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NEWSLETTERS

The Tax Man Cometh: Tax And Financial Considerations For Nonprofits

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As the IRS continues to evaluate the operations of tax exempt organizations, there has been increased scrutiny on association chapters and affiliates. More associations have received IRS questionnaires regarding their relationship, control and oversight of their chapters and affiliates. Responding to such inquiries will involve an overall evaluation of the corporate and tax relationship the association has with its components.

Relationships with Chapters and Affiliates

Many associations and foundations have been reviewing the relationship between the international/national organization ("national") and its chapters/affiliated organizations ("chapters"). In some cases, the national in which had separately incorporated chapters operating pursuant to affiliate agreements have determined to restructure the organization such that the chapters are part of the parent and are no longer separately incorporated. This process, while raising the potential for liability to the national for the chapter's actions, can be beneficial in permitting the maximum control of the national over the chapter.

In other cases in which the national has operated without any structure or separate incorporation with its chapters, the national has decided to implemented procedures to ensure that the chapters form separate corporations, adopt model bylaws and enter into an affiliate agreements. This structure protects the organization from liability but pushes much of the administrative burden on the chapters.

Further complicating the discussion is the IRS's enforcement efforts to ensure that the group tax exemption is being used property and that separately incorporated chapters are filing the appropriate version of the IRS Form 990 on an annual basis.

Unrelated Business Income

In today's competitive marketplace, associations and foundations are continuing to seek new methods of increasing non dues revenue. In so doing, it is important to ensure that any income earned by virtue of an association's activities with a for profit corporation, such as a credit card programs, can be structured as a royalty paid for the use of the association's name and logo rather than treated as unrelated business income. The key consideration is the activity level of the association. If the income is earned by the association "passively" - meaning little to no activity -- then the income will be treated as exempt and not subject to

RELATED PEOPLE

Paula Cozzi Goedert
Partner
Chicago, Washington, D.C.

P 312-214-5660
F 312-759-5646
paula.goedert@btlaw.com

Barbara F. Dunn
Partner
Chicago

P 312-214-4837
F 312-759-5646
barbara.dunn@btlaw.com

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tax. Examples of passive activities include royalties, interest and rent (all of which are specifically excluded from the unelated business income). Examples of “active” conduct on the part of the association including the association selling products and services.

Lobbying Scrutiny

As we approach mid-term elections, it is essential that associations and foundations review their lobbying activities to ensure they are staying within the permissible bounds as prescribed by the IRS. For 501(c)(6) organizations, lobbying activity – attempting to influence legislation – is permitted but the association must disclose to its members the percentage of their dues is allocated toward such lobbying activities or pay a proxy tax. For 501(c)(3) organizations, only limited lobbying activities such as grassroots lobbying is permitted. Of particular concern to the IRS is enforcing the prohibition that 501(c)(3) organizations may not directly or indirectly participate in, or intervene in, any political campaign on behalf of (or in opposition to) any candidate for elective public office status. Given the complexity of these restrictions, it is important for associations and foundations to periodically review the government relations activities and communications of the national office, chapters and its volunteers to ensure compliance.

Applications for Exemption

The IRS continues to scrutinize applications for federal tax exemptions especially among 501(c)(3) organizations. It is important to focus on the organization’s exempt purpose and to ensure that the narrative included in the application demonstrates how the organization intends to function in order to ensure it will fulfill its mission. A well thought estimated 2-3 projected budget is also important particularly as it relates to key mission functions such as education, research and scholarship programs.

Charitable Registrations

State attorney generals are continuing to enforce laws which require 501(c)(3) organizations fundraising in their state to register with the state as a charitable organization. While many organizations have undertaken this task for their state of incorporation or state in which it has offices, many organizations fail to consider the need to complete charitable registration in states in which the organization holds its meetings at which funds are solicited.

Paula Goedert is Chair of Barnes & Thornburg’s Associations and Foundations Practice Group, where she concentrates her practice on the representation of non-profit organizations, including professional societies, trade associations, public charities and private foundations. Paula can be reached at (312) 214-5660 or paula.goedert@btlaw.com.

Barbara Dunn is a Partner with the Association and Foundations Practice Group at Barnes & Thornburg where she concentrates her practice in association law and meetings, travel and hospitality law. Barbara can be reached at (312) 214-4837 or barbara.dunn@btlaw.com.

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