



# COMMUNIQUE

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## New Developments in Nonprofit Tax Law

By Howard Donkin, CPA

Retirement The 2010 AICPA Nonprofit Conference provided three days of presentations on nonprofit tax issues and an opportunity to meet with IRS headquarter officials. At these conferences I am always looking for new developments that might impact our clients. Below is a list of key new developments that might be important to your nonprofit board or accounting department staff.

### Unfavorable IRS Rulings

The following three rulings contain some important lessons about how to protect your tax exempt status.

*PLR 201008050* In this ruling the IRS revoked the tax exempt status of an educational organization based upon evidence obtained from their website. The website discussed programs that were different than their exempt purpose, offered to sell the director's books and cds, and had a link to a commercial business. The IRS determined it failed the organizational test, did not operate exclusively for charitable purposes, and served a substantial nonexempt purpose. The presence of a single substantial nonexempt purpose can destroy the exemption, regardless of the number or importance of exempt purposes. (Better Business Bureau v. United States). The lesson learned – tell your board to regularly look at the charity's website to make sure everything is accurate and consistent with their mission.

*PLR 200825046* In this ruling the IRS revoked the tax exempt status of an arts organization (ballet) because their operation of bingo games constituted a substantial nonexempt purpose and activity. The IRS does not have a bright line for how much is too much time devoted to a nonexempt purpose, but in this case, the IRS determined that about 54.7% of their time was devoted to bingo activities. Another indicator of a problem was that only 8% of their gross revenue came from tax exempt activities. For the definition of an activity that is not in furtherance of an exempt purpose see IRC Reg. 1.501(c)(3)-1(c)(1). When the IRS looked closer at the bingo operations, they found that the charity hired a promoter to raise funds, but less than 1% of the gross bingo revenue went for charitable purposes. This ruling is one of the few examples of where the IRS used the commensurate test. Based on the amount of gross bingo income that was distributed for charitable purposes, the IRS concluded that the amount of the proceeds received from the bingo activities to conduct charitable and educational programs is not "commensurate in scope" with the financial resources of the bingo operation (Rev Rul 64182, 1964-1 (Part 1) C.B. 186). Lesson learned – even if you are not involved in bingo, the same concepts apply to any activity outside the exempt purpose described in your organizing documents.

*PLR 201017067* In this ruling the IRS revoked the tax exempt status of a fraternity scholarship foundation because it did not serve a large enough charitable class. They only had 31 people eligible for scholarships because scholarships were only available to members of a local college fraternity chapter. The lesson learned – the IRS will not like it if you start a scholarship program for a small "charitable class". A great mission is not enough to keep your tax exempt status.

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### **IRS Compliance Initiatives**

The IRS has a significant compliance initiative for 2011 and you do not want to be a part of it. The IRS can revoke your tax exempt status if you are involved in a prohibited activity. They are sending out questionnaires and looking at your website to learn if you are involved in any questionable activities. For example if your website is linked to another organization that is involved in political activity you might be in trouble if the IRS cannot tell the difference between you and them. Now is the time to look at your website links and see what is on the other side.

### **IRS Report from the Top Staff**

The IRS hired 80 new auditors in the exempt organization division last year and they have hired another 20 in 2010. A recent tax study says there is a \$54 billion tax gap – the difference between the amount of tax that taxpayers should pay and the amount that is paid voluntarily and on time. The gap included charities and the IRS is looking for unrelated business income, employment taxes, and anything that might generate tax revenue. There now are about 530 exempt organization auditors and a recent IRS study says 28% of the paper filed 990's have errors.

### **Qualified Sponsorship Payments**

You want QSP's because they are not taxable as unrelated business income like advertising. To make sure that your sponsorship agreements can withstand an IRS examination, you need to know the advertising exception rules. For example, it is not taxable advertising if your newsletter contains a "recognized slogan" like "Breakfast of Champions", "Good to the last drop" or "A Diamond is Forever".

### **Alternative Investments**

Income from alternative investments could contain taxable unrelated business income, excise tax on prohibited tax shelter transactions or foreign investment excise tax. You need to read your investment agreements and ask your investment advisors about these taxes. Do not rely on the K-1 from your investments to be correct. If you make a mistake, the excise tax can be 35% of net income or 75% of the proceeds.

### **Small Business Health Care Credit & E-Filing the Form 990-T**

Here are answers to some recent tax issue questions that have been in the news. How do we file for the Small Business Health Care Credit? The latest word is that the IRS is in the process of modifying their Form 990-T to add a line to get your refund. However the revisions are not complete yet. More information will be released at a later date. Can we E-File our Form 990-T? The IRS has no plans to automate the unrelated tax form in the next two years. Are there more changes coming to the Form 990? The IRS released a revised Form 990 to be used next year, but the changes were not substantial. The IRS project manager said "The nature and scope of changes will be more in the nature of chiropractic adjustments rather than major surgery". In December, we will analyze the changes in detail and provide you with an update.

If you have questions or would like more information about these new developments, please feel free to email [howard@jjco.com](mailto:howard@jjco.com).

### ***About the Author***

Howard Donkin, CPA has more than 20 years experience in serving the not-for-profit community. Among his areas of expertise are complex tax issues, state and local tax issues, voluntary compliance issues, strategic planning, investment policies and organizational tax planning.

Howard is a member of the American Institute of Certified Public Accountants (AICPA) and the Washington Society of Certified Public Accountants (WSCP), where he served as Chairman of the Not-for-Profit Committee and Chair of the Tax Sub-Committee. He volunteers his time to the AICPA Exempt Organization Technical Resource Panel to study tax issues for not-for-profit clients on a national level, chairs the finance committee of the Bellevue Schools Foundation, is a member of The Alliance for Nonprofits' Public Policy Forum and is past Chairman of the Bellevue Arts Commission. Howard has written several articles on not-for-profit tax issues and is on the Advisory Board of The Exempt Organization Tax Review.