

TEN WAYS TO LOSE YOUR TAX EXEMPT STATUS

Michael J. Hamblin

Attorney at Law

**512 East Eleven Mile Road
Royal Oak, Michigan 48067**

(248) 565-8093

mhamblin@hamblinlaw.com

www.hamblinlaw.com

Introduction

Approximately 2 million tax-exempt organizations in the USA.

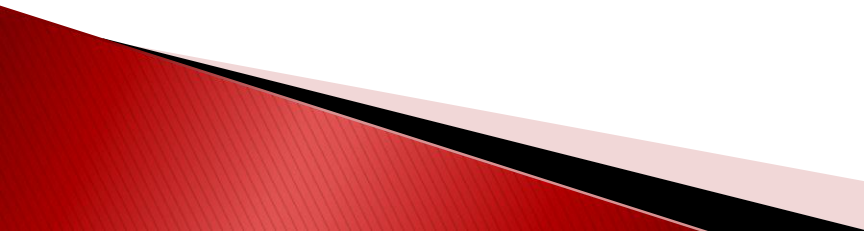
Approximately 100 501(c)(3) organizations lose their tax exempt status per year.

Loss of tax exempt status can be deadly.



Consequences of Losing Tax Exempt Status

An organization that has lost its tax-exempt status through automatic revocation may be required to file one of the following federal income tax returns and pay any applicable income taxes:

- Form 1120, *U.S. Corporation Income Tax Return*, due by the 15th day of the 3rd month after the end of an organization's tax year; or
 - Form 1041, *U.S. Income Tax Return for Estates and Trusts*, due by the 15th day of the 4th month after the end of an organization's tax year.
- 

Consequences of Losing Tax Exempt Status

A 501(c)(3) organization that loses tax-exempt status cannot:

- Receive tax-deductible contributions;
- Be identified in the IRS Business Master File extract as eligible to receive tax-deductible contributions; or
- Be included in Publication 78, *Cumulative List of Organizations Described in Section 170(c) of the Internal Revenue Code of 1986*.

Consequences of Losing Tax Exempt Status

Reinstatement of Tax Exempt Status:

- Application for exemption must be filed.
- An organization may also request retroactive reinstatement as part of its application.

Consequences of Losing Tax Exempt Status

Contributions may be deducted by persons unaware of a change in an organization's status only until:

The IRS publishes an announcement that contributions to the organization are no longer deductible (Auto-Revocation List).

Why Is This Important?

IRS Report (December 2010):

Audits of charities/nonprofits increased:

- 2009 – From 7,861 to 10,187 (i.e., 30% increase).
- 2010 – From 10,187 to 11,449 (i.e., 12% increase).

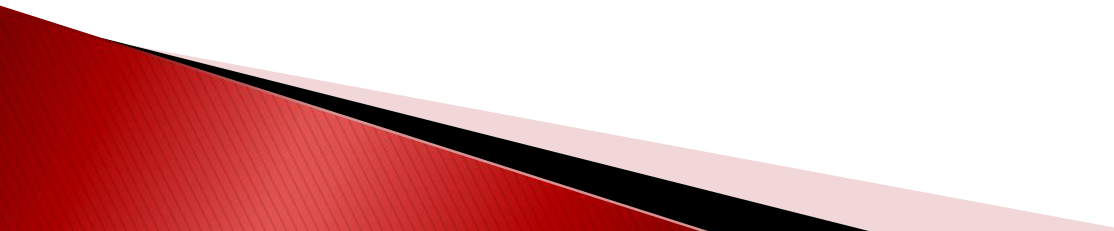
Why Is This Important?

Since 2008, the IRS has hired an additional 100 employees to handle the increase in audits.

IRS has increased scrutiny of nonprofits.



IRS scrutiny of nonprofit activities include:

- Executive compensation and loans made by nonprofits to top officials and whether they paid sufficient employment taxes.
 - Consumer credit counseling agencies.
 - Supporting organizations, which are charities that typically collect and channel money to a specific nonprofit.
 - Educational organizations.
- 

10 Ways to Lose Your Tax Exempt Status

1

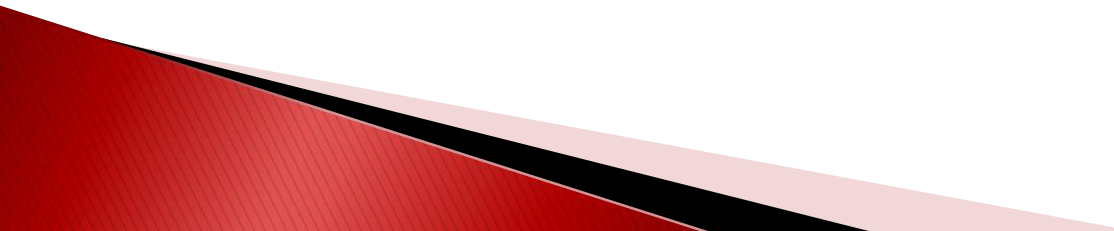
Failure to File IRS Form 990

1 Failure to File IRS Form 990

Form 990 is due on the 15th day of the 5th month following the end of the organization's taxable year.

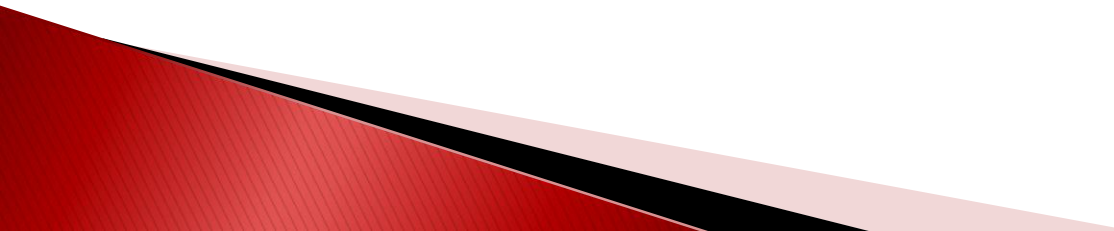
Failure to file Form 990 for three consecutive years will result in automatic revocation of exempt status.

In 2011, approximately 275,000 organizations had their tax exempt status revoked for failure to file Form 990 for three consecutive years.



1 Failure to File IRS Form 990

Form 990

- A. What organizations are required to file Form 990?
- Most federal tax-exempt organizations, with the exception of churches and state institutions.
 - All 501(c)(3) private foundations, regardless of income.
- 

1 Failure to File IRS Form 990

Form 990

- B. Which organizations are not required to file Form 990?
- Nonprofits that have not received tax-exempt status from the IRS.
 - Most faith-based organizations.
 - State institutions.
 - Subsidiary organizations covered under a group return filed by the parent organization.

For specific exceptions, see

<http://www.irs.gov/charities/article/0,,id=152729,00.html>

1 Failure to File IRS Form 990

Form 990

C. What are the different versions of Form 990?

- Form 990-PF - Filed by all 501(c)(3) private foundations and 4947(a)(1) non-exempt charitable trusts.
- Form 990-N ("ePostcard") - Any other nonprofit may file this form if its income is <\$50,000. (Started in 2006.)

1 Failure to File IRS Form 990

Form 990

- Form 990-EZ - A nonprofit may file this form if its income is <\$200,000 and assets <\$500,000.
- Form 990 - A nonprofit may file this form if its income is = or >\$200,000 or assets = or >\$500,000.

Remember: Form 990 Is A Public Document!

2

Engaging in Private Inurement/Private Benefit

2

Private Inurement/Private Benefit

What is private inurement?

When an insider – someone who has significant influence over the organization – enters into an arrangement with the nonprofit and receives benefits greater than he or she provides in return.

Private inurement is prohibited in all nonprofits.

2

Private Inurement/Private Benefit

A “disqualified person” is any person who in the five years prior to the transaction was in a position to exercise substantial influence over the organization’s affairs.

“Disqualified persons” – can be high-level managers, board members, founders, major donors, highest paid employees, family members of any of the above, and a business where the listed persons own more than 35% of an interest.

2

Private Inurement/Private Benefit

“Private inurement” is an absolute term.

2

Private Inurement/Private Benefit

IRS Code Section 501(c)(3):

[N]o part of the net earnings of [the exempt organization] inures to the benefit of any private shareholder or individual

2

Private Inurement/Private Benefit

Private Inurement Versus Private Benefit

3

Lobbying

3 Lobbying

Federal law allows 501(c)(3) public charities to lobby so long as they do not devote a “substantial part” of their activities to attempting to influence legislation.

3 Lobbying

<u>Total Annual Exempt Purpose Expenditures</u>	<u>Percent that May Be Spent on Lobbying</u>
\$500,000 or less	20%
\$500,000 - \$1 million	\$100,000 + 15% of budget over \$500,000
\$1 million - \$1.5 million	\$175,000 + 10% of budget over \$1 million
\$1.5 million - \$17 million	\$225,000 + 5% of budget over \$1.5 million
\$17 million and over	\$1 million

Note: Total lobbying expenditures may not exceed \$1 million. "Grassroots lobbying" expenditures may comprise no more than 25% of an organization's total allowable lobbying ceiling.

3 Lobbying

What is Lobbying?

The attempt to influence the passage, defeat, introduction or amendment of legislation, including bills introduced by a federal, state or local legislative body, bond issues, referenda, constitutional amendments, and Senate confirmation votes on Executive branch nominees.

3 Lobbying

Direct lobbying versus grassroots lobbying:

Direct lobbying -- In general, any attempt to influence any legislation through communication with a legislator, an employee of a legislative body or other government official, which:

- (1) refers to specific legislation; and
- (2) reflects a view on such legislation.

3 Lobbying

Grassroots lobbying -- any attempt to influence any legislation through an attempt to affect the opinions of the general public or any segment thereof.

A grassroots lobbying communication is one which:

- (1) refers to specific legislation;
- (2) reflects a view on that legislation; and

3 Lobbying

(3) encourages the recipient to take action with respect to the legislation, either by:

(a) directly urging the recipient to contact legislators or other government officials in order to influence legislation;

(b) including the address, phone number or similar information about a legislator or government official;

3

Lobbying

- (c) providing a petition, postcard or other prepared message to send to a legislator or government official in order to influence legislation; or

3 Lobbying

- (d) identifying one or more legislators who will vote on the legislation as opposing the organization's view; being undecided; being the recipient's representative in the legislature; or being a member of the legislative committee that will consider the legislation.

Encouraging the recipient to take action does not include naming the main sponsor(s) for the purposes of identifying the legislation.

3 Lobbying

Lobbying Registration and Report Requirements

Private Foundations and Lobbying



4

Political Campaign Activity

4 Political Campaign Activity

501(c)(3) organizations are expressly prohibited from intervening in a political campaign of any candidate for public office, and from engaging in partisan activity of any kind.

4

Political Campaign Activity

Voter Education?

4

Political Campaign Activity

The courts have held that it is not unconstitutional for the tax law to impose conditions, such as the political campaign prohibition, upon exemption from federal income tax. E.g., *Branch Ministries v. Rossotti*, 211 F.3d 137 (D.C. Cir. 2000).

5

Accumulating Excess Unrelated Business Income

5 Accumulating Excess Unrelated Business Income

Unrelated Business Income:

Income from a regular trade or business that is not substantially related to the charitable, educational, or other purpose that is the basis of the organization's tax exemption.

6

Not Paying Taxes on Unrelated Business Income

6

Not Paying Taxes on Unrelated Income

To comply with unrelated business income tax rules, a tax exempt organization must:

1. Determine if it has an unrelated trade or business.
2. Calculate the income and deductions from that unrelated trade or business.
3. Prepare and file Form 990-T.
4. Pay estimated taxes.

6 Not Paying Taxes on Unrelated Income

Review IRS Publication 598.

Contact the IRS Exempt Organizations Division at www.irs.gov/eo or (877) 829-5500 for additional help.

6

Not Paying Taxes on Unrelated Income

File Form 990-T and Extensions

A tax exempt organization that has \$1,000 or more in gross income from an unrelated business must file Form 990-T.

Form 990-T is filed in addition to filing the annual information return, Form 990, 990-EZ or 990-PF.

6

Not Paying Taxes on Unrelated Income

Form 990-T must be filed with the Internal Revenue Service Center, Ogden, UT 84201-0027, by the 15th day of the 5th month after the end of the organization's taxable year.

If the due date falls on a Saturday, Sunday or legal holiday the return is due by the next business day.

A Form 990-T filer may request an automatic 6-month extension by filing Form 8868.

6 Not Paying Taxes on Unrelated Income

Pay Estimated Taxes

An organization must pay quarterly estimated taxes if it expects income to exceed \$500. Form 990-W is a worksheet used to compute quarterly estimated taxes.

6

Not Paying Taxes on Unrelated Income

Find Out State Law Requirements:

The Michigan Business Tax (MBT) went into effect January 1, 2008.

The filing threshold is \$350K in gross receipts.

7

**Faulty
Corporate/Financial
Recordkeeping**



7

Faulty Corporate/Financial Recordkeeping

As a general rule, corporations are required to maintain three types of books and records:

- Books of account;
- Shareholder records; and
- Minutes of shareholder and director proceedings.

7

Faulty Corporate/Financial Recordkeeping

Some documents and business records of a nonprofit should be maintained permanently, such as:

- Articles of Incorporation
- Determination Letter from the IRS
- Insurance policies
- Minutes of meetings
- Corporate resolutions

7

Faulty Corporate/Financial Recordkeeping

Michigan Nonprofit Records

- A. Articles of Incorporation.
- B. Minutes/Consents of Incorporators in handling initial corporation business (i.e., selection of the board, adoption of bylaws).
- C. Bylaws.
- D. Minutes/Consents of Board actions.

7 **Faulty Corporate/Financial Recordkeeping**

- E. Information regarding the nonprofit corporation's Resident Agent.

7

Faulty Corporate/Financial Recordkeeping

- F. Appropriate documents reflecting organizational basis of nonprofit corporation (i.e., stock, membership, directorship).

7

Faulty Corporate/Financial Recordkeeping

- G. Documentation regarding organization meetings (i.e., notices, minutes/consents of actions taken or authorized at meetings).

7

Faulty Corporate/Financial Recordkeeping

- H. Financial records – Michigan law requires that a nonprofit corporation's balance sheet be mailed to a member or stockholder upon request.
- I. Business records such as contracts, loans, guarantees, records of disposition of assets, etc.

7

Faulty Corporate/Financial Recordkeeping

- J. Tax records. Form 990 is a public document and must be provided upon request.

7

Faulty Corporate/Financial Recordkeeping

Importance of a Document Retention Policy

7 Faulty Corporate/Financial Recordkeeping

The process of developing a document retention policy involves:

- (1) Identifying what types of paperwork (and electronic files) your nonprofit generates;
- (2) Determining the appropriate (and legal) length of time to retain them; and
- (3) Recording those retention times on a written schedule.

7 **Faulty Corporate/Financial Recordkeeping**

Sample Document Retention Policy courtesy of the
American Institute of Certified Public Accountants.

7

Faulty Corporate/Financial Recordkeeping

What Laws/Rules Govern
Document Retention Policies?

8

Mismanaging Funds

8 Mismanaging Funds

Example: Soup Kitchen

Solicited Designations.

Unsolicited Designations.

9

Providing Support to Bad People or Organizations

9

Providing Support to Bad People or Organizations

Domestic terrorism = "the unlawful use of force or violence, committed by a group(s) of two or more individuals, against persons or property to intimidate or coerce a government, the civilian population, or any segment thereof, in furtherance of political or social objectives."

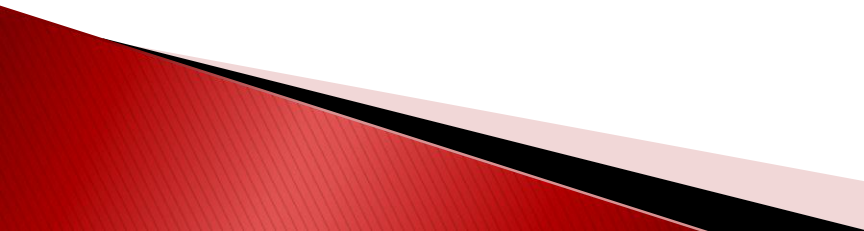
9 Providing Support to Bad People or Organizations

Under USA PATRIOT Act, acts of domestic terrorism are those which:

- "(A) involve acts dangerous to human life that are a violation of the criminal laws of the United States or of any State;
- (B) appear to be intended —
 - (i) to intimidate or coerce a civilian population;

9

Providing Support to Bad People or Organizations

- (ii) to influence the policy of a government by intimidation or coercion; or
 - (iii) to affect the conduct of a government by mass destruction, assassination, or kidnapping; and
- (C) occur primarily within the territorial jurisdiction of the United States."
- 

9 Providing Support to Bad People or Organizations

Federal Agencies Maintain Terrorism Watch Lists!

FBI Terrorist Watch List – Domestic Terrorism

Over 1/2 million entries on list.

9

Providing Support to Bad People or Organizations

Examples of domestic terrorist groups:

Earth Liberation Front

Animal Liberation Front

Jewish Defense League

Ku Klux Klan

Aryan Nations

Black Liberation Army

9

Providing Support to Bad People or Organizations

U.S. Department of State

List of Foreign Terrorist Organizations:

Hamas

Al Qaida

ETA

Shining Path

9 Providing Support to Bad People or Organizations

CASE STUDY: PETA case from 2002.

10

Not Dissolving the Nonprofit Organization Correctly

10 Not Dissolving A Nonprofit Correctly

Making A Decision to Dissolve

IRS Oversight

The IRS has also published Fact Sheet, Publication 4779, summarizing the dissolution process.

10 Not Dissolving A Nonprofit Correctly

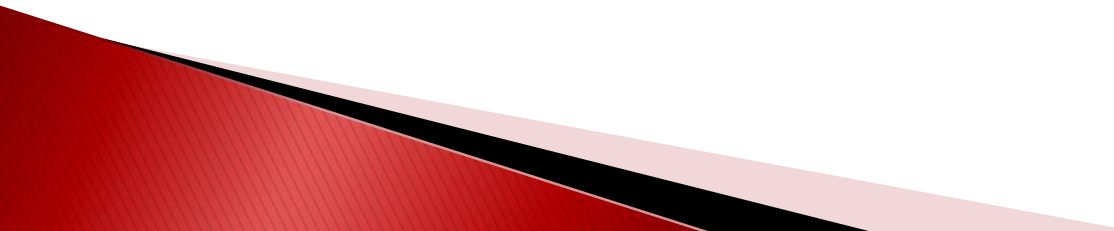
Michigan Attorney General Approval

To obtain the Attorney General's approval, the organization must submit a Dissolution Questionnaire, along with required attachments. The Dissolution Questionnaire can be printed from the Attorney General's website.

10 Not Dissolving A Nonprofit Correctly

Corporation Division - Certificate of Dissolution

The final step in actually dissolving the corporation is to file a Certificate of Dissolution, along with the Attorney General's approval letter, with the Michigan Department of Licensing and Regulatory Affairs, Corporation Division.



10 Not Dissolving A Nonprofit Correctly

Michigan Department of
Treasury Tax Clearance

DISCLAIMER: These written materials are for general informational purposes only, are based on currently available information, and are not intended to, nor shall they, constitute legal representation, advice or services. You should not rely on these written materials for any legal or tax question or matter without seeking the advice/representation of a qualified legal or tax professional.

