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Nine Nuggets for Nonprofits

by Christopher C. Scarpa and Kristin M. McKenna

We know that following the latest nonprofit tax developments is important to your organization, but we also realize that your colleagues and you have many other things to do; so we've done the work for you. Here are the nine tax-related items from the second half of 2015 that we think you should know. We focused on IRS exempt organization activities and issues in Pennsylvania and New Jersey.

We wish all our readers the very best for this holiday season and a bright, happy and successful New Year.

1. **IRS Announces Penalty Relief for Educational Institutions**

The IRS announced that for 2012 through 2014, educational institutions will not face information return penalties for filing Forms 1098-T (Tuition Statement) with missing or incorrect taxpayer information numbers (TINs) (*available at* <https://www.irs.gov/uac/Newsroom/For-Colleges-and-Universities:-IRS-Waives-Penalties-for-Missing-or-Incorrect-Taxpayer-Identification-Numbers> and <https://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/IRS-to-Waive-Forms-5498-1098T-and-1099G-Penalties-for-the-Initial-Year-of-Introduction> for additional information). Legislation enacted earlier in 2015 had provided prospective penalty relief only. An educational institution that was previously assessed penalties for 2012 should have received a letter from the IRS advising of the penalty waiver. If an institution did not receive a letter, it should respond to the IRS using the original penalty assessment notice. The IRS is not assessing penalties for incorrect or missing TINs for tax years 2013 and 2014.

Educational institutions must provide a return to IRS and a statement to the student (Form 1098-T) stating, in part, the amount paid by or billed to the student for qualified tuition and related expenses for the tax year. The form requires the educational institution to include the student's TIN. The form is used by a taxpayer in connection with claiming education-related tax credits (e.g., the American Opportunity Tax Credit and the Lifetime Learning Credit) or an above-the-line deduction for tax years beginning before Jan. 1 for qualified tuition and related expenses. Section 6721 (section references are to the Internal Revenue Code of 1986, as amended) imposes penalties for not properly and completely preparing correct information returns, including Form 1098-T.

Effective for returns required to be made and statements required to be furnished after Dec. 31, the Trade Preference Extension Act of 2015 (TPEA) waives the penalty for educational institutions that fail to file Forms 1098-T with accurate TINs of students attending the educational institution if the institution certifies, under penalty of perjury, that it properly requested TINs from the students. However, the penalty relief provided for under TPEA did not provide educational institutions with penalty relief for earlier years.

2. Final Regulations Address Good Faith Determinations for Grants to Foreign Organizations

The IRS has published final regulations (TD 9740 at <https://www.gpo.gov/fdsys/pkg/FR-2015-09-25/html/2015-24346.htm>) that provide guidance regarding the standards for making a good faith determination that a foreign organization is a charitable organization that is not a private foundation, so that grants made to that foreign organization may be qualifying distributions and not taxable expenditures.

The final regulations are intended to balance two important considerations: (1) removing barriers to international grantmaking by foundations (as well as by entities treated like foundations for these purposes) and (2) ensuring that foundations' good faith determinations are informed by a sufficient understanding of the applicable law, are based on all relevant factual information and are likely to be correct.

A foundation generally may treat grants made for charitable purposes to certain foreign organizations as qualifying distributions under Section 4942 if the foundation makes a good faith determination that the foreign organization is a "public charity" that is not a "disqualified supporting organization," or is an "operating foundation" or a "private operating foundation." Similarly, foundations may treat grants for charitable purposes to certain foreign organizations as other than taxable expenditures under Section 4945 without having to exercise expenditure responsibility if the foundation makes a good faith determination that the foreign organization is a public charity (other than a disqualified supporting organization) or is an "exempt operating foundation." Long-standing regulations under Sections 4942 and 4945 and Revenue Procedure 92-94, 1992-2 CB 507 (https://www.irs.gov/pub/irs-tege/rp_1992-94.pdf) provide rules on how a foundation can ordinarily make a good faith determination.

Consistent with proposed regulations issued in 2012 (REG-134974-12 available at https://www.irs.gov/irb/2012-47_IRB/ar07.html) and public comments, the final regulations modify the rules in the regulations to Sections 4942 and 4945 to expand the class of advisors providing written advice on which foundations may ordinarily rely in making good faith determinations to "qualified tax practitioners," including CPAs and enrolled agents (as well as attorneys) who are subject to the standards of practice before the IRS set out in Circular 230. Further, foundations may not rely solely on the opinion of foreign counsel for a determination of the foreign organization's status unless the foreign counsel is a qualified tax practitioner. Additionally, under the final regulations, a good faith determination can no longer be made solely on a grantee affidavit that attests that the foreign organization



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would qualify as a public charity or an operating foundation. The final regulations also provide that the written advice of a qualified tax practitioner serving as the basis for a good faith determination pursuant to the regulations under Sections 4942 and 4945 must be "current," *i.e.*, as of the date of the distribution, the relevant law on which the advice was based has not changed since the date of the written advice and the factual information on which the advice was based is from the organization's current or prior year. However, written advice that an organization satisfied the public support requirements under Section 170(b)(1)(A)(vi) or Section 509(a)(2) based on support over a test period of five years will be treated as current for the two years of the grantee immediately following the end of the five-year test period.

Treasury and the IRS have provided a 90-day transition period during which foundations may distribute grants in accordance with the former regulations regarding the use of grantee affidavits and opinions of counsel of the grantor or grantee. In addition, under the final regulations, if a grant is distributed pursuant to a written commitment made prior to Sept. 25, 2015, and the grantor made a determination in good faith based on the prior regulations, the distribution is treated as compliant as long as the grant is paid out to the grantee within five years.

The IRS intends to update Revenue Procedure 92-94 to reflect changes implemented by the final regulations. The final regulations apply generally to distributions made after Sept. 25, 2015.

3. IRS Tax-Exempt and Government Entities Division Releases Areas of Focus

The IRS Tax-Exempt and Government Entities Division has released its priorities list for fiscal year 2016 (available at https://www.irs.gov/pub/irs-tege/TEGE_Priorities_for_FY2016.pdf). The release indicates that TE/GE will focus on, in part, simplifying tax forms and improving their digital capabilities, evaluating possible improvements to the Form

1023-EZ process and targeting examinations on likely areas of noncompliance (such as tax-exempt bonds and possible investment limitation violations, Section 403(b)/457(b) plans, private inurement and excess benefit transactions, and unrelated business income tax).

4. IRS Rules LLC's Employees May Be Included in Member Organization's 403(b) Plan

The IRS issued Private Letter Ruling 201539031 holding that employees of a single-member limited liability company that is a disregarded entity under Section 7701 will be treated as employees of the LLC's single member, which is a Section 501(c)(3) organization, and thus is eligible to participate in the Section 403(b) plan maintained by the organization.

5. Music Ministry Loses Exemption

In Private Letter Ruling 201534014 (*available at* <https://www.irs.gov/pub/irs-wd/201534014.pdf>), the IRS revoked the tax-exempt status of a Christian music ministry after finding that the organization had paid the personal expenses of its president, which constituted private inurement, a prohibited act under Section 501(c)(3).

6. Child Care Provider Loses Exemption

In Private Letter Ruling 201534016 (*available at* <https://www.irs.gov/pub/irs-wd/201534016.pdf>), the IRS revoked the tax-exempt status of an organization established to provide child care to low-income families after finding that the organization was no longer providing such care. Rather, the organization opened a resale store offering upscale home furnishings to support its mission and goals.

7. PA Commonwealth Court Issues Opinion Denying Real Estate Tax Exemption

In *ARC Human Services, Inc. v. Clearfield Cty. Assessment Office and Tax Bureau, et al.*, Pa. Commw. Ct., Dkt. Nos. 1155 C.D. 2014; 1156 C.D. 2014; 1157 C.D. 2014, 07/13/15, the Commonwealth Court found that the trial court properly determined that the taxpayer, an operator of group homes for intellectually disabled persons, was not entitled to tax exemption on three parcels of real estate. The taxpayer argued that it was entitled to such exemption because it was an institution of purely public charity and the parcels were used for charitable purposes. However, the trial court determined that the taxpayer failed to satisfy the criteria for establishing itself as an institution of purely public charity under *Hospital Utilization Project v. Commw.*, 507 Pa 1, 487 A2d 1306 (HUP). In part, the court focused on the fact

that the taxpayer's evidence indicated that only a negligible portion of its costs of operating were from charitable contributions.

8. NJ Tax Court Upholds Denial of Real Estate Tax Exemption to Nonprofit Hospital

In *AHS Hospital Corp. d/b/a Morristown Memorial Hospital v. Town of Morristown*, the New Jersey Tax Court upheld the decision of the Town of Morristown to withdraw the real property tax exemption of Morristown Memorial Hospital (a member of the Atlantic Health Care System). Morristown rejected Morristown Memorial Hospital's claims for property tax exemptions for tax years 2006 through 2008. Although the Tax Court concluded that almost all of the hospital's property was being used for hospital use (an exempt purpose), the Tax Court focused on whether the health care activities at the hospital were being conducted for profit. The Tax Court found that the hospital maintained relationships with a number of affiliated and unaffiliated for-profit entities and owned all the stock in several for-profit physician practices. The hospital provided loans to the practices, and the employees of the practices were employees of the hospital. Based on these facts and others, the Tax Court stated, "By entangling its activities and operations with those of for-profit entities, the Hospital allowed its property to be used for a profit. This commingling of effort and activities with for-profit entities was significant, and a substantial benefit was conferred upon for-profit entities as a result."

9. New Jersey Superior Court Denies LLC Tax-Exempt Status

The New Jersey Superior Court, Appellate Division, in *1785 Swarthmore, LLC v. Township of Lakewood, N.J.* Super. Ct., App. Div., Dkt. No. A-4701-13T4, 10/28/2015, affirmed the New Jersey Tax Court's oral ruling that an LLC property owner was not entitled to an exemption from local property taxes as a nonprofit organization. The LLC held record title to property that was leased to a religious school. As such, the LLC satisfied the second and third prongs of the three-prong test to obtain exempt status. However, the LLC did not satisfy the first prong, requiring "the property owner be organized exclusively for the tax-exempt purpose," because the LLC had effectively been formed for any purpose under the LLC statutory scheme, and not specifically organized for a tax-exempt purpose.