



SECTION: SIX

Federal Tax Matters

IRS 501(c)(3) Application and Exemption Letter

The Application

After a nonprofit receives its IRS tax exemption letter from the IRS, the board's interest in the exemption application (Form 1023) often disappears. After a few years, many nonprofits have no idea where the application is located. Nonprofits must maintain a copy of the application in an accessible location because federal law requires nonprofits to make the application available for public inspection. For more information, see this Section on public disclosure requirements.

Nonprofits should review the application annually to verify whether the activities and mission of the organization match the representations made to the IRS in the application. Material changes to these items and other corporate changes must be reported to the IRS and included as attachments to the annual Form 990 filing. Questions about changes to the nonprofit's operations should be directed to: IRS Exempt Organizations, 1100 Commerce Street, Dallas, Texas 75242, (214) 767-1490 or (877) 829-5500. For other questions about charitable organizations, see the IRS website and Publication 557 at www.irs.gov.

Advance Ruling on Public Charity Status

Start-up organizations often file their request for tax-exempt status from the IRS before the organizations have a record of their operations. These organizations may obtain an “advance ruling” from the IRS stating that their nonprofit organizations are public charities rather than private foundations. If an organization receives an advance ruling that it is a public charity, the IRS will re-evaluate the operations of the organization when the advance ruling expires.

A nonprofit must obtain a permanent ruling to continue operations as a public charity. Otherwise, upon the expiration of the advance ruling period, the nonprofit will be considered a private foundation. Donations and reporting requirements for differ from those of public charities.

The difference in qualifying as a public charity rather than a private foundation is based on the variety and percentage of sources of monetary support for the organization. Therefore, it is important that the organization keep careful records of all donations, including small ones, to substantiate its public charity status.

Expiration of Advance Ruling

The advance ruling covers the first five fiscal years of an organization. The expiration date should be included on the tax exemption letter sent by the IRS. The nonprofit should designate someone to monitor the expiration date. If a nonprofit cannot locate the expiration date, the following information can be utilized to determine the date:

- ◆ The first year begins on the date of incorporation—not the date the exemption was granted.
- ◆ The ruling expires at the end of five fiscal years after the date of incorporation.

Example: Date organization incorporated: March 15, 2002
 Fiscal year: October 1-September 30
 First fiscal year ends: September 30, 2002
 Advance ruling ends: September 30, 2006

Process to Obtain a Permanent Ruling on Public Charity Status

Within 90 days after the expiration of the advance ruling period, submit Form 8734 to the IRS, available on the IRS website at www.irs.ustreas.gov/forms_pubs/forms.html. Send the form to the IRS at PO Box 192, Covington, Kentucky 41012. The IRS will then send back a final letter ruling regarding public charity status.

Public Disclosure Requirements

A nonprofit is required to make certain types of information about the organization available to the public upon request. A nonprofit must make the information available during normal business hours. The information must be made available at the main office for the nonprofit, in addition to each office of the nonprofit with more than three paid employees on site, unless the nonprofit obtains an exemption from the IRS.

Types of information that must be disclosed

- ◆ IRS Form 1023 (the application for tax exempt status filed by 501(c)(3) organizations), in addition to any correspondence between the organization and the IRS relating to the application;
- ◆ IRS determination letter;
- ◆ IRS Form 990 or 990-EZ (annual returns), including all attachments and supporting documents (except 990-T for unrelated business income), for the past **3 years**; and
- ◆ **Under Texas Law:** Nonprofits must also make available to the public all records, books, and annual reports of the financial activity of the corporation. **Exception:** the names and addresses of contributors.

Methods of disclosure

- ◆ Allow public inspection in nonprofit's office; and
- ◆ Provide copies of documents upon request.

Time for complying with the document request

- ◆ If request is made in person, the nonprofit must comply the same day.
- ◆ If request is made by mail, the nonprofit must comply within 30 days of receiving the request.
- ◆ If request is made by mail and nonprofit charges for copies, the nonprofit must comply within 30 days of receiving payment.

Reasonable fee for copies

- ◆ A nonprofit may charge a reasonable fee for copies. The IRS considers reasonable to be:
 - \$1 for first page; and
 - \$.15 for each additional page.

Federal exemptions to access requirements

The nonprofit does not need to make the information available for inspection if:

- ◆ The IRS application, IRS determination letter, and the past three years of 990s are widely accessible. To be considered “widely accessible” each of the following must be met:
 - Nonprofit publishes the materials on the internet;
 - The information can be downloaded at no cost; and
 - The requestor is told the web site address where the information is located.
- ◆ The requestor is engaged in a harassment campaign.
 - A nonprofit can ignore multiple requests for the same information from the same person or address.
 - A nonprofit can apply to the IRS to investigate whether a harassment campaign is going on.

Texas exemptions to access requirements

The broader Texas law requiring disclosure of all the records, books, and annual reports of financial activity does not apply to:

- ◆ Nonprofits that:
 - solicit funds only from members; or
 - do not receive contributions outside of membership in excess of \$10,000 a year.
- ◆ Information regarding:
 - the names and addresses of contributors; or
 - the names and addresses of members.
- ◆ A few other exemptions may also be applicable which a nonprofit should confirm with legal counsel.

Penalties for failure to comply

- ◆ Federal law: \$20 per day per Form 990 return.
- ◆ Federal law: \$5,000 for willful failure to allow inspection or copies.
- ◆ Texas law: Class B misdemeanor.

Free Internet Disclosure

Guidestar offers free internet disclosure for charitable organizations to comply with the federal disclosure requirements. See www.guidestar.org.

Disclosure to Members

Membership organizations must make books and records of account available to members of the organization. The member must make the demand in writing and state the purpose of the demand. The member has the right to examine and copy the books and records at any reasonable time at the expense of the member.

Donations

Nonprofit organizations rely on the financial support and generosity of donors. Federal tax law imposes two primary requirements on organizations that receive charitable donations and on the taxpayers who make contributions:

Disclosure for some contributions over \$75

A charitable organization is required to provide a written disclosure to a donor who makes a contribution greater than \$75 and receives goods or services in exchange. The nonprofit must provide a good faith estimate of the value of goods or services provided to the donor.

- ◆ The disclosure must contain the following information:
 - amount of the contribution or description of a non-cash contribution;
 - whether any goods or services were provided in return for the donation; and
 - a good faith estimate of the value of the goods or services provided.
- ◆ **Example:** A donor makes a \$100 contribution to attend a dinner with a fair market value of \$25. The donor is entitled to deduct \$75.
- ◆ **Exception:** Token goods or services do not have to be described in a written disclosure. This exception applies in two situations:
 - the value of the goods is less than 2% of the amount of the donation; or
 - items that meet the following requirements: the donor gives at least \$38; the only goods provided in return are items inscribed with the nonprofit's logo; and the items cost less than \$7.60.

The dollar amount of token exceptions changes frequently. Contact the IRS Exempt Organizations Customer Account Services at (877) 829-5500 for updated information.

- ◆ **Exception:** Membership benefits received in exchange for annual dues do not have to be described in a written disclosure if:
 - the dues are \$75 or less;
 - the benefits consist of privileges such as free or discounted admissions to the nonprofit's events, discounts from purchases, or parking privileges.
- ◆ **Penalties:** A penalty of \$10 per contribution, not to exceed \$5,000 per fundraising event or mailing, is imposed on nonprofits that fail to meet the written disclosure requirement.

Written acknowledgment for donations of \$250 or more

A donor is responsible for obtaining a written acknowledgment from a nonprofit for any single contribution of \$250 or more in order to claim the donation as a deduction from federal income taxes. A donor must receive the acknowledgment by the earlier of: the date on which the donor actually files his individual federal income tax return for the year of the contribution; or the due date (including extensions) of the return. A nonprofit may provide either a separate acknowledgment for each contribution of \$250 or more or an annual summary of all contributions from the donor of \$250 or more. The acknowledgment should contain the following information:

- name of the nonprofit;
- amount of contribution or description of the non-cash contribution;
- whether any goods or services were provided in return for the contribution; and
- a good faith estimate of the goods or services provided in return.

Written acknowledgment for unreimbursed expenses of \$250 or more

If a donor incurs expenses in order to perform donated services for an organization, the donor must also obtain a written acknowledgment from the nonprofit in order to deduct the expenses on her tax return. This acknowledgment must also contain a description of the services provided by the donor.

- ◆ **Example:** A director purchases an airline ticket and spends the night at a hotel to attend the annual conference of community development corporations. The director makes a report at the next board meeting regarding funding opportunities, technical assistance, and ideas for new strategies that he learned at the conference. The ticket costs \$300 and the nonprofit does not reimburse the director. The nonprofit should give the director a written acknowledgment for the unreimbursed expenditures in order for the director to deduct the expenses on his personal income tax return.
- ◆ **Example of written acknowledgment with no return goods or services:**

Cash contribution. "Thank you for your contribution of \$300 to ABC Corporation received on October 16, 2001. No goods or services were provided in exchange for your contribution."

Non-cash contribution. "Thank you for your contribution of a used oak baby crib and matching dresser to ABC Corporation received on October 16, 2001. No goods or services were provided in exchange for your contribution."

- ◆ **Example of written acknowledgment with return goods or services.** "Thank you for your cash contribution of \$300 to ABC Corporation received on October 16, 2001. In exchange for your contribution, we gave you a book with an estimated fair market value of \$60."
- ◆ **Penalties:** Obtaining a written acknowledgment is the donor's burden. However, if a nonprofit does not provide the donor with a written acknowledgment, the donor may make contributions elsewhere.

Other Considerations

Nonprofits should respect the privacy of donors and safeguard the confidentiality of information. Individual donors should have the opportunity to remain anonymous and to restrict the disclosure to the public of their name, amount of donation, or other similar information. For more information on charitable contributions, see IRS Publication 526, Charitable Contributions, or visit the IRS web site at www.irs.gov/eo.