

The Nonprofit Advocate

Covering Legal Issues for Nonprofit Organizations



August 2009

Bricker & Eckler LLP

100 South Third Street
Columbus, Ohio 43215-4291

Phone 614 . 227 . 2300
Fax 614 . 227 . 2390
info@bricker.com
www.bricker.com

COLUMBUS | CLEVELAND
CINCINNATI-DAYTON

In this issue

Recent Developments

- **Public Charity Test Guidance Desired in Wake of Elimination of Advance Ruling Period**
- **Quick Hits**

This document has been prepared as a general reference document for informational purposes. The information contained herein is not intended to be and should not be construed as legal advice. Each circumstance should be considered and evaluated separately, and possibly with involvement of legal counsel.

Please contact Bricker & Eckler for permission to reprint this newsletter in part, or in its entirety.

Public Charity Test Guidance Desired in Wake of Elimination of Advance Ruling Period

Previously, new organizations with less than one-third public support could request a definitive public charity ruling on the basis of a “10 percent plus facts and circumstances” test at the time they filed Form 8734 (the support schedule for an advance ruling period). However, under recent guidance by the Internal Revenue Service, the advance ruling period and Form 8734 are eliminated, and organizations with less than one-third public support, as well as private foundations seeking reclassification as public charities, are unsure how to proceed. The American Bar Association (ABA) has called for the IRS to add additional examples illustrating the application of the “10 percent plus facts and circumstances test” exempt organizations can use to establish that they are publicly supported. The ABA also would like to see a revenue ruling issued providing examples of the application of the test.

Public Charity Classification

To be classified as a public charity, an organization must show that it has broad support from the general public, rather than getting its funding from just a small number of donors. One of the tests for determining public support is to show that one-third of its funding comes from individuals, corporate and foundation grants, and other public charities. Donations from any one source may not exceed 2 percent. A second test allows the organization to prove it is publicly supported by showing that donations that are considered to be acceptable come to more than 10 percent of the charity’s total revenue. Additionally, other criteria must be met, such as continuity in fundraising and a board of directors that is representative of the community.

Former Rules

Under former rules, organizations had some assurance that the IRS would not try to reclassify them as private foundations, as long as facts and circumstances presented to the IRS at the time of the filing of Form 8734 remained unchanged. Moreover, Form 8734 could be used to seek reclassification as a public charity from inception, providing for a refund of any private foundation taxes previously imposed, in cases in which an organization mistakenly applied for recognition of exemption as a private foundation while consistently meeting the public support test.

Temporary Rules

Temporary and proposed rules (T.D. 9423) implemented the redesigned Form 990 and eliminated the advance ruling period for new exempt organizations. While the temporary rules considered that an organization might seek a ruling or determination letter on public charity status at any time, they fail to describe the process for requesting the ruling or determination letter. In question is whether an organization seeking a determination letter will be required to submit a formal private letter ruling request and pay the substantial user fee.

New Accounting Method

Another change under the temporary rules requires that organizations calculate their public support by using their normal method of accounting rather than the cash method. Public support is determined over a five-year period consisting of the current year and the prior four years. Thus, the change requires accrual

method organizations to recalculate and report their public support for prior years 2004 through 2007 on the accrual method when they file their 2008 Forms 990. According to the ABA, this might affect the ability of some small and mid-size charitable organizations to qualify as publicly supported, particularly in the short term. Under the accrual method, the present value of a large multiyear grant is considered public support in the year the grant commitment is made whereas, under the cash method, it would be considered public support as the funds are received. The accrual method is not limited to large organiza-

tions. This could create the potential problem of organizations failing the public support test on the accrual method but meeting it using the cash method. Commentators have recommended extending the transition rule in the temporary regulations for one or two more years and expressly allowing organizations to continue to use the cash method for purposes of applying the transition rule.

If you have any questions, please contact Meredith K. Knueve at 614.227.4886 or mknueve@bricker.com.

Quick Hits

IRS Rules on Smaller Tax-Exempt e-Postcard Filing

The IRS has issued final rules (T.D. 9454) describing how tax-exempt organizations with gross annual receipts of less than \$25,000 are to electronically file the annual e-Postcard notification (Form 990-N) with the IRS, rather than the Form 990 or 990-EZ, which organizations with greater gross receipts must file. The Pension Protection Act of 2006 added Section 6033(i)(1) to the Code to require these charities and other tax-exempt organizations to annually notify the IRS of the following basic facts:

- Legal name of the organization;
- Names under which the organization operates or does business;
- Mailing address and website;
- Taxpayer identification number;
- Name and address of a principal officer; and
- Evidence of the continuing basis for the organization's exemption from regular filing requirements.

The IRS made no changes in response to the few public comments it had received on the temporary regulations, including one comment related to the creation of a de minimis rule to exempt an organization with gross receipts under a certain amount from filing the electronic notification. If an organization files a complete long Form 990 describing revenues, expenses and program service accomplishments, or the shorter Form 990-EZ, this would qualify for the electronic notification. The new rules on the e-Postcard became effective July 23. The e-Postcard is due on or before the 15th day of the fifth calendar month following the close of an organization's accounting period.

IRS Announcement on Switching Public Charity Classification

On August 10, the IRS released Announcement 2009-62, to provide procedures that a Code Section 509(a)(3) supporting organization may use to request a change in its public charity classification. This will apply to organizations that want to request a change in classification from a 509(a)(3) supporting organization to a 509(a)(1) or (a)(2) organization. A written request must be filed meeting certain criteria for a determination as to public charity status. The Announcement supersedes a 2006 announcement on the issue. Regulations issued in September 2008 implementing revisions of Form 990 change the public support computation period from the four years before the tested year to a five-year period that includes the tested year. The new regulations also change the accounting method for calculating public support. Pursuant to Announcement 2009-62, the IRS will no longer expedite classification changes unless the request satisfies criteria described in Rev. Proc. 2009-4. Organizations will receive a determination letter in response to their request for reclassification, and there is no user fee for the letter.

Proposed Rules Issued Giving Authority for Church Tax Inquiries

The Director of IRS Exempt Organizations (currently Lois Lerner) has been given the authority to sign off on church tax inquiries, according to proposed rules issued by the IRS on July 31. The guidance will replace references to IRS positions abolished by the IRS Restructuring and Reform Act of 1998. The update arose in light of the statutorily mandated IRS reorganization and the elimination of internal revenue regions. Under Code Section 7611, the IRS is permitted to begin an inquiry into whether a church qualifies for tax exemption, or whether

it has a liability for unrelated business income tax, only if “an appropriate high level Treasury official” first “reasonably believes,” on the basis of facts and circumstances, that the church may not be exempt under Section 501. This “official” was interpreted to mean an IRS regional commissioner or higher level official but, since these positions have been abolished, the Exempt Organizations Director may now sign off. Commentators and a Minnesota U.S. District Court continue to question whether the position is high-ranking enough to make the reasonable belief determination.

“Clunkers” Program Not Helping Charities

While the popular “Cash for Clunkers” program has been well-liked by car buyers looking for rebates of up to \$4,500 for trading in gas-guzzling vehicles for new fuel-efficient cars, charities which rely on vehicle donations for funding are receiving fewer cars and trucks. However, the cash-for-clunkers requirements are stringent, and this leaves some potential customers still donating to the charities. Goodwill Industries International Inc. receives approximately \$14.5 million from 28,000 vehicles donated annually to fund job training programs. Similarly, the National Kidney Foundation receives about 30,000 vehicle donations per year, accounting for 18 percent of the charity’s total revenue. The Foundation estimates a 10 to 15 percent decline due to the federal rebates.

House Bill Introduced on Exclusion of Partnership Debt from “Acquisition Indebtedness”

House Bill 3497 (Rep. Levin, D-Mich), introduced on July 31, would add a provision to the tax code stating that “acquisition indebtedness” for exempt organizations’ unrelated business taxable income purposes does not include debt incurred by a partnership in purchasing qualified securities or commodities. According to the bill text, the measure would provide that indebtedness incurred by a partnership in acquiring securities and commodities is not treated as acquisition indebtedness for purposes of determining the unrelated business taxable income of organizations that are partners with limited liability. Although Levin’s bill passed the House twice as part of two different alternative minimum tax packages, the AMT bill that eventually became law was stripped of the other language, including Levin’s. Levin believes that the bill will correct a problem that “unfairly forces our pension funds, universities and foundations offshore to make certain investments, and we should allow these institutions to bring their investments home.”

Nonprofit Organizations Group

Jerry O. Allen, Chair
614 . 227 . 8834
jallen@bricker.com

Sally W. Bloomfield
614 . 227 . 2368
sbloomfield@bricker.com

Mark R. Chilson
513 . 870 . 6570
mchilson@bricker.com

John F. Furniss III
614 . 227 . 8919
jfurniss@bricker.com

Allen R. Killworth
614 . 227 . 2334
akillworth@bricker.com

Kevin M. Kinross
614 . 227 . 8824
kkinross@bricker.com

Meredith K. Knueve
614 . 227 . 4886
mknueve@bricker.com

Richard S. Lovering
614 . 227 . 2307
rlovering@bricker.com

Daniel C. Reynolds
614 . 227 . 2360
dreynolds@bricker.com

Hope M. Sharett
614 . 227 . 8961
hsharett@bricker.com

Nellie M. So
614 . 227 . 4827
Nelso@bricker.com