Summary of 2004 Tax Actions that Effect Tax Exempt Organizations

OVERVIEW OPERATIONAL RESTRICTIONS

In addition to the organizational and operational tests discussed in Section 471.3, there are three fundamental operational restrictions on Code Section 501(c)(3) qualified organizations:

(1) No inurement (see Section 475.2);

(2) no substantial legislative lobbying (see Section 475.3(a)); and

(3) no participation or intervention in political campaign activities in support of or in opposition to any candidate for public office (see Section 475.3(b)).

These restrictions stem from Code Section 501(c)(3) language describing qualifying organizations as having "no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in Subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office."

REVOCATION OF TAX EXEMPT STATUS

An organization that has been granted tax-exempt status by the IRS may retain this status for as long as the organization does not materially change its character, purposes, or methods of operation. Nevertheless, the IRS may revoke or modify an organization's exempt status if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented, or engaged in a prohibited transaction with the purpose of diverting a substantial part of the principal or income of the organization from its exempt purpose. Reg. Section 601.201(n)(6). A ruling or determination letter recognizing an organization's exemption may be revoked or modified upon issuance of a notice to the organization: by enactment of legislation or ratification of a tax treaty; as a result of a decision of the United States Supreme Court; upon the issuance of temporary or final regulations; or upon the issuance of a revenue ruling, revenue procedure, or other statement published by the IRS. Rev. Proc. 2004-4, 2004-1 I.R.B. 125.

CAUTION: The IRS is also authorized to suspend an organization's tax-exempt status (and, if applicable, its ability to receive tax-deductible charitable contributions from donors) if such organization is designated or otherwise individually identified as a terrorist organization or a foreign terrorist organization. 1

While the IRS is authorized to revoke an organization's tax-exempt status retroactively, it generally will make revocations effective as of the date of the organization's material change. Rev. Proc. 90-27, 1990-1 C.B. 514. Retroactive revocations of tax-exempt status recognition are discussed in Section 476.5.

SPECIAL RECORDS REQUIRED FOR TAX EXEMPT ORGANIZATIONS

Special requirements apply to books and records required for tax-exempt organizations. These organizations must keep books and records required for the tax on unrelated business income. In addition, every tax-exempt organization must keep permanent books of account or records, including inventories, which specifically show the items of gross income, receipts and disbursements. These organizations must also keep the books and records needed to substantiate the information required on their information returns.

UNRELATED BUSINESS INCOME

The unrelated business income tax (UBIT) was first introduced into law in 1950. Prior to the institution of the UBIT, tax-exempt organizations had a competitive advantage over for-profit corporations. So long as the level of business activity conducted by a tax-exempt organization was not so extensive that it caused the organization to lose its tax exemption, a tax-exempt organization could undertake business activities and retain the profits without any income tax burden. As a result of highly publicized incidents in which tax-exempt organizations undertook business activities in direct competition with for-profit businesses, Congress enacted a general tax on unrelated business income of tax-exempt organizations. Although the basic framework remains the same, this tax has been modified significantly since then. The tax is set forth in Code Sections 511 through 514.

REVENUE RULING 2004-6

Guidance on types of public advocacy activities that may constitute political campaign activity. Code Section 527.

E-FILE PROGRAM OPEN TO EXEMPT ORGANIZATIONS

REVENUE RULING 2004-51

1. Whether, under the facts described an organization continues to qualify for exemption from federal income tax as an organization described in section 501(c)(3) of the Internal Revenue Code when it contributes a portion of its assets to and conducts a portion of its activities through a limited liability company (LLC) formed with a for-profit corporation.

2. Whether, under the same facts, the organization is subject to unrelated business income tax under section 511 on its distributive share of the LLC's income.

REVENUE RULING 2004-112 2004-51

IRS ruled on whether internet activities by tax exempt trade associations meet the exception for qualified convention and trade show activities.

LETTER RULING 200431023

This memorandum presents the legal analysis as to whether credit counseling organizations can qualify for exemption as charitable or educational organizations described in section 501(c)(3). The Service found that many credit counseling organizations do not qualify for exemption.

Specifically it can and should be argued that the new generation of credit counseling organizations does not meet the criteria for exemption set forth in the two revenue rulings and case law: they are not providing any meaningful education or relief of the poor. Because the operations of the new generation of credit counseling organizations are so different from those considered in the prior case law and revenue rulings, we strongly recommend that each case be developed to enable the Service to establish many grounds for revocation, including the lack of exempt purpose, operation for substantial nonexempt purpose and the existence of private benefit. In a number of cases, there may also be a basis for arguing for revocation based on inurement.

PERSONAL USE OF EXEMPT ORGANIZATION'S VEHICLE IS EXCESS BENEFIT TRANSACTION

A particular employee of an exempt organization who used the organization's vehicle for personal reasons is a disqualified person, and that person's use of the vehicle constitutes a taxable excess benefit transaction. TAM 200435018.

A church, an exempt organization, has a policy under which its vehicles are to be used only for church business and not for any personal reason. Under this policy, someone using a church vehicle for personal reasons would have to reimburse the church at the current IRS approved rate per mile. According to the church, all of its employees and ministers have their own vehicles and thus have little or no reason to drive a church-owned vehicle for personal use.

In response to an IRS information document request, the church's founder indicated that his son-in-law had exclusive use of a truck owned by the church. The son-in-law stated that he only used the truck for work-related duties at a location owned by the church and that he did not assume those duties until after the years covered by the document request.

Issues arose regarding: (1) whether the church is a tax-exempt organization; (2) whether the son-in-law is a disqualified person; (3) whether the son-in-law's use of the truck is an excess benefit transaction; and (4) if so, whether the son-in-law is liable for the excise taxes on excess benefit transactions imposed by Code Section 4958(a)(1) and 4958(b).

The National Office advised that the church is a tax-exempt organization because the IRS recognized it as an exempt Code Section 501(c)(3) organization that is not a private foundation.
The National Office further advised that the son-in-law is a disqualified person under Code Section 4958(f)(1)(B) because he is a family member of an individual in a position to exercise substantial influence over the church's affairs.

In addition, the National Office advised that the son-in-law's use of the truck constituted an excess benefit transaction. The National Office pointed out that the son-in-law offered no evidence for his claim that he only used the truck for work-related duties at a location owned by the church and that he did not assume those duties until after the examination years. In fact, no evidence at all was furnished regarding how the truck was used. As a result, the National Office advised that the use of the truck must be treated as an automatic excess benefit.

Finally, the National Office advised that the son-in-law, as a disqualified person, is liable for the excise taxes provided by Code Section 4958(a)(1), equal to 25 percent of the excess benefit amount; and Code Section 4958(b), equal to 200 percent of the excess benefit amount.