

# **NON –PROFIT HANDBOOK UPDATE Practical Internal Revenue Service (IRS) Practice and Procedures**

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**Disclosure: The information contained in this document is for discussion purposes only and doesn't replace the reliance of qualified professional advice for any of the suggestions herein.**

## **HANDBOOK PRESENTATION - TAX SECTION**

- **IRS Publication 557**
- **Application for exemption, Form 1023**
- **Rulings and Determination Letters**
- **Annual Compliance Requirements**
- **Form 990, Schedule A**
- **Form 990, Schedule B**
- **Revenue Issues**
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- **Current IRS Initiatives**
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## **IRS PUBLICATION 557**

- *Written in IRS English that does a good job in describing non-profit entities and the requirements for tax filings.*
- *Provides a general overview of Non-Profit filing requirements and not a comprehensive detailed set of instructions for every situation.*
- *Provides a good description of various Section 501(c)(3) organizations.*
- *Includes an Organization Reference Chart as attached that provides an overview of the various non-profits on one page.*
- *Last Revised as of May, 2003.*

## **APPLICATION FOR EXEMPTION FORM 1023**

- *The application should give an accurate description of the Exempt Function Purpose of the non-profit organization.*
- *The application is due within 15 months of the creation of the non-profit organization and should be filed as soon as possible.*
- *A \$500 application fee payable to the United States Treasury is due with the filing of the application to the IRS.*
- *An approved tax exemption letter is effective retroactively to the date the non-profit was created, if the application is filed, accepted, and approved by the IRS within 15 months of the tax-exempt entity creation date.*
- *Non-profit organizations accepting donations without an approved IRS tax exemption letter run the risk of having taxable income if the IRS rejects their application.*
- *Prepare the Form 1023 at the same time the non-profit is created and submit to the IRS.*

## **RULINGS AND DETERMINATION LETTERS**

- *It will take the IRS on average about 6 to 9 weeks to respond to the exemption application.*
- *The IRS usually requires additional information to answer questions on the initial Form 1023 submitted.*
- *Then it may take another 6 weeks for the IRS to approve the application for tax-exempt status, effective retroactively up to 15 months.*
- *It is possible to request an advance ruling for tax-exempt status before the organization is operational. This is suggested to get the process started as soon as possible and gives the applicant time to address the concerns the IRS may have.*
- *If the application for tax-exempt status is rejected, the Rejection can be appealed. However the appeal process can be lengthy and costly, so it is best to make sure the application will stand on its merits prior to submission.*

## **ANNUAL COMPLIANCE REQUIREMENTS**

- *A Form 990 is the required annual return for a non-profit organization and many times it is better for the non-profit to elect a fiscal year end other than a calendar year end of December 31<sup>st</sup>. The fiscal year end may better reflect the revenue cycle of the non-profit and may minimize costs of required accounting fees.*
- *Don't file a 990 if the organization qualifies to file an easier to complete Form 990-EZ. A non-profit can file a 990-EZ if the organization has gross receipts of less than \$100,000 for the year and assets of less than \$250,000.*
- *The non-profit is exempt from filing if the total annual gross receipts are usually less than \$25,000. However, States still may require the filing of tax return even though a Federal return is not required.*

- *Exempt from filing – applicable for organizations with less than \$25,000 in gross receipts.*
- *The IRS can charge several different types of penalties for non-compliance. The IRS will charge a \$20 dollar a day penalty for returns filed with incomplete information if it is not submitted within 30 days of the request from the IRS.*
- *The IRS can charge a \$20 per day penalty for filing the return late. The IRS is charging this penalty when a return has not been properly extended and the penalty is \$100 per day for non-profits with annual gross receipts of \$1 million.*
- *A responsible person of the non-profit, such as an officer or director, can be charged \$10 per day the failure to file a tax return.*
- *The IRS can be judge and jury and assess a penalty before the awareness of a problem exists, so it is imperative and important to have timely tax filings.*

### **FORM 990, SCHEDULE A**

- *The schedule includes the completion of the public support schedule. The form needs to be completed correctly to assure that the organization does not lose its public charity status and not classified as a private foundation.*
- ***I have seen the most mistakes being made on Form 990, Schedule A, Part IV – A, Support Schedule. Double check to make sure this schedule is completed correctly and disqualified individual receipts are handled correctly.***

### **FORM 990, SCHEDULE B**

- *This schedule reports and discloses the names and addresses of donors that generally gave more than \$5,000 to the non-profit. The Schedule B is not required to be disclosed to the public and donor generally like privacy get upset when information is needlessly given to third parties. The information is also not required to be given to most state tax authorities.*
- *The \$5,000 threshold for donor disclosure is increased to be 2% of total contributions, gift, grants, and similar amounts received (Form 990, Line 1d) if higher than \$5,000. This increased threshold applies to most publicly*

*supported charities and don't disclose donor that don't have to be disclosed  
– the donor will appreciate this.*

- *Have a donor pay in \$4,999 on the last day of the non-profit's tax year end and \$4,999 on the first day of the non-profits subsequent tax year to get the most amount of donation without any disclosure required. Remember, the disclosure of the donor is not open to public inspection, but does get reported to the IRS.*

## **REVENUE ISSUES**

- *Classify the receipts of a non-profit correctly to minimize the chance of the IRS having questions and requesting additional information. For example, grants received as payment for services are general program service revenue and not contributions. In addition, donated services, materials and facilities are not contributions and are not reported as revenue on page 1, Form 990 at all.*
- *Other reporting of revenue issues include correctly reporting property in kind contributions at Fair Market Value (FMV) to match the donor's charitable contribution donation and excluding investment income from the Unrelated Business Income Tax (UBIT).*
- *Make sure that the non-profit complies with contemporaneous documentation requirements for donations. Receipts are required for donations in excess of \$250 and an estimate of FMV of goods and services provided by the non-profit is required for quid pro quo contributions in excess of \$75.*

## **EXPENSE ISSUES**

- *Make sure that expense classifications are properly segregated into required functional expense categories (program services, management and general fundraising). Many times the tax return is the only financial document a non-profit prepares and having the correct classification can give the information necessary to manage costs.*
- *In addition, make sure that separate line items are provided for grants and scholarships, officer salaries, and depreciation expense. Depreciation expense is a non-cash outlay and may distort the true picture of what is net*

*excess of revenue over expenses. Consider attaching a depreciation schedule on a yearly basis to the return to keep track of the basis of fixed assets.*

- *Make sure that the Form 990 Part II, Statement of Functional Expenses Column B reconciles to Form 990 Part III, Statement of Program Service Accomplishment. When these don't reconcile, it generates questions.*
- *And report joint costs for educational campaign, and fundraising solicitation activities when appropriate on Form 990 Part II so it reconciles to the partner that shares the costs – it could be embarrassing to the other non-profit partner if they don't reconcile.*

### **PUBLIC INSPECTION REQUIREMENTS**

- *The non-profit tax returns, including exemption application, is required to be given to the public if requested. The public is also allowed to receive all attachments to the return except for the donor disclosure statement. Make sure the donor disclosure statement is eliminated when providing a copy of the return to the public.*
- *A web page can be used to satisfy disclosure requirements and web pages such as – [www.guidestar.com](http://www.guidestar.com) - have copies of all non-profit tax returns filed with the IRS.*
- *If the application for tax exemption, Form 1023 includes proprietary information such as trade secrets and patents, etc., it can be requested from the IRS commissioner to be eliminated from the return. In addition, applications filed before July 15, 1987 are exempt from the disclosure rules.*
- *Requests for tax returns as part of harassment campaign are exempt from the disclosure rules as well. However, it may be difficult to prove harassment if it is suspected under the present rules. Consult an appropriate attorney in this situation.*

### **CURRENT IRS INITIATIVES**

- *The IRS has restructured across the nation to coordinate several services and industries from single locations. Tax exempt entities are part of this restructuring.*

- *The government has created the Advisory Committee on Tax Exempt and Government Entities (ACT) -- an 18 Member Group to increase IRS accountability and responsiveness to the public.*
- *The current IRS Education Guidebook emphasizes the application of the tests to determine Public Charity Status vs. Private Foundation Status of a non-profit organization and to determine if the non-profit is meeting the current Disclosure Requirements – both to the public and to the IRS.*
- *The IRS has created the Exempt Organizations Compliance Unit (EOCU) – “ a new 15-person unit, to be established January 1, 2004 and headquartered in Ogden, Utah, which will focus on “soft contacts”, ranging from educational initiatives to correspondence exams. The Case Selection will be directed from Dallas and will involve the new data analysis unit and may include market segment follow up”.*
- *The IRS Coordinated Examination Program has been renamed the Team Examination Program (TEP) and will be utilized on a wider array of taxpayers and examine entities with the largest audit potential.*
- *TEP’s Key Focus Areas includes auditing joint ventures of non-profits with taxable organizations. The increase activity of the government may lead to more IRS examinations of non-profits requiring more assurance that the non-profit is in timely compliance with its tax filings obligations.*

### **CURRENT ORGANIZATIONAL TRENDS**

- *I have seen more non-profits being treated as vehicles to make money and get tax write offs by donors by classifying the non-profit as a support organization.*
- *I have seen more charitable bequests at death and more interest in trusts that create potential charitable beneficiaries.*
- *I have seen more transactions between different types of non-profits organized under the Internal Revenue Code including mergers, acquisitions and consolidations.*
- *I see potential for more IRS scrutiny, but the scrutiny may be for larger organizations.*

## Organization Reference Chart

Section of 1986 Code	Description of organization	General nature of activities	Application Form No.	Annual return required to be filed	Contributions allowable
501(c)(1)	Corporations Organized under Act of Congress (including Federal Credit Unions)	Instrumentalities of the United States	No Form	None	Yes, if made for exclusively public purposes
501(c)(2)	Title Holding Corporation For Exempt Organization	Holding title to property of an exempt organization	1024	990 <sup>1</sup> or 990EZ <sup>8</sup>	No <sup>2</sup>
501(c)(3)	Religious, Educational, Charitable, Scientific, Literary, Testing for Public Safety, to Foster National or International Amateur Sports Competition, or Prevention of Cruelty to Children or Animals Organizations	Activities of nature implied by description of class of organization	1023	990 <sup>1</sup> or 990EZ <sup>8</sup> , or 990-PF	Yes, generally
501(c)(4)	Civic Leagues, Social Welfare Organizations, and Local Associations of Employees	Promotion of community welfare; charitable, educational or recreational	1024	990 <sup>1</sup> or 990EZ <sup>8</sup>	No, generally <sup>2,3</sup>
501(c)(5)	Labor, Agricultural, and Horticultural Organizations	Educational or instructive, the purpose being to improve conditions of work, and to improve products of efficiency	1024	990 <sup>1</sup> or 990EZ <sup>8</sup>	No <sup>2</sup>
501(c)(6)	Business Leagues, Chambers of Commerce, Real Estate Boards, Etc.	Improvement of business conditions of one or more lines of business	1024	990 <sup>1</sup> or 990EZ <sup>8</sup>	No <sup>2</sup>
501(c)(7)	Social and Recreational Clubs	Pleasure, recreation, social activities	1024	990 <sup>1</sup> or 990EZ <sup>8</sup>	No <sup>2</sup>
501(c)(8)	Fraternal Beneficiary Societies and Associations	Lodge providing for payment of life, sickness, accident or other benefits to members	1024	990 <sup>1</sup> or 990EZ <sup>8</sup>	Yes, if for certain Sec. 501(c)(3) purposes
501(c)(9)	Voluntary Employees Beneficiary Associations	Providing for payment of life, sickness, accident, or other benefits to members	1024	990 <sup>1</sup> or 990EZ <sup>8</sup>	No <sup>2</sup>
501(c)(10)	Domestic Fraternal Societies and Associations	Lodge devoting its net earnings to charitable, fraternal, and other specified purposes. No life, sickness, or accident benefits to members	1024	990 <sup>1</sup> or 990EZ <sup>8</sup>	Yes, if for certain Sec. 501(c)(3) purposes
501(c)(11)	Teachers' Retirement Fund Associations	Teachers' association for payment of retirement benefits	No Form <sup>6</sup>	990 <sup>1</sup> or 990EZ <sup>8</sup>	No <sup>2</sup>
501(c)(12)	Benevolent Life Insurance Associations, Mutual Ditch or Irrigation Companies, Mutual or Cooperative Telephone Companies Etc.	Activities of a mutually beneficial nature similar to those implied by the description of class of organization	1024	990 <sup>1</sup> or 990EZ <sup>8</sup>	No <sup>2</sup>
501(c)(13)	Cemetery Companies	Burials and incidental activities	1024	990 <sup>1</sup> or 990EZ <sup>8</sup>	Yes, generally
501(c)(14)	State Chartered Credit Unions, Mutual Reserve Funds	Loans to members	No Form <sup>6</sup>	990 <sup>1</sup> or 990EZ <sup>8</sup>	No <sup>2</sup>
501(c)(15)	Mutual Insurance Companies or Associations	Providing insurance to members substantially at cost	1024	990 <sup>1</sup> or 990EZ <sup>8</sup>	No <sup>2</sup>
501(c)(16)	Cooperative Organizations to Finance Crop Operations	Financing crop operations in conjunction with activities of a marketing or purchasing association	No Form <sup>6</sup>	990 <sup>1</sup> or 990EZ <sup>8</sup>	No <sup>2</sup>
501(c)(17)	Supplemental Unemployment Benefit Trusts	Provides for payment of supplemental unemployment compensation benefits	1024	990 <sup>1</sup> or 990EZ <sup>8</sup>	No <sup>2</sup>
501(c)(18)	Employee Funded Pension Trust (created before June 25, 1959)	Payment of benefits under a pension plan funded by employees	No Form <sup>6</sup>	990 <sup>1</sup> or 990EZ <sup>8</sup>	No <sup>2</sup>
501(c)(19)	Post or Organization of Past or Present Members of the Armed Forces	Activities implied by nature of organization	1024	990 <sup>1</sup> or 990EZ <sup>8</sup>	No, generally <sup>7</sup>
501(c)(21)	Black Lung Benefit Trusts	Funded by coal mine operators to satisfy their liability for disability or death due to black lung diseases	No Form <sup>6</sup>	990-BL	No <sup>4</sup>

Section of 1986 Code	Description of organization	General nature of activities	Application Form No.	Annual return required to be filed	Contributions allowable
501(c)(22)	Withdrawal Liability Payment Fund	To provide funds to meet the liability of employers withdrawing from a multi-employer pension fund	No Form <sup>6</sup>	990 or 990EZ <sup>8</sup>	No <sup>5</sup>
501(c)(23)	Veterans Organization (created before 1880)	To provide insurance and other benefits to veterans	No Form <sup>6</sup>	990 or 990EZ <sup>8</sup>	No, generally <sup>7</sup>
501(c)(25)	Title Holding Corporations or Trusts with Multiple Parents	Holding title and paying over income from property to 35 or fewer parents or beneficiaries	1024	990 or 990EZ	No
501(c)(26)	State-Sponsored Organization Providing Health Coverage for High-Risk Individuals	Provides health care coverage to high-risk individuals	No Form <sup>6</sup>	990 <sup>1</sup> or 990EZ <sup>8</sup>	No
501(c)(27)	State-Sponsored Workers' Compensation Reinsurance Organization	Reimburses members for losses under workers' compensation acts	No Form <sup>6</sup>	990 <sup>1</sup> or 990EZ <sup>8</sup>	No
501(c)(28)	National Railroad Retirement Investment Trust	Manages and invests the assets of the Railroad Retirement Account	No Form <sup>11</sup>	Not yet determined	No
501(d)	Religious and Apostolic Associations	Regular business activities. Communal religious community	No Form	1065 <sup>9</sup>	No <sup>2</sup>
501(e)	Cooperative Hospital Service Organizations	Performs cooperative services for hospitals	1023	990 <sup>1</sup> or 990EZ <sup>8</sup>	Yes
501(f)	Cooperative Service Organizations of Operating Educational Organizations	Performs collective investment services for educational organizations	1023	990 <sup>1</sup> or 990EZ <sup>8</sup>	Yes
501(k)	Child Care Organizations	Provides cares for children	1023	990 or 990EZ <sup>8</sup>	Yes
501(n)	Charitable Risk Pools	Pools certain insurance risks of 501(c)(3)	1023	990 <sup>1</sup> or 990EZ <sup>8</sup>	Yes
521(a)	Farmers' Cooperative Associations	Cooperative marketing and purchasing for agricultural procedures	1028	990-C	No
527	Political organizations	A party, committee, fund, association, etc., that directly or indirectly accepts contributions or makes expenditures for political campaigns	8871	1120-POL <sup>10</sup> 990 or 990EZ <sup>8</sup>	No

<sup>1</sup>For exceptions to the filing requirement, see chapter 2 and the form instructions.

<sup>2</sup>An organization exempt under a subsection of Code sec. 501 other than 501(c)(3) may establish a charitable fund, contributions to which are deductible. Such a fund must itself meet the requirements of section 501(c)(3) and the related notice requirements of section 508(a).

<sup>3</sup>Contributions to volunteer fire companies and similar organizations are deductible, but only if made for exclusively public purposes.

<sup>4</sup>Deductible as a business expense to the extent allowed by Code section 192.

<sup>5</sup>Deductible as a business expense to the extent allowed by Code section 194A.

<sup>6</sup>Application is by letter to the address shown on Form 8718. A copy of the organizing document should be attached and the letter should be signed by an officer.

<sup>7</sup>Contributions to these organizations are deductible only if 90% or more of the organization's members are war veterans.

<sup>8</sup>For limits on the use of Form 990EZ, see chapter 2 and the general instructions for Form 990EZ (or Form 990).

<sup>9</sup>Although the organization files a partnership return, all distributions are deemed dividends. The members are not entitled to *pass-through* treatment of the organization's income or expenses.

<sup>10</sup>Form 1120-POL is required only if the organization has taxable income as defined in IRC 527(c).

<sup>11</sup>Application procedures not yet determined.