## **Tax Exemption 101**

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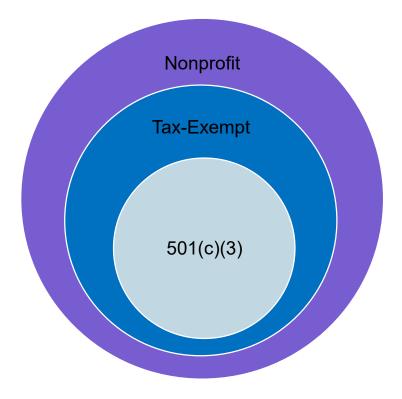


### Agenda

- Nonprofit vs Tax Exempt
- 501(c)(3) Organizations
- Private Foundations vs Public Charities
- Other Tax-Exempt Organizations
- IRS Form 1023 Application and IRS Form 990
- Property Tax Exemption
- Sales Tax Exemption

# Nonprofit vs. Tax Exempt

#### Nonprofit vs. Tax-Exempt



### Nonprofit vs. Tax-Exempt

- <u>Nonprofit</u>: Legal status under state law
  - MN Nonprofit Corporation Act Minn. Stat. Chapter 317A
  - Religious Corporations Minn. Stat. Chapter 315
  - Charitable trusts
  - Others
- <u>Tax Exemption</u>: Primarily whether organization is exempt from federal income taxes
  - 28 categories of tax exemption. Most common include:
    - 501(c)(3): Religious, educational, charitable, scientific, literary, etc.
    - 501(c)(4): Social welfare organizations
    - 501(c)(6): Business leagues
    - 501(c)(7): Social clubs
    - 501(c)(8): Fraternal organizations
    - 501(c)(13): Cemeteries
- Often must apply to IRS to be tax-exempt

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#### **Benefits of Tax-Exempt Status**

- Exempt from federal income tax
- Reduced postal rates
- 501(c)(3) Organizations
  - Contributions are deductible to donors
    - 501(c)(3)'s and limited other exempt organizations
  - Increased access to philanthropic grants and governmental funding
  - Can be exempt from property tax (but not automatic!)
  - Can be exempt from sales tax in some circumstances
  - Eligible for tax-exempt bond financing

# 501(c)(3) Organizations

### 501(c)(3) Organizations

501(c)(3)'s are organized and operated for one or more of the following purposes described in Internal Revenue Code Section 501(c)(3):

- Charitable
- Educational
- Scientific
- Literary
- Religious
- Testing for public safety
- Foster amateur sports competition
- Prevention of cruelty to children or animals

#### **Two-Part Test**

To qualify as tax-exempt under Code Section 501(c)(3), an organization must meet an <u>organizational</u> and an <u>operational</u> test.

- The organization's governing documents must:
  - Limit its purposes to one or more exempt purposes described in Code Section 501(c)(3),
  - Not permit the organization to engage in a non-exempt activity, and
  - Permanently dedicate its assets to exempt purposes.
- Must be operated "exclusively" for charitable purposes
  - Engages primarily in activities that accomplish 501(c)(3) purposes
  - No more than an insubstantial part of its activities may further an exempt purpose or may involve lobbying
- Net earnings may not inure to benefit of private shareholders or individuals
- Prohibition on supporting or opposing candidates

## Private Foundations vs Public Charities

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#### **Private Foundations vs. Public Charities**

## 501(c)(3) Organizations

#### **Public charities**

Supported by donations 170(b)(1)(A)(vi) Supported by fees 509(a)(2) Churches, hospitals, schools 509(a)(1) Supporting Organizations 509(a)(3) [3 Types] Private (nonoperating) Foundations

Private Operating Foundations

### Key Private Foundation Rules (or, Why it's Easier to be a Public Charity)

- Minimum distribution requirement
  - 5% payout
- Self-dealing prohibition
  - Prohibits most financial transactions between PF's and their disqualified persons
  - DP's are all board members, officers, substantial contributors, their families and businesses, and all government officials
  - Exception for reasonable compensation for personal services
- Qualifying distributions / no taxable expenditures
  - Grants to public charities, individuals, non-exempt organizations, foreign organizations all treated differently
- Lobbying and political activity prohibition
- Excess business holding limitation
- No jeopardy investments

#### **How to Check**

#### **Bush Foundation**

EIN: 41-6017815 | Saint Paul, MN, United States

> Other Names

#### Publication 78 Data 🛛

Organizations eligible to receive tax-deductible charitable contributio

**On Publication 78 Data List: Yes** 

Deductibility Code: PF

https://www.irs.gov/charities-non-profits/tax-exempt-organization-search

# **Other Tax-Exempt Organizations**

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### **Other Types of Exempt Organizations**

- 501(c)(4) social welfare organizations
  - Can engage in unlimited lobbying
- 501(c)(5) labor or agricultural orgs
- 501(c)(6) business leagues, chambers of commerce
- 501(c)(7) social clubs

# Applying for recognition of taxexempt status and annual returns

#### IRS Form 1023 and 1023-EZ

- Application to the IRS for recognition of 501(c)(3) status
- Nonprofit has the burden of proving that it qualifies to be a 501(c)(3) organization
- If filed within 27 months, exemption is retroactive to formation date
- IRS issues "determination letter"
- Choosing to file a 1023 vs 1023-EZ
  - Eligibility rules (cannot use EZ if expected annual gross receipts >\$50K)
  - User fee: \$600 for Form 1023, \$275 for EZ
  - Nature of application
  - Educational value
  - Determination letter silent on application type
  - Some pushback from grantmakers
  - Less reliance value for EZ (determination letter is based on representations to IRS)
- Both applications are submitted on <u>www.pay.gov</u>

### IRS Form 1023

- Specific Questions
- Narrative Description of Activities
  - Make the case that you are "charitable" within the meaning of Code Section 501(c)(3)
    - Resources: Internal Revenue Code, Tax Regulations, IRS Revenue Rulings and Revenue Procedures, IRS EO "CPE Texts"
  - Distinguish activities that have "for-profit flavor"
- Financial Statements
- Attachments
  - Articles, Bylaws, Conflict of Interest Policy, arrangements with directors or officers

#### While Form 1023 is Pending

- Operate as though you are a 501(c)(3) perform only charitable activities
- Do not say you are a 501(c)(3)
- Do not say that contributions are deductible
- OK to say you are a "nonprofit"
- Consider a fiscal sponsor

#### Form 1024/1024-A: Other Tax-Exempt Orgs

- Application is generally optional
- Two forms:
  - Form 1024-A: Section 501(c)(4) orgs
  - Form 1024: Section 501(c)(6), (c)(7), and others
- Online application only at <u>www.pay.gov</u>
- 501(c)(4)s must file a Form 8976 (regardless of whether they file a 1024-A)

#### **IRS Form 990**

- Nearly all tax-exempt organizations must file IRS Form 990
  - Exemption for churches
- Due each year on 15th day of 5th month following close of accounting year
- Types of IRS Form 990:
  - Form 990-N: Income < \$50,000
  - Form 990-EZ: Income < \$200k & Assets < \$500k</p>
  - Form 990: Income \$200k+ or Assets \$500k+
  - Form 990-PF: Private Foundations
- Failure to file for 3 consecutive years results in auto-revocation of exempt status

#### **MN Attorney General Registration**

- A nonprofit must register with the MN Attorney General if it will:
  - Solicit charitable contributions in MN (If receive \$25,000 or greater in any year)
  - Hold funds for a charitable purpose
    - E.g. Family foundations, other private foundations, trusts
- Process
  - Initial registration with AG's office
  - Annual report (Form 990)
- Other States
  - If a nonprofit will solicit contributions in other states, check those state laws regarding registration requirements
  - Charleston Principles regarding online solicitations

# **Property Tax Exemption**

#### **Property Tax Exemption**

- Taxation is the rule and exemption is the exception.
  - All property is subject to tax unless an exemption applies
  - Not all nonprofits are exempt from property tax in Minnesota
  - Exemptions are to be narrowly construed
- To be exempt, property must be <u>owned</u> by an entity entitled to exemption and <u>used</u> in a manner consistent with that exemption.

### **Property Tax Exemption**

- Two methods of qualifying for property tax exemption
- Categorical exemption (Full list at Minn. Stat. § 272.02)
  - Schools
  - Hospitals
  - Churches
  - Nursing homes
- Institutions of purely public charity
  - Other 501(c)(3) organizations
  - Must meet multi-factor test to qualify (Minn. Stat. § 272.02, subd. 7)
    - Evolution of factors from case law to statute
      - North Star Factors
      - Under the Rainbow case

#### Not categorically exempt but "consensus"

- MN Dept of Revenue Report: consensus that the following should be exempt:
  - day care centers that make free or reduced cost services available on a sliding-scale program
  - group homes
  - youth activities centers (boy and girl scouts, youth camps, etc.)
  - animal shelters
  - nature and history preservation sites
  - sobriety-based organizations
  - senior citizen centers
  - organizations devoted to the training of disabled persons
  - YMCA buildings
  - crisis pregnancy centers
  - Salvation Army locations
  - American Red Cross sites
  - Food shelf/food bank locations
  - Land owned by Habitat for Humanity (until transferred to individual homeowners)
  - Transitional housing facilities
  - Housing and services for persons with physical and/or mental disabilities
  - Art and cultural institutions

### **Property Tax Procedural Issues**

- Administration
  - Local county assessors with Dept. of Revenue oversight
  - Tax Court with Supreme Court appeals
- Application
  - Organizations claiming property tax exemption must file an exemption application with the appropriate county (Minn. Stat. § 272.025)
  - County assessors make initial determination
  - May appeal to Tax Court
- Obtaining categorical exemptions
  - Application puts assessor on notice
- Obtaining institution of purely public charity exemption
  - Applications due Feb. 1 and renewals due in 2022, 2025, and every three years thereafter

### **Property Tax Procedural Issues**

- Leased property
  - To be exempt, must be owned and leased by exempt organizations
    - And used for exempt purposes
- Prorating
  - If part of property is used for exempt purposes and part not for exempt purposes, tax should be prorated based on % of use

### **Exempt Org Purchases Property**

Before July 1

- Taxes payable in year of purchase are still due
- Apply for exemption asap after purchase
- If granted, exemption applies for entire assessment year
  - No taxes payable in year *after* purchase and thereafter

#### After July 1

- Taxes payable in year of purchase are still due
- Apply for exemption asap after purchase
- If granted, exemption applies for *next* assessment year
  - Taxes payable in year after purchase
  - No taxes payable in second year purchase and thereafter

# **Sales Tax Exemption**

#### Sales Tax Exemption

- All retail sales subject to tax unless exception or exemption applies
- Seller collects tax and buyer pays tax
  - If seller fails to collect, seller pays tax
- MN Dept of Revenue
  - Sales Tax Fact Sheets and Industry Guides
  - <u>https://www.revenue.state.mn.us/sales-tax-fact-sheets-and-industry-guides</u>

#### **Sales Tax – Nonprofits as Purchasers**

- Charitable organizations
  - Regulations incorporate North Star factors
  - Case law suggests standard similar to property tax exemption
- Religious organizations
  - Churches and affiliates
- Educational organizations
  - Schools, youth groups, arts groups, museums, educational issue advocacy organizations
- Must be a 501(c)(3), but not all 501(c)(3)'s qualify

#### **Nonprofits as Purchasers**

- Apply for and present Certificate of Exemption when making purchases
- Only purchases of items used in furtherance of mission qualify
- Construction materials
  - Can appoint contractor agent for purchasing
  - Special rules and requirements
  - Exemption not available if fixed-price construction contract

#### Sales Tax – Nonprofit as Seller

- In general, all retail sales are subject to tax
- Nonprofit as seller generally required to collect and remit sales tax on its sales

### **Fundraising Sales**

- 24-day rule
  - Sales at fundraising event for charity not taxable
    - Admission, food, meals, drinks, personal property
  - Limited to 24 days per year
    - If exceeded, all sales become taxable
  - Nonprofit must sponsor the event
  - Detailed records required
    - Separate records of event, receipts, disbursements, deductions, etc. for each event
  - Cautions:
    - Chapters
    - All sales count (candy, dinners, luncheons)

### **Fundraising Sales**

- Youth groups
  - Gross annual fundraising receipts < \$10,000
  - All sales exempt
- Senior Citizen groups
  - Membership limited to 55 and up
  - Exclusively for pleasure, recreation and similar nonprofit purposes
  - Gross annual fundraising receipts < \$10,000</li>
  - All sales exempt
- Golf tournaments
  - If beneficiary of net proceeds is 501(c)(3)
- Candy sales
  - Only for educational and social org for youth

#### **Certain other sales**

- Admissions to arts programs
- Admission to school events
  - Regular season games, events and activities
- YMCA, YWCA and JCC memberships
- Statewide amateur athletic games
- Camp fees

#### **Questions?**

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