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IRS Areas of Scrutiny for Tax-Exempt Organizations

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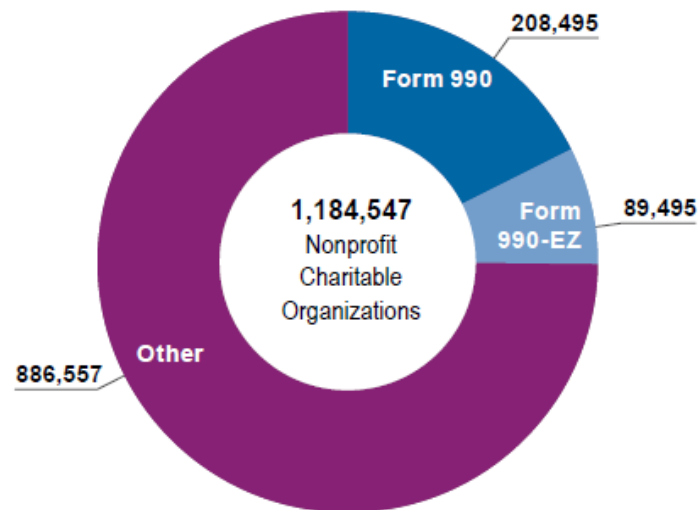
... What Are We Covering Today?

1. Taxpayer Certainty and Disaster Tax Relief Act of 2019.
2. The Taxpayer First Act of 2019.
3. IRS Priority Guidance Plan 2019-2020 – Exempt Organizations.
4. Tax Exempt Entities Fiscal Year 2020 Program Letter.
5. Additional Reminders for Exempt Organizations.

Nonprofit Charitable Organization Number of Filers, Tax Year 2015

- Of the 1,184,547 nonprofit charitable organizations recognized by the IRS in 2015, some 298,440 filed Forms 990 and 990-EZ for the tax year. Nearly all the remaining organizations were required to report only minimal information on an “e-postcard.”

**Nonprofit Charitable Organizations:
Number of Filers, Tax Year 2015**



.... Returns of Tax-Exempt Organizations, Employee Retirement Plans, Government Entities, and Tax-Exempt Bonds Examined, by Type of Return, Fiscal Year 2018

Type of return	Number of returns examined
Tax-exempt organization, employee retirement plan, government entity, tax-exempt bond returns, and related taxable returns examined in Fiscal Year 2018, total	15,562
Forms 990, 990-EZ, and 990-N [1]	2,004
Forms 990-PF, 1041-A, 1120-POL, and 5227 [2]	263

[1] Includes the Form 990 series, as follows: 990 (tax-exempt organization information return, long form); 990-EZ (tax-exempt organization information return, short form); 990-N (electronic notice (e-Postcard) for tax-exempt organizations not required to file Forms 990 or 990-EZ).

[2] Includes Form 990-PF (private foundation information return); Form 1041-A (information return of charitable contribution deductions by certain trusts); Form 1120-POL (income tax return for certain political organizations) and Form 5227 (split interest trust information return).

SOURCE: Tax Exempt and Government Entities.

... Taxpayer Certainty and Disaster Tax Relief Act of 2019

1. Repeal of the provision taxing qualified transportation fringe benefits (the “Parking Tax”).
2. Simplification of the private foundation excise tax on net investment income.

... Repeal of Taxation of Qualified Transportation Fringe Benefits

Pre-Act Law: The 2017 Tax Cuts and Jobs Act taxed as unrelated business income (UBI) transportation fringe benefits such as parking and other transit benefits provided by nonprofit organizations.

Taxpayers were required to file a Form 990-T and pay the excise tax due on transportation fringe benefits provided to employees in excess of \$1,000.

... Repeal of Taxation of Qualified Transportation Fringe Benefits

New Law: This Act repeals this provision retroactively to January 1, 2018, essentially it is as though the provision in the 2017 Tax Act was never enacted.

Nonprofit organizations may seek a refund of excise taxes already paid. A streamlined process for making refund claims is being advocated for. Absent additional guidance, an amended Form 990-T would be filed to obtain the refund.

... Private Foundation Excise Tax

Pre-Act Law: A two-tiered system where a foundation would pay 2 percent or a reduced 1 percent excise tax rate on investment income.

Foundations would need to monitor their investments and grant making during the year in an attempt to manage the tax rate it would be subject to.

... Private Foundation Excise Tax

New Law: The private foundation excise tax on investment income is replaced with a flat rate of 1.39 percent.

The 1.39 percent tax rate is effective for tax years beginning January 1, 2020.

... The Taxpayer First Act of 2019

Requires tax-exempt organizations to electronically file information returns and related forms. Affects tax-exempt organizations in the tax year beginning after July 1, 2019.

The following forms are included in the mandate:

- Form 990, Return of Organization Exempt from Income Tax.
- Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation.
- Form 8872, Political Organization Report of Contributions and Expenditures.
- Form 1065, U.S. Return of Partnership Income (if filed by a Section 501(d) apostolic organization).

... The Taxpayer First Act

Transitional Relief - The IRS will postpone the required e-filing of Form 990-EZ, while optional e-filing is available. For tax years ending August 31, 2020 and later, Forms 990-EZ must be filed electronically.

Forms 990-T and 4720 will come under the e-filing requirement next year pending conversion to electronic format.

... The Taxpayer First Act

Change for 990-N filers:

Prior Law: If an organization fails to file the information returns for three consecutive years, it automatically loses tax-exempt status.

New Law: If the organization fails to file for two consecutive years, the IRS is required to reach out with a notice stating that if the organization doesn't file for another year, the tax-exempt status will be revoked.

... IRS Priority Guidance Plan 2019-2020

- Released October 8, 2019, contains a list of guidance projects that Treasury and the IRS intend to focus on from July 1, 2019 through June 30, 2020.
- Contains 203 guidance projects and prioritizes implementation of the 2017 Tax Cuts and Jobs Act and the 2019 Taxpayer First Act.

... Implementation of the Tax Cuts and Jobs Act

- Regulations under Section 274 concerning qualified transportation fringes. **Already taken care of!**
- Regulations on computation of unrelated business taxable income for separate trades or businesses under Section 512(a)(6). **Nothing new yet.**
- Regulations on the increased contribution limit under Section 529A, and final regulations under Section 529A on qualified ABLE programs. **Proposed regulations published October 9, 2019.**

... Implementation of the Tax Cuts and Jobs Act

- Regulations under Section 4960 regarding the excise tax on excess remuneration paid by “applicable tax-exempt organizations.” **Nothing new yet.**
- Final regulations on the excise tax on net investment income of certain private colleges and universities under Section 4968. **Proposed regulations published July 3, 2019.**

... Tax-Exempt Organizations

- Guidance implementing Section 3101 of the Taxpayer First Act on new electronic filing requirements for exempt organization returns. **Already taken care of!**
- Guidance revising Rev. Proc. 80-27 regarding group exemption letters. **Nothing new yet.**
- Guidance on circumstances under which an LLC can qualify for recognition under 501(c)(3). **Nothing new yet.**

... Tax-Exempt Organizations

- Final regulations on Section 506 regarding the notification requirement for organization under 501(c)(4). **Final regulations published July 23, 2019.**
- Final regulations on Section 509(a)(3) supporting organizations. **Nothing new yet.**
- Guidance under Section 4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners. **Nothing new yet.**

... Tax-Exempt Organizations

- Regulations regarding the excise taxes on donor-advised funds and fund management. **Nothing new yet.**
- Regulations and other guidance under Section 6033 regarding exempt organization reporting and filing requirements. **Proposed regulations published September 10, 2019.**
- Final regulations under Section 6104(c) related to certain information to state officials. **Nothing new yet.**

Charitable Contributions

- Guidance under 170(e)(3) regarding charitable contributions of inventory. **Nothing new yet.**

... Other Items Affecting Tax-Exempt Organizations

- Final regulations under Section 512 explaining how to compute unrelated business taxable income of voluntary employees' beneficiary associations ("VEBAs") described in Section 501(c)(9). **Nothing new yet.**
- Guidance under Section 7701 providing criteria for treating an entity as an integral part of a state, local, or tribal government, and guidance on tribally chartered corporations. **Nothing new yet.**

... Other Items Affecting Tax-Exempt Organizations

- Guidance regarding employee benefit plans of tax-exempt organizations and governmental entities, including VEBAs. **Nothing new yet.**
- Final regulations on the fractions rule under Section 514(c)(9)(E). **Nothing new yet.**

... Tax Exempt Entities Fiscal Year 2020 Program Letter

Sets forth the tax-exempt entities compliance program for the new fiscal year divided into the following six programs:

1. Compliance strategies.
2. Data-driven approaches.
3. Referrals, claims, and other casework.
4. Compliance contacts.
5. Determinations.
6. Voluntary compliance and other technical programs.

... Compliance Strategies

- Hospital organizations with unrelated business income (UBI): focus on unrelated business taxable income (UBTI) reported on Form 990-T, Exempt Organization Business Income Tax Return, where expenses materially exceed gross income.
- IRC 501(c)(7) entities: focus on investment and nonmember income by tax-exempt pleasure, social, and recreation clubs.
- IRC 4947(a)(1) Non-Exempt Charitable Trust (NECTs): organizations that under-report income or over-report charitable contributions.

... Compliance Strategies

- Previous for-profit organizations: formerly operated as for-profit entities prior to the conversion to IRC Section 501(c)(3) organizations.
- Private benefit and inurement: organizations show indicators of potential private inurement to individuals or private entities by way of private foundation loans to disqualified persons.

... Data-Driven Approaches

- Query sets: continue to improve compliance query sets based on information reported on tax forms.
- RAAS collaboration: continue to review various items and activities, including benefit/inurement.

... Referrals, Claims, and Other Casework

Referrals: continue to pursue referrals received from internal and external sources that allege noncompliance by an exempt organization and pursue taxpayer and interagency referrals, including information items from sources within and outside the IRS that allege noncompliance with an employment tax law by an exempt organization

Claims: continue to address requests for refunds or credits or overpayments of amounts already assessed and paid, including tax, penalties, interest, or an adjustment of tax paid or credit not previously reported or allowed.

... Referrals, Claims, and Other Casework

Other casework: continue to examine entities that filed and received exemption using Form 1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(C)(3) of the Internal Revenue Code.

Additionally support IRS-wide compliance efforts on IRC Section 4980H with respect to certain exempt employers.

... Compliance Contracts

Compliance check: correspondence with organization to inquire about an item on a filed return to determine if specific reporting requirements have been met to determine whether an organization's activities are consistent with its tax-exempt purpose.

- Payroll Tax Returns.
- 990-T.
- Form 1099.

... Compliance Contracts

Soft Letter: correspondence with organization that provides notification of changes in tax-exempt law or compliance issues.

... Determinations

Hire more revenue agents to address determination letters and offset anticipated attrition losses.

Determination letters are issued to exempt organization on exempt status, private foundation classification, and other determinations relating to exempt organization.

Additional Reminders for Tax-Exempt Entities

- Public disclosure requirements.
- Number of volunteers.
- Program service descriptions.
- Form 1099s and backup withholding.
- Independent board members.
- Conflict of interest policy.
- Significant diversion of assets.
- Compensation.

Public Disclosure Requirements

IRC Section 6104 contains the public inspection requirements.

Forms required to be made available for public inspection:

- Form 990 and 990-EZ and corresponding schedules with the exception of redacted Schedule B and excess contributions list from Schedule A.
- Form 990-PF and Schedule B.
- Form 990-T.
- Form 1023.

Public Disclosure Requirements

Why must forms be made available for public inspection:

- Promotes compliance.
- Ensures accountability and transparency.
- Serves as a public relation tool.

... Number of Volunteers

- Form 990 question – estimate if necessary.
- Volunteers are individuals who serve the organization without compensation including full-time and part-time members of the organization's governing body.

... Program Service Descriptions

- Advertise your organization.
- Include specific details such as clients served, days of care provided, and number of students.
- Include reasonable statistics of successes.

... Form 1099s and Backup Withholding

- Publication 1281 requires organizations to request Form W-9's for all of its vendors to confirm that they are not required to withhold taxes.
- If organization doesn't receive a Form W-9 from vendor than it is required to withhold.
- Form 1099s should be filed for payments to vendors of \$600 or more (and subject to additional requirements as well).

Form 1099s and Backup Withholding

Penalty Rates: The penalty rates and maximums for not filing correct information returns and/or not furnishing correct payee statements, including inflationary adjustments if applicable, are reflected in the following table (*- as adjusted for inflation):

Large businesses with gross receipts of more than \$5 million (*average annual gross receipts for the most recent 3 taxable years) and government entities (other than Federal entities) IRC 6721 and IRC 6722.				
Time returns filed/ furnished	Not more than 30 days late	31 Days late – August 1	After August 1 or not at all	Intentional disregard
Due 01-01-2020 thru 12-31-2020	\$50 Per return or statement - \$556,500* maximum	\$110* Per return or statement - \$1,669,500* maximum	\$270* Per return or statement - \$3,339,000* maximum	\$550 Per return or statement - No limitation
Due 01-01-2019 thru 12-31-2019	\$50 Per return or statement - \$545,500* maximum	\$100 Per return or statement - \$1,637,500* maximum	\$270* Per return or statement - \$3,275,500* maximum	\$540* Per return or statement - No limitation

Form 1099s and Backup Withholding

Note: Increased penalty amounts may apply for certain failures in the case of intentional disregard. See IRC 6721(e)(2) and IRC 6722(e)(2).

Small businesses with gross receipts \$5 million or less (*average annual gross receipts for the most recent 3 taxable years) IRC 6721 and IRC 6722.				
Time returns filed/ furnished	Not more than 30 days late	31 Days late – August 1	After August 1 or not at All	Intentional disregard
Due 01-01-2020 thru 12-31-2020	\$50 Per return or statement - \$194,500* maximum	\$110* Per return or statement - \$556,500* maximum	\$270* Per return or statement - \$1,113,000* maximum	\$550* Per return or statement - No limitation
Due 01-01-2019 thru 12-31-2019	\$50 Per return or statement - \$191,000* maximum	\$100 Per return or statement - \$545,500* maximum	\$270* Per return or statement - \$1,091,500* maximum	\$540* Per return or statement - No limitation

... Independent Board Members

A member of the governing body is considered “independent” only if all four of the following circumstances applied at all times during the year:

- The member was not compensated as an officer or other employee of the organization or of a related organization;
- The member did not receive compensation exceeding \$10k during the year as an independent contractor;
- Neither the member, nor any family member was involved in a transaction with the organization required to be reported on Schedule L; and
- Neither the member, nor any family member was involved in a transaction with a related organization required to be reported on Schedule L.

... Conflict of Interest Policy

- If organization states that it has a conflict of interest policy, but it doesn't monitor conflicts, IRS might ask questions.
- Organization needs to describe their monitoring practices and how it deals with potential conflicts.
- The description should include:
 - Which persons are covered under the policy;
 - The level at which determinations are made;
 - The level at which the conflicts are reviewed; and
 - Restrictions imposed on persons with conflicts.

... Significant Diversion of Assets

Any unauthorized conversion or use of the organization's assets.

Material diversions are lesser of:

- \$250,000;
- 5 Percent of gross receipts; or
- 5 Percent of total assets.

... Significant Diversion of Assets

Form 990 question must be answered, and incident must be described in detail including:

- Nature of diversion;
- Dollar amounts or other property involved;
- Corrective action taken; and
- Pertinent circumstances.

... Compensation

- IRS permits nonprofits to pay executives “fair and reasonable” compensation.
- There is not formula to determine what is reasonable.
- However, if the nonprofit is not paying the right amount, it could be subject to taxes.
- The penalties for an excess benefit transaction are levied on both the executive who received the benefit and the board members who approved it or didn’t prevent it.

... Compensation

Biggest risk – reputation of both the organization and the individuals involved.

The organization can establish rebuttable presumption of reasonableness by:

- Approving compensation in advance.
- Approval by only independent board members.
- Basing compensation on data obtained before the compensation is paid.
- Documenting the process and decision at the time it is made, including terms of the transaction, members that voted, and comparable data used.

Questions



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