

Tax Exemption 101

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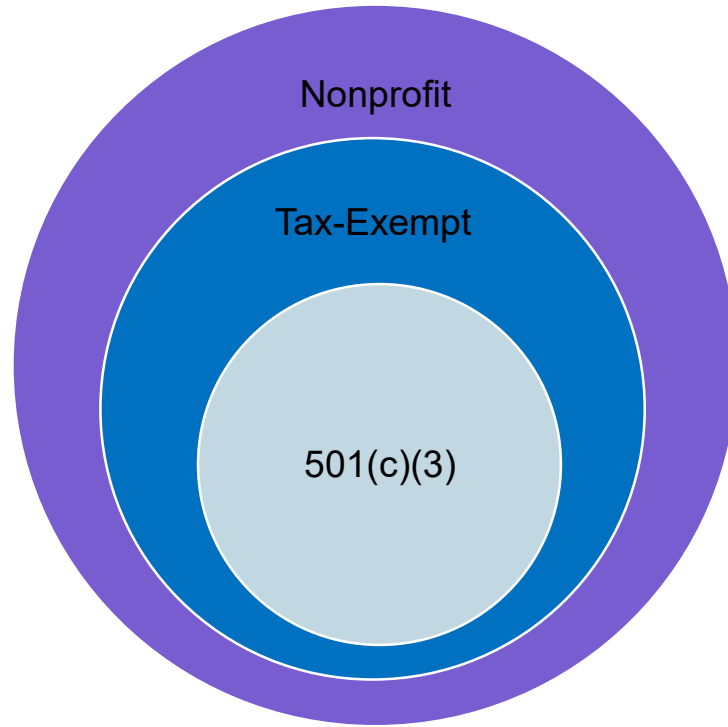


Agenda

- 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

- Nonprofit: Legal status under state law
 - MN Nonprofit Corporation Act – Minn. Stat. Chapter 317A
 - Religious Corporations – Minn. Stat. Chapter 315
 - Charitable trusts
 - Others
- Tax Exemption: 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

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 organizational and an operational 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

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
(non-
operating)
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 contributions

On Publication 78 Data List: Yes

Deductibility Code: PF

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

Other Tax-Exempt Organizations

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 tax-exempt 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 www.pay.gov

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 www.pay.gov
- 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
 - 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 owned by an entity entitled to exemption and used 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
 - <https://www.revenue.state.mn.us/sales-tax-fact-sheets-and-industry-guides>

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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