

Preserving Your Organization's Tax-Exempt Status

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Steps to Non-Profit Formation

- Define your mission and scope;
- Develop a business plan;
- Incorporate and adopt bylaws;
- Develop your board of directors;
- File for tax-exempt status;
- Register with your state

Traps for the Unwary Non-Profit Executive

- Not filing required IRS returns and state reports;
- Not filing complete and accurate returns;
- Deviating from your tax-exempt purposes/mission;
- Paying unreasonable compensation to board members and executives;
- Permitting the organization's assets to be used personally by employees or board members;
- Violating terms of your Articles and/or Bylaws;

- Entering into conflict of interest transactions;
- Not filing state returns where your organization does business;
- Engaging in excessive lobbying;
- Engaging in political campaign activity;
- Engaging in activities that generate too much unrelated taxable business income;
- Ignoring correspondence from the IRS

Steps to Preserve Exempt Status

- Maintain current corporate status in the state of incorporation – you must file annual reports and pay the required annual assessment;
- Failure to do so will result in penalties and even the loss of corporate status and loss of reduced liability exposure to organization;
- Select a reliable registered agent for service;
- File for authority to conduct business in states where your non-profit has a presence;
- Register with the state(s) in which you will be conducting solicitations. A failure to do so may result in state imposed penalties;

- Timely file the appropriate Form 990 with the IRS each year;
- Confirm accuracy and completeness of Return before filing and seek an extension if necessary;
- Failure to file on time - \$20 per day penalty up to maximum of \$10,000 or 5% of your non-profit's gross receipts for the year;
- If gross receipts are over \$1,000,000, the fine is \$100 per day up to a maximum of \$50,000;
- Automatic revocation of tax-exempt status if your organization fails to file 3 consecutive years, with the revocation effective to the original filing due date of the third annual return. Refer to IRS list of organizations that have lost tax-exempt status due to auto revocation

Impact of Loss of Exempt Status

- May be required to file federal income tax returns and pay applicable income taxes;
- It can no longer receive tax-deductible contributions;
- Donors can deduct contributions made before the organization's name appears on the Automatic Revocation List;
- No appeal provided by IRS – the organization must refile for tax-exempt status, costly in both time and expense;
- Restricts ability to apply for grants from private foundations/government;
- Organization may be subject to property tax, state sales and use taxes and income tax

Changes to Tax-Exempt Mission

- Deviating from the tax-exempt purposes disclosed to the IRS can result in loss of exempt status;
- Ensure activities comply with purposes disclosed on Form 1023 application as well as Articles of Incorporation and Bylaws;
- If you seek to change the mission or purposes, consult with legal counsel, your CPA and with the IRS before doing so;
- You may be required to amend the organization's Articles and Bylaws

Excessive Unrelated Business Taxable Income

- *“Income from a regularly-carried-on trade or business that is not substantially related to the organization’s exempt purpose”*
- Activity must be a trade or business;
- Must be regularly carried on;
- Must be substantially unrelated to your organization’s exempt purpose, i.e. activity does not contribute importantly to accomplishing your tax-exempt purpose

UBTI Continued

- Examples, sale of advertising space in --- weekly bulletins, journals, on the website;
- Sale of merchandise and publications not having a substantial relationship to the exempt purpose;
- Providing management or other services to another organization;
- If you have UBTI, file a Form 990T
- Excluded from UBTI – passive income sources like dividends, interest, rents, properly structured royalties;
- No black and white test for how much is too much UBTI– More than 15%? More than 30%? Case by case analysis followed

Avoidance of Private Benefit/Private Inurement

- Your organization's activities should not serve the private interests, or private benefit of any individual or organization (other than the 501(c)(3)) more than insubstantially;
- No part of an organization's net earnings may inure to the benefit of a private shareholder or individual who, because of the person's relationship to the organization, has an opportunity to control or influence its activities (disqualified person);
- Insiders include officers, directors, management (CEO, CFO, COO), substantial contributors, DQ person's spouse, siblings, children, etc.

- Prohibited inurement includes payment of dividends, the payment of unreasonable compensation to insiders, and the transfer of property for less than fair market value;
- 501(c)(3) organizations that engage in inurement or substantial private benefit risk loss of tax-exempt status and the imposition on *insiders* guilty of inurement of an excise tax (intermediate sanctions) which can be substantial;
- Remember – The intent of a 501(c)(3) organization is to ensure that it serves a public interest, not a private one
- Any doubts? Consult your CPA or attorney

Issues with Lobbying

- 501(c)(3) organizations can conduct “some” lobbying activities, but not too much;
- “Lobbying” – when an organization contacts, or urges the public to contact members or employees of a legislative body for the purpose of proposing, supporting, or opposing legislation, or when it advocates the adoption or rejection of legislation;
- “Substantial” lobbying by a (c)(3) can result in a loss of exempt status;
- Option of making election under Section 501(h) to have its lobbying activities measured by an “expenditure test” to determine if the lobbying activities are “substantial” in nature

More on Lobbying

- With the 501(h) election an organization agrees not to spend more than a certain percentage of its total expenses on lobbying activities;
- The alternative is to determine if based on facts and circumstances an organization's lobbying constitutes a *substantial* part of its activities;
- Substantial part test is more subjective, while the election provides greater certainty as to the actual limit that may be spent on lobbying activities;

Political Activity

- All 501(c)(3) organizations are prohibited from directly or indirectly participating in, or intervening in any political campaign on behalf of or in opposition to any candidate running for public office;
- This prohibition applies to federal, state and local campaigns and beyond mere candidate endorsements;
- Contributions to political campaign funds or public statements of position made by or on behalf of an organization in favor of, or in opposition to, any candidate for public office violate the prohibition;

Some politically related activities are permissible:

- promotion of voter registration;
- encouragement of voter participation;
- providing voter education, but not with the intent of favoring or opposing any particular candidate for public office;
- Whether an activity is political campaign intervention depends on the particular facts and circumstances;
- Engaging in political activity can result in a loss of exempt status.

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