

NACBA-NCC Seminar
Charitable Contributions and Unrelated Business Income Issues
December 15, 2011

Topics covered today:

- I. Tax deductible contributions (p. 2) – and substantiation requirements (p. 4)
- II. Unrelated Business Income Tax (p.5) – and specific examples
 - Impact on income tax; sales tax and property tax
- III. Miscellaneous tax reminders (p.7)
- IV. Year-end accounting considerations and record retention – See Handout
- V. List of useful publications (We have copies for you to view)

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I - What is a tax deductible donation?

Designated individuals or projects

1. Donations by donors directly to individuals are never tax deductible – even if they are for an exempt purpose.
2. Designation by donor of specific church projects is ok.
 - a. Ensure that all gifts are desirable and meet church exempt purpose
3. Designation of specific individuals - Missionaries
 - a. Church payments – as long as payments made by the church are made in furtherance of their exempt purpose, payments can be made directly to individuals. There are no requirements that a missionary be part of a formal mission agency, etc.
 - b. Designated donor contributions – designating a specific individual are tax deductible so long as the church “has full control of the donated funds, and discretion as to their use.” In other words, the church has the ability to exercises full administrative control over the donated funds.
 - i. The Church and Clergy Tax Guide at Chapter 8 discusses a number of recommended monitoring activities over the missionary activities.
4. Designation of specific individuals – Benevolence giving
 - a. Ideal is to donate funds without designating specific recipients, and to have church leadership usually decide benevolence beneficiaries.
 - b. Contributions to a church benevolence fund can be deductible, even if the donor mentions a beneficiary, if the facts demonstrate that the church once again has “full control of the donated funds, and discretion as to their use.”
 - i. Ensure the donor understands that their recommendation is advisory only and that the church retains full control over the donated funds, including the authority to accept or reject the donor’s recommendations.
5. Designation of specific individuals – Pass-through contributions. Be wary of donor pass-through contributions to individuals for the purpose of avoiding non-deductibility by donor –
 - a. Once again ensure that the church has the ability to exercise full administrative and accounting control over the funds.
 - i. Including monitoring activities to ensure exempt purpose if fulfilled.
 - b. It would likely be helpful if your church has other similar arrangements whereby they accept contributions and then distribute funds to missionaries or others, etc.
 - c. It would also likely be helpful if the missionary’s purpose is consistent with your church’s exempt purpose.
 - d. Otherwise, even the phrase “pass-through” could appear to potentially suggest a sham transaction with the only goal of facilitating a direct payment by an individual.

Other special circumstances

6. **Donated Services** – only unreimbursed expenses incurred in performing donated services are tax deductible, not the services themselves.
 - a. Recording donated services in Church GL may be proper – record as revenue and expense (with possible capitalization for fixed assets)
 - b. Donated services may be recognized, at fair value, if the services:
 - i. Create or enhance nonfinancial assets (such as fixed assets) or
 - ii. Require specialized skills, are provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation.
 - iii. Services requiring specialized skills are provided by accountants, architects, carpenters, doctors, electricians, lawyers, nurses, plumbers, teachers, and other professionals and craftsmen.
 - iv. Services which typically do not meet these requirements include Sunday school teachers, ushers, choir members, governing board members, workers at fairs and conferences.
 - a. Remember, a tax deduction is never allowed for the value of a volunteer's time.
7. **Travel expenses** – charitable contribution can be claimed for travel and out-of-pocket expenses incurred while away from home performing services for a charitable organization, only if there is no significant element of personal pleasure, recreation or vacation in the travel
 - a. Exception for chaperoning trip, such as overseeing setup and providing adult supervision – deductible even if enjoyable!
 - b. Must provide written receipt to substantiate
8. **Thrivent Choice designations** – not tax deductible to donors
9. **Donor contributions to Foreign charities** – not tax deductible to donors

Communicating with your members before year-end

1. Year-end communications with your members – reminders about 12/31 cutoff requirement. Also helps encourage increased contributions.
2. Don't file personal tax return until you've received your contribution receipt – due to contemporaneous requirement. Church must issue the receipt within 60 days, and donor must receive the receipt before filing tax return, and no later than due date plus extension.
 - a. Examples where deductions were disallowed because the church did not provide substantiation before the tax return was filed.

Receipting / Substantiation:

1. For cash, check or other monetary gift, donor must maintain a record of the contribution, such as a bank record, or a written receipt.
2. For cash or other property with FMV of \$250 or more (individually, not in aggregate) – Must substantiate contribution with a written receipt, which must:
 - a. Include name of church, date, and amount of cash; and clear description (but not value) of non-cash property contributed.
 - i. Clear description may include information regarding the quality, age, or condition of the donated property that would enable the IRS to determine its value at the time of the donation.
 - ii. Impact of noncash gifts on fulfilling pledge amounts –
 - Who determines value?
 - Donated services?
 - b. Include a description and good faith estimate of the value of any goods or services provided by the church in exchange for the contribution, or state that such goods or services consist solely of intangible religious benefits.
 - i. The term “intangible religious benefit” means any intangible religious benefit which is provided by the church exclusively for religious purposes and which generally is not sold in a commercial transaction (e.g. worship services, teaching and sacraments).
 - c. Be provided contemporaneously –
 - i. By the earlier of the date taxpayer files return, or due date (including extensions) for filing return.
 - Let members know not to file their returns before receiving the receipt.
 - ii. Can’t provide retrospectively – this will disallow the deduction.
3. Non-cash gifts – donor responsibilities for IRS Form 8283:
 - a. If their total deduction for all noncash contributions is more than \$500 (items, or groups of similar items), must complete and attach to return Form 8283, Section A
 - b. If they claim a deduction for noncash property worth more than \$5,000 (other than publicly traded stocks)
 - Need a qualified appraisal of the noncash property
 - Must complete Form 8283, Section B
 - c. If they claim a deduction for noncash property worth >\$500,000
 - Must also attach the qualified appraisal to the return
 - d. Donated cars are different
4. Stock gifts - Maintain a brokerage account, transfer stocks to the account, with instructions to liquidate immediately.

II - Unrelated Business Income

Unrelated business income – Does not further the exempt purpose of the organization. The activity must meet these three criteria:

1. The activity must be a trade or business;
2. The trade or business must be regularly carried on – consider the frequency of activity compared to the for-profit businesses with which we compete; (Ex: Christmas card sales)
3. The trade or business (the income-generating activity) must not be substantially related to exempt purposes

Exceptions:

1. Substantially all the work is done by volunteers (85%)
2. The activity is conducted for the convenience of the members.
3. The trade or business involves selling merchandise substantially all of which was donated.
4. IRS code specifies that royalties, rents, capital gains, and interest and dividends ordinarily are not subject to the unrelated business income tax unless financed with borrowed money (“acquisition indebtedness”).

Other considerations:

1. Use of the funds is irrelevant
2. Expenses – direct and indirect
3. Net Operating losses – carry back 2 years, forward 20 years
4. A 990-T is required if there is more than \$1,000 in gross receipts, even if there is no tax after deductions. This is equivalent to a corporate income tax.
5. A 990-W may be required for estimated tax payments if the church owes more than \$500 per year in tax.
6. The commerciality doctrine – competition with existing businesses

Examples:

1. Before and after school care – if related to the church or church school, they meet exempt purpose requirements. Stand alone programs may not.
2. Rental income –
 - a. rents from real property are excluded in computing UBIT,
 - b. rents from personal property are not excluded
 - c. If the rental is mixed, no more than 10% from personal property. (10 – 50% break out personal property, over 50% all is considered personal property)

3. Building rentals
 - a. For-profit business / Not-for-profit business
 - b. Debt-free / Debt financed property
 - i. Debt/basis percentage
 - ii. Exceptions - the 85% rule / how to determine
 - iii. Exceptions – exempt purposes / convenience of members / use of volunteers / sale of donated items
4. Parking lot rentals
 - o Rental of spaces – UBI
 - o Rental of entire lot – not UBI
5. Neighborhood property rule – property purchased for future exempt use
 - o Contiguous or within one mile
 - o 10-year period (15 for churches)
 - o Removal of structures
 - o No leases of more than 5 years
 - o Change in intent
6. Bookstores / Coffee shops
7. Fund raising activities – sales / rummage sales / use of volunteers
8. Allowing others to sell on your property
 - a. Your youth group
 - b. Individuals – selling cookies once per month / donate proceeds to FMSC
9. Impact on tax exempt status, UBIT – substantial business
10. Partnerships and other business investments

UBI Impact on property tax exemption – in question....

Sales tax obligations:

- a. Definition of business activity
 - i. Bookstores / Coffee shops – collect if frequent
 - ii. Annual rummage sale - infrequent
- b. Frequency of conduct
 - i. Number of times per year for this activity
 - ii. Seems to suggest more than twice per month / 24 times per year.

Fundraising vs. unrelated business income

1. Sales of tangible personal property (including the sale of prepared food, candy, and soft drinks at the fund-raising event), and admission charges for sponsored fund-raising events, are exempt if:
 - a. All gross receipts are recorded as revenue on the books of the nonprofit; and
 - b. The entire proceeds, less the necessary expenses for the event, will be used solely and exclusively for charitable, religious, or educational purposes.
2. The exemption does not apply under the following circumstances
 - a. All gross receipts are taxable if fund-raising events exceed 24 days per year;
 - b. It does not apply to fund-raising events conducted on premises leased for more than five days but less than 30 days; and
 - c. The activities do not support the tax exempt purpose, or they do inure to the benefit of individuals.

III - Miscellaneous Tax Reminders

1. **Ensure the church's income tax withholding is paid!** We still see examples of trust fund penalties upheld against "responsible persons"- and that likely includes business administrators – for nonpayment by other church leaders
2. Make sure you are preparing 1099s for independent contractors providing services for your church.
3. If church operates a school, including a preschool, file form 5578 Annual Certification of Non-Discrimination for a Private School Exempt from Federal Income Tax.
4. File a TD F 90-22.1 if the church has control of a foreign bank account.

IV - Year-end Procedures Checklist – see additional handout

Record Retention – See "Record Keeping," Hammer, Church Law and Tax

From the July 30, 2010 Friday Epistle - The Evangelical Lutheran Church in America (ELCA) has great pages offering advice on records retention. Check 'em out at <http://www.elca.org> separately for Business Records, and for Programmatic Records.

V - IRS publications / other helpful resources www.irs.gov

Tax Topic 506 – Charitable contributions – good overall summary for members

Pub 526 – Charitable contributions

Pub 561 – Determining the value of donated property

Pub 1771 – Charitable contributions – substantiation and disclosure requirements.

Publication 598 – Tax on Unrelated Business Income of Exempt Organizations

Mn Rev Dep't Fact Sheet #132, Occasional Sales of Business Equipment and Goods

Hammer - Church and Clergy Tax Guide – Chapter 8 Charitable contributions;

Chapter 12B Unrelated business income