Nonprofit Alert: Five Legal Updates for Tax-Exempt Organizations

October 10, 2019

Now that school is back in session, here is a recap of some of the summer's legal developments impacting tax-exempt organizations. These include the latest on the IRS donor-disclosure rules for tax-exempt organizations other than 501(c)(3)s or political organizations, a modernization of the requirement that private schools publish their nondiscrimination policies, the requirement that all tax-exempt organizations e-file their Form 990s, and regulations on how state tax credits and deductions affect federal charitable contribution deductions. Read on for more.

1. Donor-Disclosure Saga

For decades, most tax-exempt organizations have generally been required to disclose the names and addresses of donors of more than $5,000 to the IRS on their annual Form 990 information returns. This information is not available to the public, except in the case of political organizations described in Code Section 527 and private foundations.

Then, in 2018, the IRS announced a new policy that would no longer require organizations — other than 501(c)(3)s or 527s — to disclose donors' names and addresses to the IRS (or the public). Stated another way, 501(c)(4) and (c)(6) organizations (and other less common types of organizations) would no longer have to disclose their donors. The States of Montana and New Jersey sued to prevent the IRS from adopting this new policy in part because the states felt that disclosure of donor information helps them regulate charities and prevents "dark money" in politics. On July 30, 2019, a Federal District Court ruled that the IRS did not follow the proper procedures in adopting this new policy and thus could not implement it.

The IRS has now attempted to remedy that procedural defect by issuing proposed regulations that would clarify that organizations — other than 501(c)(3)s and 527s — do not have to report donor names and addresses on annual returns or provide them to the public. However, all organizations are *still required to keep the contributor information and make it available to the IRS upon request*. If the regulations are finalized, an affected tax-exempt organization would not need to disclose donor names and addresses for returns filed after September 6, 2019. In addition, the IRS has waived penalties for organizations that filed

their 990s without including donor information in reliance on the 2018 guidance before the court struck it down on July 30.

All of this is a separate development from the fairly recent change to the *FEC's* disclosure rules relating to organizations other than PACs that engage in independent expenditures expressly advocating the election or defeat of a clearly identified candidate. Those rules are summarized here. Remember that 501(c)(3) organizations cannot expressly advocate for or against candidates for public office.

2. Schools May Now Post Notice of Nondiscriminatory Policy Online

No private school (including a college or university) can be tax-exempt unless it has a racially nondiscriminatory policy regarding students and operates in accordance with that policy. Since the 1970s, the IRS has required schools to make that policy known to its community by publishing an annual notice in a newspaper of general circulation or in broadcast media. On May 28, the IRS revised this guidance to allow schools to publicize their policy on their "primary publicly accessible internet homepage at all times . . . in a manner reasonably expected to be noticed by visitors to the homepage." The guidance is clear that the notice actually needs to appear on the homepage, not on a page linked to the homepage. The IRS guidance says this specific language satisfies the requirement, but other language may also be acceptable:

NOTICE OF NONDISCRIMINATORY POLICY AS TO STUDENTS

[Name of school] admits students of any race, color, national, and ethnic origin to all the rights, privileges, programs, and activities generally accorded or made available to students at the school. It does not discriminate on the basis of race, color, national, and ethnic origin in administration of its educational policies, admissions policies, scholarship and loan programs, and athletic and other school-administered programs.

3. Mandatory E-Filing and Notice Prior to Automatic Revocation

The Taxpayer First Act, Public Law No. 116-25 (July 1, 2019), will require all tax-exempt organizations subject to the requirement to file a Form 990, 990-EZ, or 990-PF to file their returns electronically rather than on paper. This provision generally applies to tax years beginning after July 1, 2019.

Under prior law, if a tax-exempt organization failed to file a required tax return or 990-N ("e-Postcard") for three consecutive years, its tax-exempt status was revoked. The Taxpayer First Act requires the IRS to attempt to notify tax-exempt organizations if the IRS has not received the required form for two consecutive years. This may reduce the number of organizations whose tax-exempt status is revoked due to failure to

file.

4. Effect of State Tax Credits and Deductions on Federal Charitable Contribution Deductions

Donors who make charitable contributions to state and local governments have long been eligible for federal charitable contribution deductions (if they itemize). In addition, taxpayers have been able to take an itemized federal deduction for their payment of state or local taxes (this is sometimes referred to as the "SALT" deduction). However, the 2017 "Tax Cuts and Jobs Act" limited the SALT deduction to $10,000. Several states considered attempting to blunt the impact of that change by encouraging taxpayers to make charitable contributions in lieu of paying state taxes. The IRS eliminated that workaround with the final rule discussed below.

The final regulations generally provide that if a taxpayer makes a contribution to any charity or state or local government and receives a state-level tax-credit, the taxpayer may only take a federal charitable deduction for the amount of the contribution that exceeds the state tax credit. For example, if a taxpayer makes a charitable contribution of $1,000 and is eligible for a $300 state tax credit, the taxpayer may only take up to a $700 federal charitable contribution deduction. If the donor gets a state tax credit, this rule applies regardless of whether a state government or a private nonprofit receives the gift.

There are a few exceptions to the new general rule. First, taxpayers receiving a state-level *deduction* (as opposed to a credit) do not have to reduce their federal charitable contribution deduction. Second, the final regulations provide that if the state tax credit does not exceed 15 percent of the contribution, the general deduction-reduction rule does not apply. Finally, the IRS announced additional guidance that allows a taxpayer to consider the amount disallowed under the general rule as a deductible payment of state or local taxes, up to the $10,000 cap on the SALT deduction. In other words, using the example above, a taxpayer could take a SALT deduction for the $300 that was disallowed as a federal charitable contribution deduction, assuming the taxpayer hadn't reached the $10,000 cap on the SALT deduction.

Some states, such as Iowa and North Dakota, have long-existing charitable tax credit programs that were obviously not designed to get around the new $10,000 cap on the SALT deduction. Nonetheless, this new regulation affects how donors who use these programs will calculate their federal deductions. Minnesota law effectively allows taxpayers who *do not itemize* their deductions on their federal returns to deduct 50 percent of their charitable contributions over $500 from their state taxes. The new IRS guidance does not affect this Minnesota rule, which only applies to taxpayers who do not take a federal charitable contribution deduction.

5. Continued Conversation about 2017 Tax Act

Tax-exempt organizations are continuing to digest the guidance regarding the 2017 Tax Act, including IRS Notice 2019-9, which relates to executive compensation over $1 million and "excess parachute payments," IRS Notice 2018-99, which relates to the tax on qualified transportation fringe benefits, such as parking, and IRS Notice 2018-67, which relates to the separate calculation of unrelated business income tax for each "trade or business." The IRS is expected to release additional guidance soon.

For more information about these new rules, contact Gray Plant Mooty's Nonprofit and Tax-Exempt Organizations team.

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