2014 Tax & Legal Update for Nonprofits

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IRS Planned Activities

a. *Freedom From Religion Foundation v. Werfel*, 2013 U.S. Dist. LEXIS 132886 (W.D. Wis. 2013). While not a planned activity, it is worth mentioning that the move to require Form 990 filing by churches is proceeding down the road. The Foundation alleges they are injured by the fact they have to file Form 990 and churches do not. The court grants it standing to proceed denying the government's request for dismissal based on lack of standing to bring suit. The Foundation also argued for an equality in the exemption application process, but the court did not grant standing in this issue until the Foundation can prove it has a "redressable injury."

b. *American Atheists, Inc. v. Shulman*, 2014 U.S. Dist. LEXIS 68148 (E.D. Ky. 2014). The atheist group denied standing to challenge the church exemption from filing Form 990.

c. *Freedom From Religion Foundation v. Shulman*, 2013 U.S. Dist. LEXIS 117234 (W.D. Wis. 2013). The court grants the Foundation standing to challenge the IRS on is selective enforcement of political campaign activities in Section 501(c)(3) organizations against nonreligious v religious exempt organizations.

d. *Freedom From Religion Foundation v. Koskinen*, 2014 U.S. Dist. LEXIS 12783 (W.D. Wis. 2014). (NOTE: Same case as above, new IRS Commissioner.) The court allowed Holy Cross Anglican Church to intervene. Church represented by the Becket Fund.

e. Determinations - IRS attracts attention due to its irregular processing of certain Form 1023s and 1024s related to Christian causes and conservative political points of view. Expect processing to slow to a crawl because it must respond to Congressional subpoenas and deal with vacancies in key positions. On June 24, 2013, the IRS announced streamlined processing for Section 501(c)(4) applicants that are willing to give up their issue advocacy forever. In IR 2013-92; 2013 IRB LEXIS 629, the IRS proposed regulations that would regulate all forms of political speech in a tax exempt organizations. The National Taxpayer Advocate reviews 16 suggestions that were previously made to EO to assist in areas that affect this process and related controversies.

f. New Form 1023-EZ is now available to file for organizations with planned income of less than $50,000 in annual income and assets less than $250,000. See http://www.irs.gov/pub/irs-pdf/f1023ez.pdf. It must be filed online. See Rev. Proc. 2014-40. In the Fiscal Year 2015 Objectives Report to Congress. The National Taxpayer Advocate issues severe criticism of the new application and its lack of any review of an organization's mission or organizational documents.

g. *Z Street v. Koskinen*, 2014 U.S. Dist. LEXIS 71638 (D.D.C. 2014). Motion to dismiss from IRS denied. The IRS sought dismissal because it claimed that court lacked jurisdiction since IRS had not made a decision on Form 1023. Z Street claimed that its 1st Amendment was violated when IRS challenged its support for Israel. IRS may have waived sovereign immunity when it violated the First Amendment.

h. New EO Director, Tamera Ripperda, announced at the AICPA Nonprofit Conference that one of the new compliance initiatives will look at foreign activities and that the report on the group ruling compliance initiative is not yet ready and is still forthcoming.

Tax Exemption Issues

a. PLR 201433020 – Organization formed to publish materials to be used in studying the Quran is not exempt. The organization would not own any of the intellectual property and only the members of the board had submitted their works for publishing.

b. PLR 201433016 -- Nonprofit formed to assist medical professors in writing and publishing their works is not exempt due to private benefit and inurement.

c. PLR 201433018 – Application for exemption denied to an organization that was created to enhance collaboration and the development of shared services among nonprofit hospital members. However, the organization did not qualify as a cooperative hospital service organization under 501(e). The organization was not organized correctly and did not perform one of the required services.

d. PLR 201433017 – Application for exemption denied due to lack of response to IRS request for additional information as to breakdown of time devoted to activities, details as to relationships with other organizations, and qualifications, average hours worked and duties for the individuals on the governing board.

e. PLR 201433019 – Organization denied exemption since its primary purpose was to take the founder's patents and ideas and develop them into marketable inventions, therefore, the net earnings inure to the benefit of the founder.

f. *ABA Retirement Funds v. U.S.*, 114 AFTR 2d 2014-5368 – The organization's exemption denial was upheld on the grounds the it is not a "business league" since it had no members per se and was not operating for the improvement of business conditions in the legal field and it engages in a business ordinarily conducted for profit.

g. PLR 201432037 – Revocation of group's parent's exemption revokes everyone's exemption.

h. PLR 201429030 – An organization learns it pays to know the difference between types of exempt organizations when they are denied status as a (c)(4) because its recreational facilities were not available to the general public. It would have needed to be classified as a (c)(7). The gated community did not meet the test of the general public.

i. PLR 201429028 – Organization exempt under (c)(7) loses exempt status since the nonmember income exceeded 15% of gross receipts.

j. PLR 201429027 – Organization created to serve as an administrative intermediary between wireless mobile phone companies and their customers desiring to make contributions via their mobile devices is not exempt. Its articles of incorporation were defective and it was deemed they operated for the private benefit of a related for profit and the mobile wireless carriers. Additional the income *may* inures to the founders because they have control over the organization.

k. PLR 2014323026 – An organization created to have members that promote and refer business within the membership ranks through referrals and leads was denied exemption since it was primarily organized and operated to provide a particular services to its members and did not promote the general business interest of a business or industry community.

l. PLR 201428019 – Organization that only conducts fundraising type businesses was not exempt even though all of the profits were given to other charities. The most unusual statement contained in the ruling is the fact that the operations were the same as they had been described in the 1023 when the exemption was granted. The IRS states that the exemption had been granted erroneously and it cannot be allowed to continue with substantially unrelated purposes.

m. PLR 201317012 -- Christian drug and alcohol rehabilitation organization denied exemption because it failed to respond adequately to IRS questions about its operations, took inconsistent positions, provided documents in Spanish with no translation and could not produce minutes from board meetings.

n. PLR 201334043 – Trust formed to assist a widow and her family failed to qualify for exemption. Exemption not granted due to assistance limited to one family.

o. *Capital Gymnastics Booster Club, Inc. v. Comm*. TC Memo 2013-193. Exemption denied where the club allowed parents to satisfy the annual team assessment either by cash or by allocated fundraising dollars. Organization operated for the private benefit of the parents who did not have to show financial need or that they were otherwise a member of a charitable class. Primary purpose of the organization was the fundraising for the parents.

p. PLR 201327012 & 201327013 & 2013335025 & 201335015– Organizations lose tax exempt status due to lack of any activities. Failed operational test.

q. PLR 201405024 – Organization formed to connect teachers and students with resources that avoided the need for textbooks not exempt because resources owned for-profit company.

r. PLR 201403018 – Organization to pay stipends to allow ministerial students to study at foreign religious seminary not exempt because it did not adequately exercise expenditure responsibility over the funds and did not require all decision makers to be independent.

Unrelated Business Income Issues

a. TAM 201430019 – Advertising income and event sponsorship payment and raffles for a (c)(7) are not nontraditional activities, but the income from nonmembers would constitute UBI. For purposes of the nonmember gross receipts testing, sponsorship payments cannot be reduced by an allocation to sponsorship benefits.

b. PLR 201429029 – Related merchandise in museum gift shop does not create UBI. In a situation similar to the Komen ruling, the museum provided descriptive literature/educational material with each item sold. The IRS once again reiterates that if the primary purpose of the article is utilitarian, ornamental or as a souvenir, it would not be considered substantially related and that the items must specifically relate to the particular museum selling the items.

c. PLR 201428030 – A tax exempt hospital's provision of lab testing for patients of private physicians didn't create UBI. The hospital is located in an area designated as "medically underserved population" by the U.S. Department of HHS and there are no full service labs located in the area other than the hospital's lab. The IRS found that while these types of services generally create UBI, in this instance, the service was fulfilling the hospital's exempt purposes of improving the health of the residents in this medically underserved area.

d. PLR 201405029 - Moving a periodical from paper to website did not change the application of the unrelated business income rules regarding advertising.

Payroll Tax Issues

a. *Jones,* T.C. Memo 2014-125 – Wife of attorney who provided services to the law firm was correctly classified as an independent contractor and was not an employee. The court utilized the 7 factor test now in use.

b. *Commonwealth Bank and Trust Company v. U.S.*, (DC KY 07/03/2014) 114 AFTR 2d 20214-5033 – failure to deposit penalties may be assessed even if deposits made but they are made by the wrong method.

c. Treasury Inspector General Report –TIGTA has determined that 3.8% of tax exempt organization owed approximately $875 million in payroll tax debts as of June 2012. More than 1500 organizations owed more than $100,000 each. The GAO also determined that more than 1200 organizations with unpaid payroll and other taxes received more than $14 billion in direct Federal grants in Fiscal Years 2005 and 2006.

d. Small Business Health Insurance Credit applies to nonprofit organizations with fewer than 25 full time equivalent employees and having less than $50,000 per full time employee average compensation. Ministers are excluded from the compensation computation. Starting with a renewal after August 26, 2014, the nonprofit must purchase its group health insurance through the Small Business Health Options Program (SHOP) Marketplace. (Certain counties in Washington and Wisconsin are excepted from this rule.) Starting in 2014 the credit is limited to two consecutive years. Final Regulations issued on June 24, 2014.

e. DOL Technical Release 2013-03 and IRS Notice 2013-54 clearly state that an HRA that is not integrated with other group health coverage that meets the unlimited dollar amounts for certain benefits fails to qualify as a tax free benefit. It also states that where the health plan that it is integrated with individual market coverage will also fail to qualify as a tax free benefit. As of January 1, 2014, this effectively ends the practice of reimbursing employees for health insurance that is obtained in the open market as an individual policy.

f. *Freedom from Religion Foundation v. Lew*, (W.D. Wis. 2013). Section 107(2) (cash housing allowance) is unconstitutional. On appeal to 7th Circuit.

Minister Tax Issues

a. *Freedom from Religion Foundation v. Lew*, (W.D. Wis. 2013). Section 107(2) (cash housing allowance) is unconstitutional. On appeal to 7th Circuit.

b. *Gardner v. Commissioner*, T.C. Memo 2013-67. Minister formed Arizona corporate sole and stopped filing income tax returns due to his vow of poverty. Church's bank accounts included in his taxable income, fraud penalty assessed. Failure to produce an IRS approved Form 4361 resulted in an assessment of self employment taxes.

c. *Bernstine v. Commissioner*, T.C. Summary Opinion 2013-19. Home office deduction allowed where his housing expenses far exceeded his housing allowance.

d. *Rogers v. Commissioner*, TC Memo 2013-177. Pastor required to include in income home mortgage payments, credit card and utility payments that the church made on their behalf. No exclusion was allowed under IRC Sec. 107 since the payments weren't properly designated by the church to be housing allowance.

e. *Gunkle v. Commissioner*, 2014 U.S. App. LEXIS 9257 (5th Cir. 2014). Pastor who dissolved his Texas nonprofit corporation (City of Refuge Church) and contributed the

assets to a corporate sole is subject to income taxes on all income received by the church. Same nonprofit consultant as *Gardner* above. Great quote:

"Every year, with renewed vigor, many citizens seek sanctuary in the ***free exercise clause of the first amendment***. They desire salvation not from sin or temptation, however, but from the most earthly of mortal duties—income taxes."**

Charitable Contributions

a. *Bell v. Commissioner*, T.C. Summary Opinion 2013-20. Taxpayer who is CPA and accounting professor could not deduct charitable contributions to charity due to inadequate receipts and documentation. She also made noncash contributions of materials and travel, but did not receive a qualifying letter from the charity recognizing those noncash gifts.

b. *Boone Operations Co., LLC v. Commissioner*, T.C. Memo 2013-101. Bargain sale of fill dirt disallowed because settlement agreement did not mention the presence of a charitable contribution. Though the settlement agreement called the gift a charitable contribution, it failed to recognize the other benefits conferred in settling the case.

c. *Villareale v. Commissioner*, T.C. Memo 2013-74. Taxpayer could not deduct contributions that exceeded $250 based solely on her bank statement. She was president of the charity and claimed that she did not need a qualifying receipt from the charity because she knew that she did not receive any goods or services in exchange for the gifts.

d. *Estate of Evanchik v. Commissioner*, T.C. Memo 2013-34. Taxpayer submitted appraisal of land owned by corporation, then donated the stock in the corporation instead of the land. Since no appraisal was presented on the corporate stock, no deduction.

e. *Crimi v. Commissioner*, T.C. Memo 2013-51. Donation allowed of bargain sale/donation of land though the appraisal contained defects. The IRS contended that the acknowledgment from the charity was defective because it was not signed but the court ruled that nothing requires the acknowledgment be signed. Though the acknowledgment did not contain the exact words "no goods or services were provided in exchange for this gift," the contract and acknowledgment letter both stated the consideration being provided and that met the statutory requirements.

f. *Humphrey v. Commissioner*, T.C. Memo 2013-198. Taxpayer made cash contributions to the Seventh Day Adventist Church, St. Jude and other charities totally $6,365 but was only allowed $650 due to the fact he failed to obtain documentation that met the substantiation requirements.

g. *Rehman v. Commissioner*, TC Memo 2013-71. Taxpayer was denied charitable contributions for donations made to an individual in India that was not a charitable organization or authorized to accept donations on behalf any charitable organization.

h. *Golit v. Comm.* TC Memo 2013-191. Taxpayer was denied contribution deductions for contributions to a Nigerian church as it could not be proved that the church met the requirements of IRC Sec. 170(c)(2)(A)'s provision that such be created or organized in the U.S.

i. *Payne v. Commissioner*, T.C. Summary Opinion 2013-64. Twenty year IRS Revenue Agent could not deduct her cash contributions to her friend's church. She fabricated letters from the church reflecting her cash contributions and had her child sign the letters. The pastor first denied knowing the taxpayer, later said he did know her and she made the contributions, and finally testified that he did not know whether she made them. Deduction denied because no credible evidence that she made them. Negligence penalty applied.

j. *Engler v. St. John the Evangelist Catholic Church*, 497 B.R. 125 (M.D. Fl. 2013). Contributions earmarked (restricted) for Haitian ministry were never the assets of the church and the church did not have to turn over the fund to the bankruptcy trustee.

k. *Koriakos v. Commissioner*, T.C. Summary Opinion 2014-70. The court allowed the taxpayers a charitable contribution deduction of $500 (out of the $5,000 originally claimed) though the taxpayer lacked the substantiation. The taxpayer testified that he put "about $100 per week" in cash into the offering each week. On cross examination, he could not name the church. Same result: *Jermihov v. Commissioner*, T.C. Summary Opinion 2014-75 (allowed $1,000 out of $7,762 claimed, without records).

Scholarships

a. PLR 201433025 – Private foundation's program to fund a paid internship program qualifies under IRC Section 4945(g)(3).

b. PLR 201432037 – The organization was one of the state's beauty pageant organizations and was granted exemption as a scholarship organization. However, it was determined that the vast majority of the organization's activities were involved in organization and conducting beauty pageants and support the national organization that was a (c)(4). Neither of these purposes is a (c)(3) purpose. Additionally, due to contractual obligation of the pageant participants, the primary recipients of the scholarships, it was deemed that the scholarships were not true scholarship under IRC Section 117 and all payments made to the recipients under the plan were taxable compensation.

c. PLR 201432023 & PLR 201432024 & 201433026– Private foundations' scholarship programs qualify under 4945(g)(1).

d. PLR 201304009. IRS approved scholarship selection procedures. First, the Foundation will publicize the availability of the scholarship in its community. Any high school or college student was eligible to apply. The primary criteria for selection was need. The

committee selecting the recipients and their relatives were ineligible to apply or receive scholarships. Scholarships were restricted to be spent on tuition and required fees. Recipients must provide verification of enrollment, the classes taken and the semester grades when received from the college.

e. PLR 201302042. IRS approved scholarships selection procedure. Scholarships were to be awarded to the first person to attend college from their family who is a resident of X. The selected colleges will send a list of candidates to the Foundation who will select the recipient.

f. PLR 201301040. IRS approved scholarship selection criteria though it includes the potential to award scholarships for study at foreign colleges and universities.

Health Care Reform

a. Websites dedicated to health care reform are found at www.irs.gov/aca and www.dol.gov/ebsa/healthreform/.

b. DOL Technical Release 2013-03 and IRS Notice 2013-54 clearly state that an HRA that is not integrated with other health coverage that meets the unlimited dollar amounts for certain benefits fails to qualify as a tax free benefit. It also states that where the health plan that it is integrated with individual market coverage will also fail to qualify as a tax free benefit. As of January 1, 2014, this effectively ends the practice of reimbursing employees for health insurance that is obtained in the open market as an individual policy.

c. Employer Notices – The Affordable Care Act requires employers to provide notice to current employees with information regarding their coverage options, including information on the Health Insurance Marketplace, by October 1, 2013 and to each new employee at the time of hire or no later than 14 days after an employee's start date. However, there is no fine or penalty for failure to provide the notice. Sample notices can be found at http://www.dol.gov/ebsa/pdf/FLSAwithplans.pdf and http://www.dol.gov/ebsa/pdf/FLSAwithoutplans.pdf.

d. Notice 2013-57 – The IRS has determined that a health plan won't fail to qualify as "high deductible health plan" under the provisions governing HSAs just because it provides for preventive health services without a deductible as is now required by the Public Health Services Act.

e. Religious Exemptions

i. Members of Certain Sects, *i.e.*, the Amish or Old Order of Mennonites

ii. Members of a health care sharing ministry that is a Section 501(c)(3) organization and has been around since at least 1999, *i.e.*, Christian Healthshare Ministries (Christian Brotherhood), Samaritan Ministries or Medi-Share.

f. Employer Concerns -2014

i. For 2015, 50 or more full time equivalent employees (or 100 or more for qualifying employers) – A penalty imposed if one of the full time employees is certified as having had to enroll in a state Exchange plan or tax credit program. Employer must provide access to group health insurance to at least 70% of their employee for 2015 (95% for 2016). Failure to provide access results in a penalty that can reach $3,000 per employee (less 30). A second penalty applies if either the insurance is not a qualified policy or if it costs too much. A qualified policy is one that does not pay at least 60% of the healthcare costs or if the employee pays more than 9.5% of their family income for health insurance a penalty applies. Two penalties may apply separately. The penalty is $3,000 for each full time employee that can claim a tax credit on their individual tax return. The maximum penalty is $2,000 times the number of full time employees (less 30). No penalties apply if you have less than 50 full time equivalent employees (100 or more for qualifying employers until 2016).

ii. Beginning in 2014 – Employers with more than 200 employees must automatically enroll its new employees in a plan.

iii. Health expenses flexible spending accounts will be capped at $2500 or the cafeteria plan will be disqualified effective 2013.

iv. Full time employee defined by IRS for health insurance purposes Final regulations issued February 10, 2014. For existing employees, you use up to the last 12 months to determine the classification for the next 12 months. For new employees, you use the first 90 days as the predictor for the remaining 9 months. If the employee is intended to work more than 30 hours per week on a regular basis, then that person is treated as a full time employee.

v. Form W-2 Healthcare Payments mandatory on Form W-2 for year 2013 if you issue 250 or more Forms W-2.

1. Reporting does not mean that the benefit is taxable or not.
2. Report health insurance premiums (paid by employer and/or employee to third party insurer)
3. Report COBRA Applicable Premium for self insured health benefits (assuming that the Modified COBRA does not apply)
4. Box 12, Code DD (2012)
5. HIPAA "excepted benefits" plans are not subject to the W-2 reporting requirements (accident, disability income, supplemental liability, workers' compensation insurance).

6. Stand-alone dental and vision plans are also not subject to the reporting.

7. Coverage under an HRA, amounts contributed to an HSA or an Archer MSA, as well as salary reduction contributions to a health FSA are not reportable.

8. *See* http://www.irs.gov/uac/Form-W-2-Reporting-of-Employer-Sponsored-Health-Coverage for more information

vi. As of January 2014, every stand alone HRA must provide for unlimited liability to the employer for employee health expenses.

vii. For policies purchased or renewed after September 24, 2010, health insurance benefits must be made available on a nondiscrimination basis to remain a fully tax free fringe benefit. Enforcement of this requirement has been delayed pending the issuance of regulations. If the new regulations follow the same test as in Section 105(g), then plan cannot discriminate in favor of highly compensated employees. Highly compensated employees include (i) the employer's five highest paid officers; (ii) individuals who are 10% or more shareholders of the employer; and (iii) the highest paid 25% of all employees. But this is delayed. However, the penalty associated with the discriminatory plans currently does not apply to "church plans."

viii. New IRS Form 1095-B will be required for 2015 tax year to reflect whether the employer provided coverage complies with Affordable Care Act.

ix. At least 125 lawsuits have been filed challenging the constitutionality of a provision in the Affordable Care Act requiring all health plans to provide for abortifants (morning after pill and other drugs that induce an abortion of embryos) to female employees. For example, *Newland v. Sebelius*, 2013 U.S. App. LEXIS 20223 (10th Cir. 2013)(Act violates the religious freedom.) But See *Autocam, Inc. v. Sebelius*, 2013 U.S. App. LEXIS 19152 (6th Cir. 2013)(Act does not violate religious freedom.) *Burrell v. Hobby Lobby Stores, Inc.*, 2014 U.S. LEXIS 4505 (2014). Supreme Court found that Regulations violated RFRA when applied to closely held corporations. Also, the Court implied that the Regulations issued defining the religious exemption also violated RFRA when it issued injunction in the *Wheaton College v. Burrell*.

Employment Law Developments

a. *Swift v. The Christian Broadcasting Company*, 2013 U.S. Dist. LEXIS 147405 (M.D. Tenn. 2013). Well documented performance issues prevail over claims of race discrimination.

b. *Victor v. Davis*, 2013 U.S. Dist. LEXIS 169471 (D. Md. 2013). Gentile director over facilities could not sue for religious discrimination when his documented misconduct justified firing.

c. *Herx v. Diocese of Fort Wayne-South Bend*, 2013 U.S. Dist. LEXIS 144420 (N.D. Ind. 2013). For violation of morals clause in contract, Diocese and school declined to renew contract of teacher pregnant by artificial insemination. Court allows extensive discovery into all 41 Diocesan schools and their treatment of pregnant teachers.

Church Property Issues

a. *Episcopal Diocese of Fort Worth v. The Episcopal Church*, 2013 Tex. LEXIS 694 (Tex. 2013). The Texas Nonprofit Corporation Act applies to a local diocese and local parishes and overrules canon law. The Court remanded the case to the trial court to determine if "neutral principles of law," such as the Texas Nonprofit Corporation Act, can be applied to determine the appropriate owner of $100 million of real estate. Motion for rehearing has been filed. Like Iowa, Texas ruled in favor of the local parishes after the national church had won in 8 other states.

b. *Episcopal Diocese of South Carolina v. The Episcopal Church.* In this case, the lawsuit was filed in federal court instead of state court. Over $500 million worth of real estate is in controversy. Again, The Episcopal Church mostly won over breakaway diocese. The departing diocese has no right to use the intellectual property of The Episcopal Church and the court required the Bishop of the breakaway diocese to abandon his office and the property of the diocese. Case on appeal to 4th Circuit.