



## ***Council Tax-Exempt Status Workshop***

**Purpose:** To review the requirements for securing and maintaining Internal Revenue Service Section 501(c)(3) tax-exempt status for a Navy League council.

**Learning Objectives:**

1. To review the process for requesting tax-exempt status with the Internal Revenue Service as a Section 501(c)(3) organization.
2. To identify the requirements for maintaining tax-exempt status, using IRS Publication 4221 "Compliance Guide for 501(c)(3) Tax-Exempt Organizations".
3. To discuss council-specific examples relevant to the IRS Guide.
4. To develop a council action plan for achieving compliance.

- Agenda:**
1. Review the process for requesting IRS tax-exempt status as an individual organization and under the NLUS Group exemption.
  2. Discuss the benefits and responsibilities of tax-exempt status under section 501(c)(3).
  3. Review requirements to maintain 501(c)(3) tax-exempt status:
    - Records required;
    - Accounting procedures;
    - Tax reports; and
    - Disclosures required.
  4. Discuss council-specific examples of requirements (items 2 and 3).
  5. Finalize action plans.

**Limit:** 1 Hour

## ***Tax Exemption - An Overview***

The Navy League of the United States recommends that all councils maintain Internal Revenue Service (IRS) tax exemption as an education organization under section 501(c)(3).

### ***Why?***

***A council without an exemption must file a tax return as a business and pay corporate taxes on all council income. Furthermore, donations to the council by any business or individual are not tax deductible.***

In 1990 the Navy League of the United States established a group tax exemption program with the Internal Revenue Service that enables a council to qualify as a 501(c)(3) tax-exempt organization. Alternatively, many councils have received an individual exemption by applying to the Internal Revenue Service using **IRS Form 1023**.

Councils receiving a determination letter, either from the Internal Revenue Service (individual exemption) or from the Navy League Senior Director of Finance (group exemption), certifying them as a tax-exempt organization must follow certain procedures to maintain their tax-exempt status. Complete procedures are described in **IRS Publication 557** "Tax-Exempt Status for Your Organization". In addition, the IRS offers a one-day Exempt Organizations Workshop that utilizes **IRS Form 4221** "Compliance Guide for 501(c)(3) Tax-Exempt Organizations". Together, these documents provide the foundation for this workshop.

***Note that under the Navy League Group Exemption program each participating council must file a tax return based upon the gross receipts and assets of the council, as described below.***

Finally, we are interested in your questions and concerns and will make every effort to get a definitive answer for each. The last element of this workshop is to develop an action plan to respond to the needs identified.

### ***Requesting Tax Exempt Status***

The Navy League Operations Manual, pages 71-73, describes the process for applying to join the Navy League Group Exemption. A summary of these pages and the IRS instructions for applying for an Employee Identification Number (EIN) using Form SS4 are included with this workshop and will be briefly reviewed. *This workshop does not review the process for requesting an individual tax-exemption. The instructions are included with the IRS Form 1023 package.*

Applications to join the NLUS Group Exemption are made to the Senior Director of Finance. The following documents, described in the Operation Manual, must be included with the application:

- A letter requesting inclusion in the group exemption;
- A copy of the Council Bylaws and Articles of Incorporation - the council name must follow the following protocol: "Navy League of the United States \_\_\_\_\_ Council" (**Note 1:** *councils adopting the Sample Bylaws in the Operations Manual are cautioned to complete the blank spaces for council name, council dues date - Article II, Section 2 - and the quorum requirement - Article VII, Section 2; and Note 2: Sample documents in the Operations Manual are for guidance only - however, each element should be included in your council's adopted Bylaws and Articles*);
- Notification of the council's permanent address, which must be either a Post Office Box number (preferred) or a permanent office address;
- A brief description of the council's activities (the last Annual Report will suffice if Part II is completed);
- A copy of the last year-end financial report - the council must be on a December 31 accounting period (the last Annual Report will suffice with an audited report preferred);
- The council Employer Identification Number (**Note:** *an EIN is required even though a council has no employees*); and
- A copy of the council board resolution relinquishing any previously-issued individual tax exemption, if applicable.

The submitted package of documents is reviewed to verify that your council's activities are aligned with the charitable purpose of the Navy League. Satisfactory review should result in approval of your request; concerns will be resolved before approval is granted. Approval of an application for tax-exempt status is complete when the council receives a group

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*determination letter.* For a group exemption, the Senior Director of Finance signs the group determination letter; attached to group determination letter is the group exemption number (GEN) document and a copy of the Navy League HQ group determination letter. The IRS District Director normally signs an individual determination letter. **Your determination letter documents your tax-exempt status and should be kept as a permanent record of your council!**

### ***Benefits/Responsibilities of Tax Exempt Status***

As a tax-exempt organization, the following benefits accrue to your council:

- Revenues are not taxable as income unless your council generates unrelated business income (discussed below);
- Donations to your council are deductible on the donor's tax return;
- Your council may apply for a non-profit bulk mailing indicia with the U.S. Postal Service (USPS Publication 417 "Nonprofit Standard Mail Eligibility" applies);
- You may be eligible for sales-tax exemption for the state in which your council is incorporated (*state laws must be researched by the council - not all states exempt meals and hotel taxes, for example; National HQ does not maintain records of state laws for non-profits*).

As a tax-exempt organization, your council must assume the following responsibilities (**Note:** Councils should seek competent professional counsel for specific questions concerning interpretation of these responsibilities):

- Your council must file a tax return annually. If your council currently has gross receipts of less than \$25,000, a Form 990N, (e-Postcard return) must be filed electronically. This gross receipts limit will increase to \$50,000 in tax year 2010. If your council has gross receipts exceeding \$25,000 in any year (until 2010), a Form 990 "Return of Organization Exempt From Income Tax" must be filed by May 15<sup>th</sup> of the following year. If gross receipts are less than \$200,000 and council assets are less than \$500,000, form 990EZ may be used. Gross receipts include donations and the gross proceeds from activities and events. **Note: Higher limits for gross receipts and assets apply in tax years 2008 and 2009 (see handout).**
- If your council generates unrelated business income in excess of \$1000 in any year, a Form 990-T "Exempt Organization Business Income Tax Return" must be filed by

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May 15<sup>th</sup> of the following year with a payment for taxes due. The following quotes are from the IRS article Unrelated Business Income Tax (UBIT) - General Rules:

*"An activity will be considered an unrelated business (and subject to UBIT) if it meets the following three requirements: (1) it is a trade or business (i.e. selling goods or providing services), (2) it is regularly carried on, and (3) it is not substantially related to the furtherance of the exempt purpose of the organization"; and*

*"The activities that generate the income must contribute importantly to the accomplishment of the organization's exempt purposes to be substantially related".*

- If your council has employees (full or part-time) receiving more than \$100 annually, the Federal Insurance Contributions Act - FICA requires that social security and Medicare taxes must be paid by the council using Form 941 "Employer's Quarterly Federal Tax Return" (see Form 941 instructions and Publication 15 "Circular E, Employer's Tax Guide" for details). Federal Unemployment tax (FUTA) payments are not required for 501(c)(3) organizations.
- You must notify the IRS if there is any change in the purposes, character or method of operation of you council and any change in the name or address of your council. **For group exemption councils**, notify the Senior Director of Finance of these changes (*especially Post Office Box number changes*), which will then be communicated to the IRS. All changes to the Articles and/or Bylaws for your council must also be sent to the Senior Director of Finance.

### ***Maintaining Tax Exempt Status***

To maintain its' tax-exempt status, a council must maintain certain records, file tax returns, and meet federal and state disclosure requirements.

**A. Records.** Each council with a tax exemption should maintain the following records to demonstrate their compliance with tax rules:

- Original Articles and Bylaws, with subsequent amendments - permanent record
- Original application and determination letter - permanent record
- Copies of all tax returns - permanent record

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- Backup documentation, including financial statements, bank records, accounting journals & ledgers (record of transactions), receipts for sources of revenue (rebates, council dues, donations, fund-raisers, event proceeds, royalties, interest on funds), donor letters for cumulative donations over \$250 in the same tax year, copies of receipts for donations of less than \$250, authorized expenditures, related correspondence, annual budgets, audit/review reports, minutes of Board meetings, council annual reports - three years past the latest date that the tax return was due (May 15<sup>th</sup>), filed or amended (minimum).
- Payroll and employment tax records, including Form 1099-MISC - four years past the latest date that the tax return was filed or amended.
- Records for owned assets (property, investments, furniture, office equipment) to include:
  - ✓ When & how asset was acquired
  - ✓ Whether any debt was used to acquire the asset
  - ✓ Purchase price
  - ✓ Cost of improvements
  - ✓ Depreciation deductions, if any
  - ✓ Casualty loss deductions, if any
  - ✓ How the asset was used
  - ✓ When and how the asset was disposed of
  - ✓ Selling price
  - ✓ Expense of sale

Asset records must be retained for the life of the asset +3 years.

**B. Accounting Procedures.** Navy League councils under the group exemption must use a December 31 (calendar year-end) accounting period. Councils with individual exemptions may be on a fiscal tax year or calendar tax year. The council must also select an accounting method - basically *cash* or *accrual*. Under the *cash method* all receipts and expenditures are recorded in the tax year of their occurrence. Under the accrual method, receipts and expenditures are recorded for the tax year incurred (i.e. an event, such as a ship commissioning, which may extend through more than one tax year), regardless of the year received or paid. Publication 538 "Accounting Periods and Methods" has guidance for accounting procedures.

**C. Tax Reports.** Requirements for filing tax reports are summarized below:

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- Form 990N (ePostcard) - Exempt councils with gross receipts less than \$25,000 until 2010, then \$50,000 (filed electronically).
- Form 990 EZ and Schedules A, B, C, E, G, L and N - Exempt councils with gross receipts of \$25,000, but not exceeding \$100,000, and total assets are less than \$250,000.
- Form 990 and Schedules A through R - Exempt councils with gross receipts of \$200,000 or total assets over \$500,000. *Transition rules apply for tax years 2008 and 2008 (see handout).*
- Form 990-T - Exempt councils with unrelated business income of \$1000 or more in any year. Quarterly estimated tax payments must be filed if the total tax for the year is estimated to be \$500 or more. Publication 598 "Tax on Unrelated Business Income of Exempt Organizations" has details for this report, including a worksheet to estimate taxes due.
- Form 941 and 1099-MISC - Councils with employees must withhold, deposit and pay all employment taxes, including federal income taxes, state income taxes, social security and Medicare (FICA) taxes. Payments are recorded on Form 941 "Employer's Quarterly Federal Tax Return". Independent contractors receiving more than \$600 in any year from a council must receive a 1099-MISC by February 15th, which is also filed with the IRS. Publication 15 "Circular E, Employer's Tax Guide" and Publication 15A "Employer's Supplemental Tax Guide" provide additional information on employment tax returns.
- **Penalties** - The IRS may assess penalties of \$20 per day for failure to file required tax returns, or for failure to provide complete, correct information in the return. The penalty may not exceed \$10,000 or 5% of the exempt organization's gross receipts for the tax year in question. Officers may be held accountable to pay employment taxes due and may be penalized for failure to file tax returns. Councils that fail to file a tax return can have their tax-exemption suspended or revoked.

**D. Disclosures.** Disclosure requirements are detailed in Publication 557 "Tax-Exempt Status for Your Organization". In general, tax-exempt organizations must publicly disclose their exemption application (Form 1023 or application to NLUS for group exemption) and determination letter, Form 990/Form 990EZ tax returns, including all Schedules **except Schedule B** (list of donors). Exempt councils are also required to provide *written acknowledgement for donations of \$250 or more* and must provide

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disclosure of the value of any goods or services provided (not deductible) for combined payments (donation plus goods/services) in excess of \$75. Donors may not take deductions for donations that have not been acknowledged and/or disclosed as described above. Councils must also provide receipts for any individual donations if requested by the donor; copies of these receipts should be retained. Publication 1771 "Charitable Contributions - Substantiation and Disclosure Requirements" provides details on these tax rules.



**Exercise**

**Purpose:** To prepare a list of action items to confirm your council has a legitimate tax exemption and is following the rules for record keeping, reporting and disclosure.

- Action:**
1. Locate your council's permanent records -
    - Original Articles, Bylaws and all subsequent amendments
    - Application for tax-exempt status and determination letter received
  2. Review your council's gross receipts to determine whether your gross receipts are \$25,000 or more. Confirm tax returns (Form 990/990EZ/990N) have been filed based upon gross receipts and assets. Take action to file returns, as required.
  3. Review your council's unrelated business income to determine whether your income exceeds \$1000 in any year. Confirm Form 990-T has been filed for each year above \$1000.
  4. Review employment records for full or part-time employees and independent contractors paid more than \$600. Confirm payroll taxes are paid for employees and Form 1099-MISC filed, as appropriate, for independent contractors.
  5. Review donor acknowledgement letters and receipts to ensure they comply with the federal tax laws.
  6. Review your council's record keeping requirements:
    - Payroll records retained for four years after tax return was filed, or four years total if no tax return is required.
    - Backup documentation for each tax return is kept for three years past the latest filing date or amendment.
    - Records for owned assets are kept for three years past the date of disposition for each asset.
    - Copies of all tax returns filed are kept as a permanent record.
  7. Complete the matrix on the next page.

**Council Tax-Exempt Status Matrix**

<b><u>Requirement</u></b>	<b><u>Record Location</u></b>	<b><u>Compliance?</u></b>	<b><u>New Action Required</u></b>
Original Articles, Bylaws, tax exemption application, determination letter (Item 1, above)	Articles - Bylaws - Application - Determination letter -		
Gross receipts (Item 2, above)	2006 2007 2008		
Unrelated business income (Item 3, above)	2006 2007 2008		
Employment records - Form 941 and Form 1099-MISC (Item 4, above)	2006 2007 2008		
Acknowledgement letters and receipts (Item 5, above)	2006 2007 2008		
Records retention (Item 6, above)	Payroll records - Tax return backup - Owned assets - Tax returns -		

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8. *Prepare an action plan to achieve conformance to the requirements detailed in this workshop.*

<i><b>What action is needed?</b></i>	<i><b>Who will complete this action?</b></i>	<i><b>Is Board approval required?</b></i>	<i><b>When will action be completed?</b></i>	<i><b>Remarks</b></i>

9. *Schedule a follow-up meeting to review progress and complete the final list.*

***Limit:*** *This exercise may take up to one day.*

**Final Note:** We strongly suggest your council obtain tax and legal advice from a professional who knows both federal and state non-profit law. This workshop is intended to raise awareness and provide guidance only.

***Thank You and Good luck!***