

# New and Enhanced Sources of Publicly Available Information about Nonprofits May Lead to Increased Exemption Challenges by State and Local Governments

January 02, 2009

Tax-exempt organizations with gross receipts of more than \$25,000 are now required to file the new Form 990 so many organizations have just filed their first revised return or recently filed extension requests. The new return is viewed by the Internal Revenue Service as both a tool for information gathering and an opportunity to educate organizations and their donors on the requirements for maintaining tax-exempt status. The new rules will benefit nonprofit organizations because the annual organizational “soul searching” required to respond to the detailed questions contained on the form and schedules will help to keep the organization’s management and volunteer leaders focused on the organization’s obligations under the law. An organization that is able to provide the “right” answers to the many detailed questions regarding “conflict of interest” policies and compensation will also be more able to protect its “insiders” from drastic penalties (“intermediate sanctions”) for inadvertently inappropriate transactions. Of course, small tax-exempt organizations whose annual gross receipts are normally \$25,000 or less, may electronically submit Form 990-N, also known as the e-Postcard, unless they opt to file the complete Form 990 or Form 990-EZ.

While the goals of transparency and accountability are likely to be served by the new Form 990, the availability of this information to state and local taxing agencies should cause organizations to consider undertaking a quick review to ensure that they are compliant with state and local tax exemption rules. The new Form 990 requires an organization to report information much more extensively than in the past, and, when combined with the mandatory public disclosures under IRC § 6104(d) this has resulted in new and enhanced sources of publicly available information about nonprofits at a time when state and local governments are becoming increasingly aggressive in challenging exemptions. While most of this activity has taken place in the property tax area and has involved hospitals, nursing homes, residential housing for the elderly and affordable housing charities for the poor, sales and use tax exemptions have also been challenged in states that provide a general exemption for nonprofits. Further, although many states automatically grant state income tax exemption based on a federal determination of exemption, applicable statutes in other states have state-specific rules for granting exemption from income tax. The 2006 Pension Protection Act authorized the IRS to disclose to State taxing agencies certain

proposed actions with respect to nonprofit organizations including when the IRS issues a notice of proposed deficiency with respect to certain taxes, a notice of proposed refusal to recognize exemption, a notice of proposed revocation of exemption and the names and identifying information of taxpayers who have applied for exemption as well as returns and return information for organizations to which any of the foregoing apply. Nevertheless, most of the recent litigation involving exemption challenges has involved denial of property tax exemptions by local governments for organizations that are considered tax-exempt for both federal and state income tax purposes.

### **New and Enhanced Reporting and Disclosure Requirements**

In the last few years, nonprofits have become much more transparent – both with respect to their exempt income and their non-exempt income. Although an exempt organization that receives gross income of \$1,000 or more from all of its unrelated trades or businesses must report that income (all of its UBTI) and related expenses on one Form 990-T, as a result of the 2006 Pension Protection Act, Forms 990T are now required to be made public. Further, the new Form 990 changes the threshold amounts for reporting compensation which must now be reported on a calendar year basis. It also requires greater disclosure of disposition of assets and has added key employees to the list of persons who must be reported.

Hospitals around the country have found themselves particularly vulnerable to exemption challenges as a result of billing and collection practices and flexible federal standards for when a hospital is considered to be sufficiently benefiting the community as compared to for-profit hospitals, so as to merit exemption from tax. The new Form 990 contains “Schedule H” for hospitals which requires the disclosure of significant additional information to the IRS. The IRS has indicated that it plans to use this information to create standards for use in determining the extent to which bad debt, Medicare shortfalls, and community building should be considered when determining whether the organization has satisfied the community benefit standard.

Nonprofit organizations may be required to have audited financial statements in a number of situations including where the organization has issued tax-exempt bonds or if it receives federal funds or in those states in which organizations are required to register before making solicitations and must file audited financial statements as part of the registration process. FIN 48 may require the reporting of any activity which would impact an organization’s tax-exempt status on those financial statements. The new Form 990 requires an organization to “Provide the text of the footnote to the organization’s financial statements that reports the organization’s liability for uncertain tax positions under FIN 48.” Since the Form 990 becomes a publicly available document, the disclosure of the tax risk, as required by FIN 48, becomes available to all.

**Important to Note:** Although an organization is required to make its returns, including schedules and attachments, available to the public, exempt organizations other than private foundations are not required to disclose the names and addresses of contributors and so organizations should make sure that employees know to redact identifying information regarding donors from Schedule B before making the returns and return information public. Any required public disclosures may be made by the organization strictly on request or by publishing it on a website. The tax returns of many nonprofit organizations are available on [www.guidestar.org](http://www.guidestar.org).

### **Increased Scrutiny by State and Local Authorities**

The availability of all of this information is perhaps one reason for an increase in activity on the part of local governments questioning property tax exemptions afforded to nonprofit organizations. The availability of property tax exemptions to nonprofit hospitals is based on the hospital's satisfaction of a facts and circumstances "community benefit" test. The additional information now required to be reported and made public by hospitals on Schedule H of the new Form 990 will give state and local tax authorities new sources of information to determine a hospital's satisfaction of this test.

Similarly, local governments have been increasingly challenging property tax exemptions and even sales tax exemptions for charities that provide housing for the elderly. Likewise, in Louisiana and elsewhere, affordable housing projects and particularly mixed-income developments (that include units rented to tenants who do not strictly qualify as low income under federal guidelines) have been having their exemption for property taxes challenged.

This new transparency is undoubtedly a good thing for tax-exempt organizations, their volunteers and employees, the altruistically-minded and the public, in general. Nevertheless, in order to protect the organization's budget and ability to fulfill its mission, the organization's leadership would be wise to include a quick review of the organization's compliance with state and local tax rules in addition to federal tax concerns.