Tax Exemption 101

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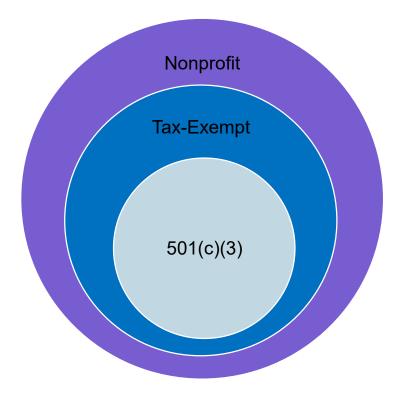


Agenda

- 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
 - 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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