommend that religious and charitable organizations have a Board-approved, established response plan in place, with which staff and other leaders are knowledgeable. When an incident of suspected abuse is reported, the person(s) to whom the report is made should follow the written response plan, which should include these measures:

- (1) secure the safety of any children involved;
- (2) notify parents or guardians, if they are not the accused;
- (3) contact legal counsel as soon as possible;
- (4) show care and support for the alleged victim and his or her family;
- (5) treat the accused with dignity and support (but relieve that person temporarily of duties that allow access to vulnerable persons);
- (6) complete a written suspected abuse report;
- (7) document all investigative efforts;
- (8) report the incident to the organization's insurance carrier;
- (9) safeguard the privacy and confidentiality of all involved, disclosing information only on a "need to know" basis and resisting the temptation to share information more broadly than appropriate under the circumstances; and
- (10) designate a spokesperson who can communicate, as necessary, with the congregation, organization, or media in a discreet, informed, and diplomatic matter.

Our office occasionally works with religious organizations dealing with some form of objectionable behavior. There is a strong temptation for leadership to report such matters to the congregation, usually this is out of concern for public safety. However, the problems that can arise out of public disclosure of private immoral behavior usually makes the raising of "hue and cry" inadvisable.

Due to the highly sensitive and fact-specific nature of abuse allegations, we strongly recommend that organizations faced with such claims contact legal counsel for specific legal advice.

In future editions of the Moshierlaw Nonprofit Update, we will address other abuse prevention policies as well as financial abuse and prevention matters.

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#### **Moshier & Associates**

19 South LaSalle Street, Suite 1400  
Chicago, IL 60603

Phone: 312-220-0019

Fax: 312-220-0700

Email: [info@mosherlaw.com](mailto:info@mosherlaw.com)

We're on the web!  
Visit us at  
[www.mosherlaw.com](http://www.mosherlaw.com)