2024
National Income Tax
Workbook

Chapter 5: Business Entity
Tax Issues

Land Grant University
Tax Education Foundation

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**Chapter Issues
P 145**

- 🏛 Pass-Through Entity Tax
- 🤝 Beneficial Ownership Interest Reporting
- ✴ I.R.C. §501(c)(3) Charitable Organizations, Maintaining Tax-Exempt Status
- 💵 Change in Tax-Exempt Status
- 👥 Electing Out of the Centralized Partnership Audit Regime

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**Learning
Objectives
P 145**

- 💵 Understand the federal tax treatment of pass-through entity payments of state and local tax
- $ Know when a refund of pass-through entity credits may be included in income under the tax benefit rule
- ✓ Understand the FinCEN beneficial ownership interest reporting requirements
- 👤 Recognize the actions that can jeopardize the tax-exempt status of an I.R.C. 501(c)(3) organization

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Learning Objectives P 145

- Explain how an I.R.C. §501(c)(3) organization can change its tax-exempt status to a different §501(c) organization

- Understand what partnerships are eligible to elect out of the centralized partnership audit regime

- Know the advantages and disadvantages of electing out of the centralized partnership audit regime

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Introduction P 146

- State laws allow pass-through entities to pay state & local taxes at the entity level
  - Deduction is taken at the federal-level with corresponding or offset at the owner-level
  - Discussion of I.R.C. §111, tax benefit rule
- Corporate Transparency Act (CTA)[87 F.R. 59498] – prevent & combat money laundering, terrorist financing, corruption, tax fraud and other illicit activity
  - Discussion of filing requirements
  - Beneficial Owner
  - Non-compliance
- Issues of Tax-Exempt organization compliance and loss of status is increasingly more common
- New revenue procedures that allows an exempt organization to change its designation is provided.
- Electing out of the centralized partnership regime is reviewed.

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Issue 1

Pass-Through entity tax

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Tax Cuts & Jobs Act P 147

Limited limit on state & local taxes on Schedule A, itemized deduction

$ 10,000 for all filing statuses exempt MJS ($ 5,000)

State & local taxes (SALT) include:

- Personal property tax
- Income tax
- War profits and excess profits
- General sales tax

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Tax Cuts & Jobs Act of 2017   P 147

- I.R.C. §164(b)(6) – taxes imposed at the entity level, that are reflected on Schedule K-1 (or similar) will reduce the recipients distributive or pro rata share of income
- 36 states have passed a SALT "work around"

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Mechanics of State Pass-Through Entity Tax (PTET) P 147

- Partnership or S Corp pays the tax & deducts it
- The entity passes it through to its partners or shareholders on their Schedule K-1
  - Reducing adjusted gross income (AGI)
- Partners or owners received a credit/offset against their state tax liability

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Slide 10

Mechanics of State Pass-Through Entity Tax (PTET) P 147

- Notice 2020-75, 2020-49, I.R.B. 1453 – intent to issue proposed regs
  - Separately state taxable income/loss are not subject to SALT limitations
  - Specified income tax payments (SITP) – as any amount paid by a partnership or an S corporation to a state, a political subdivision of a state, or the District of Columbia
    - satisfies its income tax liability imposed by the domestic jurisdiction on the partnership or the S corporation.

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Slide 11

Notice 2020-75 P 147 & 148

- PTE makes an SITP during a tax year,
- PTE can deduct the SITP when computing its taxable income for the tax year in which the payment is made.
- Partners and S corporation shareholders receive a federal deduction for these entity-level payments,
- Benefit that is similar to what was provided to PTE owners before the SALT limitation was enacted.

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Slide 12

Notice 2020-75 P 147 & 148

- I.R.C. § 164(b)(2) -- a tax imposed by a state, a possession of the United States, or a political sub- division of any of the foregoing, or by the District of Columbia
- Deduction by a partnership is not disallowed under I.R.C. § 703(a)(2) (B),
- I.R.C. § 1363(b)(2) -- Income taxes for which a deduction by an S corporation is not disallowed (deductions for taxes paid to foreign countries or possessions).

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Notice
2020-75
P 147 &
148

Does not differentiate between the character of the income (i.e., capital or ordinary)

Does not specify that the payment must be for trade or business activities versus for investment activities.

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Notice
2020-75
P 147 &
148

Not-separately stated item

I.R.C. § 702 or 1366 -- determining the PTE owner's own federal income tax liability for the tax year.

Schedule K-1 reporting of a partners, or an S corporation shareholder's distributive or pro rata share of non–separately stated income or loss

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Notice
2020-75
P 147 &
148

Example 5.1 – Deduction of PTET Payment

Any SITP made by a PTE is not taken into account in applying the SALT deduction limitation

Example 5.2 – PTET Payment Does Not Reduce Itemized Deductions

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Practitioner Note
P 148

- Notice 2020-75 was issued in November 2020, but the proposed regulations have not yet been published.
- AICPA requesting Additional Guidance
- Forthcoming Regulations Regarding the Deductibility of Payments by Partnerships and S Corporations for Certain State and Local Income Taxes
- §163 and S469 Regarding Nonpassive vs. Passive Income and Interest Expense Tracing (March 6, 2023).

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Tax Benefit Rule — P 149

I.R.C. §111 – refundable PTE tax credits may be includable in income tax	Include recovered losses, credits, or deductions only if the amounts claimed in a prior year provided a tax benefit.	Tax year originally included on a tax return if it reduces the tax liability for that or any other year.
Itemized deductions give rise to a tax benefit because they reduce tax liability.	A net operating loss (NOL) that can be carried over creates a tax benefit in the original tax year of the NOL.	I.R.C. §111(b)(3) does not apply to • Investment tax credit • Foreign tax credit

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Tax Benefit Rule — P 149

- Example 5.3 – State Tax Refund Included in Income
  - Figure 5.1 – Portion of Refund Included in Cheyenne's Income
- Example 5.4 – Refund Not Included in Income

FIGURE 5.1
Portion of Refund Included in Cheyenne's Income

Tax Item	2024 Itemized Deduction	2024 Standard Deduction	Difference
Adjusted gross income	$250,000	$250,000	$ 0
Itemized or standard deduction	(16,000)	(14,600)	1,400
Taxable income	$234,000	$235,400	$1,400

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Tax Benefit Rule — P 150

- Cross-Reference – Recovery Exclusion
  - Tax benefit items in a tax year are considered as a group
  - A group of tax benefit items for one year must be kept separate from a group of tax benefit items for another year
  - A recovery exclusion is any amount in the group of tax benefit items that did not create a tax benefit

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Maines v. Commissioner, 144 T.C. 123 (2015) — P 150

- Whether refundable state tax credits were included in federal income
- Married New York residents who received a credit for state property taxes
- Credit was limited to actual property taxes paid by their partnership
- Court found the credit to be like a refund of overpaid property taxes

- Held that the property tax credit that reduced the taxpayers' state tax liability
- The refundable portion of the property tax credit was subject to the tax benefit rule
- Included in income to the extent that the taxpayers received a corresponding tax benefit for prior-year property tax deductions.

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Tax Benefit Rule — P 150

- Example 5.5 – Refundable Credit Included in Income

FIGURE 5.2
Sylvia's State Taxable Income

Item	Amount
Federal adjusted gross income	$300,000
SITP	30,000
State standard deduction	(10,000)
State taxable income	$320,000
State tax rate	× 6.75%
State tax liability	$ 21,600
SITP credit	(30,000)
State tax refund	$ 8,400

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Ordering Rules
P 151

- A state income tax refund from an SITP may be excludable from federal taxable income
  - Estimated and withholding tax payments were applied last; and
  - Claimed the federal standard deduction.
- Example 5.6 – Ordering of Estimated Tax Payment

FIGURE 5.3
Sylvia's State Taxable Income with Estimated Tax Payment Applied First

Item	Amount
Federal adjusted gross income	$300,000
SITP	30,000
State standard deduction	(10,000)
State taxable income	$320,000
State tax rate	× 6.75%
State tax due (6.75%)	$ 21,600
Estimated tax payments	10,000
SITP credit	(30,000)
State tax refund	$18,400

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Ordering Rules
P 151

- Example 5.6 – Ordering of Estimated Tax Payment
  - Refund is entirely of PTET credit
  - Offsets Sylvia's federal tax liability
  - Sylvia must include the credit in her taxable income
- Sylvia did not itemized deductions, and it is not includable in her income

FIGURE 5.4
Sylvia's State Taxable Income with Estimated Tax Payment Applied Last

Item	Amount
Federal adjusted gross income	$300,000
SITP	30,000
State standard deduction	(10,000)
State taxable income	$320,000
State tax rate	× 6.75%
State tax due	$ 21,600
SITP credit	(30,000)
Estimated tax payments	10,000
State tax refund	$18,400

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MI Flow-Through Entity

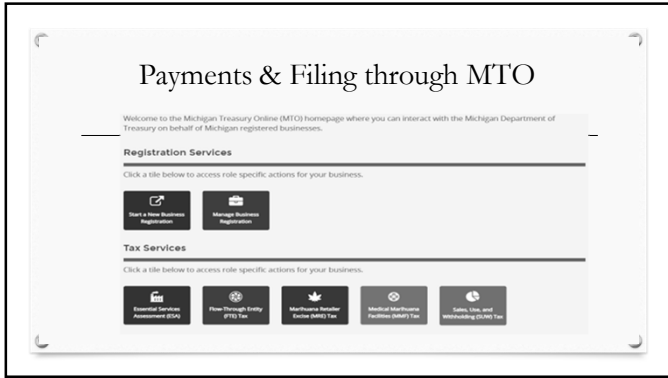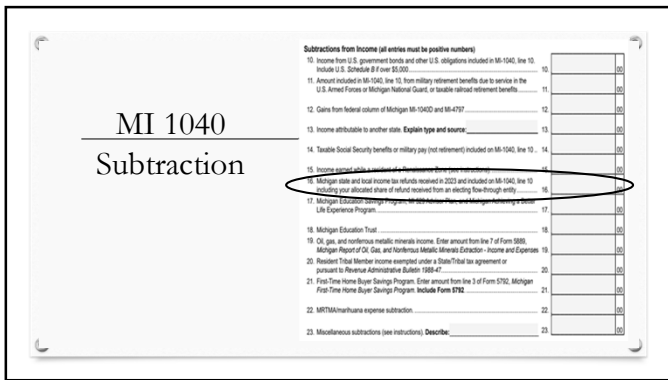| |
|---|
| Estimated Tax Payments required |
| $ 500 expected annual income tax liability |
| Entity Name & EIN |
| Calendar tax year payments even if Fiscal year filers |
| Irrevocable Election – 15th day of third month |
| Election effective 3 years |
| www.michigan.gov/taxes/business-taxes/flowthrough-entity-tax |

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Payments & Filing through MTO

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MI 1040
Subtraction

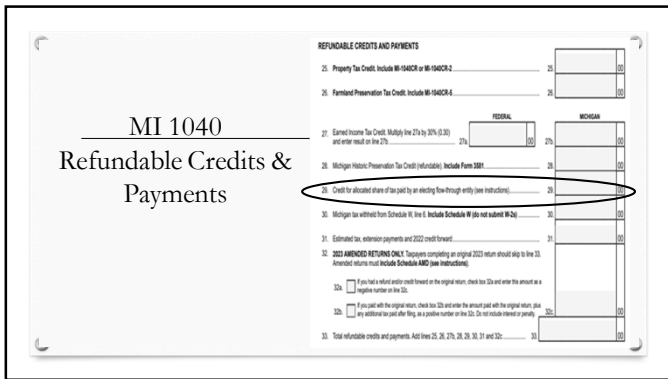26

MI 1040
Refundable Credits &
Payments

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Issue 2

Beneficial Ownership Interest Reporting

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Corporate Transparency Act   P 152

In September 2022, Financial Crimes Enforcement Network (FinCEN) issued a final rule implementing the beneficial ownership information reporting requirements of the Corporate Transparency Act (CTA) [87 F.R. 59498].

These requirements are intended to help prevent and combat money laundering, terrorist financing, corruption, tax fraud, and other illicit activity, while minimizing the burden on entities doing business in the United States.

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Corporate Transparency Act P 152

These regulations went into effect on January 1, 2024.

The final rule requires certain entities to file FinCEN reports that identify two categories of individuals:

(1) the beneficial owners of the entity and

(2) individuals who have filed an application with specified governmental authorities to create the entity or register it to do business.

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Cross-Reference – Unauthorized Practice of Law   P 152

- Involves interpreting laws and giving advice regarding a client's rights and obligations under those laws.
- See the "Ethics" chapter in this book for information about how a tax practitioner can comply with his or her ethical duties to not engage in the practice of law, to protect confidential client information, and the duty of competence when assisting with CTA reporting.

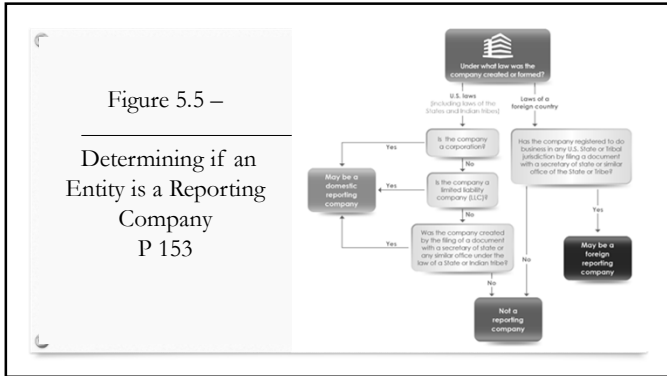31

The Corporate Transparency Act   P 152

January 1, 2021: 31 U.S. Code §5336

Identify beneficial owners

Reporting Companies

Entities organized in US & Territories/Possessions

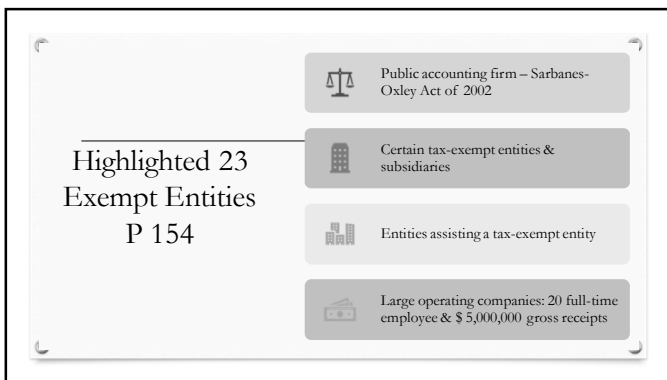Entities operating in US & Territories/Possessions

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Reporting Companies   P 152

- Domestic Corporations (both C & S)
- Domestic Limited Liability Companies – regardless of how they're taxed
- Other Domestic Entities created by State or Tribal Filings
  - Limited Partnerships
  - Family Limited Partnerships
  - General Partnerships
- Foreign Entities
  - Corporations
  - Limited Liability Companies
  - Registered to do business in a U.S State
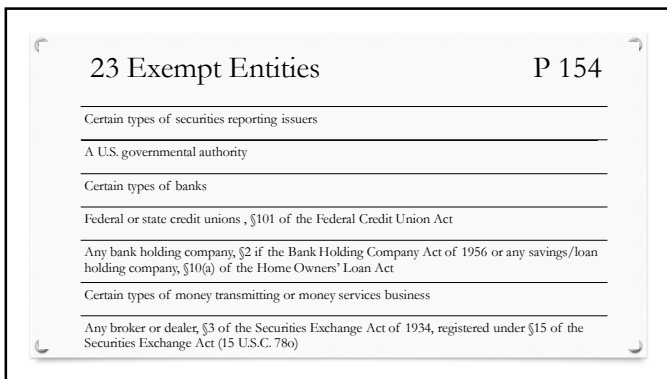 - Registered to do business in a Tribal Community

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Figure 5.5 –

Determining if an
Entity is a Reporting
Company
P 153

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Highlighted 23
Exempt Entities
P 154

- Public accounting firm – Sarbanes-Oxley Act of 2002
- Certain tax-exempt entities & subsidiaries
- Entities assisting a tax-exempt entity
- Large operating companies: 20 full-time employee & $ 5,000,000 gross receipts

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23 Exempt Entities   P 154

Certain types of securities reporting issuers

A U.S. governmental authority

Certain types of banks

Federal or state credit unions , §101 of the Federal Credit Union Act

Any bank holding company, §2 if the Bank Holding Company Act of 1956 or any savings/loan
holding company, §10(a) of the Home Owners' Loan Act

Certain types of money transmitting or money services business

Any broker or dealer, §3 of the Securities Exchange Act of 1934, registered under §15 of the
Securities Exchange Act (15 U.S.C. 78o)

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23 Exempt Entities — P 154

Securities exchanges or clearing agencies, §3 of the Securities Exchange Act of 1934, and that is registered under 6 or 17A of the Act

Certain other types of entities registered with the Securities & Exchange Commission under the Securities Act of 1034

Certain types of investment companies, §3 of the Investment Company Act of 1940, or investment advisers under §202 of the Investment Advisors Act of 1940

Certain types of venture capital fund advisers

Insurance companies, §2 of the Investment Company Act of 1940

State-licensed insurance producers with operating presence at a physical office within the United States, and authorized by a State, and subject to supervision by a States' Insurance Commissioner or a similar official or agency

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23 Exempt Entities — P 154

Commodity Exchange Act registered entities

Any public accounting firm registered in accordance with §102 of the Sarbanes-Oxley Act of 2002

Regulated public utilities, 26 U.S.C. 7701(a)(33)(A), that provides telecommunications services, electrical power, natural gas, or water & sewer services within the United States

Any financial market utility designated by the Financial Stability Oversight Council, §804 of the Payment, Clearing & Settlement Supervision Act of 2010

Certain pooled investment vehicles

Certain types of tax-exempt entities (I.R.C. §501(c), §501(a); Political organizations I.R.C. §527(e)(1), §527(a); Charitable or split-interest trusts I.R.C. §4947(a)

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23 Exempt Entities — P 154

Entities assisting a tax-exempt entity described in (xix) above

Large operating companies with at least 20 full-time employees, more than $ 5,000,000 in gross receipts or sales and an operating presence at a physical office within the United States

The subsidiaries of certain exempt entities

Certain types of inactive entities that were in existence on or before January 1, 2020

Any entity/class of entity that Secretary of the Treasury, with written concurrence of the Attorney General and the Secretary of Homeland Security has, by regulation, determined should be exempt from requirements.

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Practitioner Note – Sole Proprietor
P 155

It is not a reporting company.	Filing a document with a government agency to obtain an IRS employer identification number	Filing a document for a fictitious business name (d/b/a), or a professional or occupational license

Does not create a new entity	Does not make a sole proprietorship filing such a document a reporting company.

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Beneficial Ownership   P 155

- Directly controls 25% ownership
- Indirectly controls 25% ownership
- Exercise substantial control
- Substantial influence

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Exempt Individuals P 155

Minor Child – parent/legal guardian required to report	Nominee, intermediary, custodian or agent
Individual with only further interest	Creditor of a reporting company

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Substantial Control   P 155

Is a Senior Officer

Has authority to hire, fire, appoint or remove Senior Officers and/or Board Members

Directs, determines or has substantial influence over day-to-day decisions as well as high-level decisions;

- Financial decisions – entering into contracts, finance obligations
- Reorganization, dissolution, merger, sale
- Investments & major expenditures, incurring debt
- Determining business line, ventures or the termination of them
- Compensation of officers, senior staff as well as incentive programs
- Amendments to governing documents

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Ownership Interest P 056

EQUITY, STOCK, OR VOTING RIGHTS
any interest classified as stock or anything similar, regardless whether it confers voting power or voting rights, and even if the interest is transferable
EXAMPLES include:
- equity, stock, or similar instrument
- preorganization certificate or subscription
- transferable share of, or voting trust certificate or certificate of deposit for, an equity security, interest in a joint venture, or certificate of interest in a business trust

CAPITAL OR PROFIT INTEREST
any interest in the assets or profits of a company organized as an LLC, which is similar to stock in a corporation and sometimes referred to as a "unit"

CONVERTIBLE INSTRUMENTS
any instrument convertible into **equity, stock, or voting rights** or **capital or profit interest**, whether or not anything needs to be paid to exercise the conversion. The RELATED items are also ownership interests:
- any future on any convertible instrument
- any warrant or right to purchase, sell, or subscribe to a share or interest in **equity, stock, or voting rights** or **capital or profit interest**, even if such warrant or right is a debt

OPTION OR PRIVILEGE
any put, call, straddle, or other option or privilege of buying or selling **equity, stock, or voting rights, capital or profit interest**, or **convertible instruments**, EXCEPT if the option or privilege is created and held by others without the knowledge or involvement of the reporting company

CATCH-ALL
any other instrument, contract, arrangement, understanding, relationship, or mechanism used to establish ownership

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Beneficial Ownership & Key Employees

President → Chief Financial Officer → General counsel, in-house counsel

Chief Executive Officer → Chief Operating Officer → Any other officer

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FinCEN Identifier P 157

A FinCEN identifier is a unique identifying number that FinCEN will issue to individuals who have provided FinCEN with their beneficial ownership information (BOI) (Individual FinCEN identifiers)

Given to reporting companies that have filed initial BOI reports (entity FinCEN identifiers).

Once a beneficial owner or company applicant has obtained a FinCEN identifier, the reporting entity may report the identifier in place of the otherwise required personal information in their BOI reports.

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When to File

Companies Created or Registered before January 1, 2024
- Will have until January 1, 2025, to file its initial beneficial ownership information report.

Companies Created or Registered after January 1, 2024
- 2024 only -- 90 days to file its initial beneficial ownership information report.
- Begins when company receives notice of its creation or registration is effective;   OR
- After a secretary of state or similar office first provides public notice of its creation or registration, whichever is earlier.
- Starting in 2025 -- 30-days

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Updated Reporting P 158-159

Update or report changes within 30 days

The following are some examples of the changes that would require an updated beneficial ownership information report: • A change to the information reported for the reporting company, such as registering a new business name	A change in beneficial owners, such as a new CEO, or a sale that changes who meets the 25% ownership interest threshold	A change to a beneficial owner's name, address, or unique identifying number previously provided to FinCEN (If a beneficial owner obtained a new driver's license or other identifying document that includes a changed name, address, or identifying number, the reporting company also would have to file an updated beneficial ownership information report with FinCEN, including an image of the new identifying document.)

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FinCen Enforcement P 159

- $ 500 per day for willfully failing to report or willfully providing false information
- Civil Fine up to $ 10,000
- Up to 2 years imprisonment
- Initial filing
- 30 days from "any information change"

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FinCen Enforcement P 159

- Unauthorized disclosure
- Use of beneficial ownership data
- Criminal fine up to $ 250,000
- 5 years in prison
- Conduct of financial wrongdoing
  - Up to $ 500,000
  - 10 years in prison

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National Small Business United v. Yellen
Case No. 5:22-cv-01448 (N.D. Ala.)

- Federal District Court, Northern District of Alabama, Northeastern Division
- Exceeds "the Constitution's limits on Congress's power"
- Enjoined Dept. of Treasury & FinCEN
- Cannot enforce against the plaintiffs
- March 11, 2024 – DOJ Appealed on behalf of Dept. of Treasury

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Who are the Plaintiffs?

- Isaac Winkles et.al.
- National Small Business Association (NSBA)
- Named Members on March 1, 2024
- 65,000 Business Members
- Unnamed Members – limited or not at all
- Non-parties – fulling enforceable

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Issue 3

§501(c)(3) Charitable Organizations
& Maintaining Tax-exempt status

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Overview
P 160

- Organizations described in section 501(c)(3), other than testing for public safety organizations, are eligible to receive tax-deductible contributions under I.R.C. § 170.
- Ongoing compliance issues that may result in denial or revocation of tax-exempt status, or a change in that status:
  - Failing the organizational or operational test by, for example, engaging in more than insubstantial nonexempt activities or deviating from the exempt purpose reported on the application for tax-exempt status
  - Filing Form 1023-EZ when the charitable organization is ineligible to file the short form
  - Failing to maintain public charity status by not generating public support from grants and donations
  - Earning too much income from unrelated business activities
  - Not complying with annual notice or return filing requirements

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Failing the Organizational or Operational Test
P 160

- Engage in non-exempt activities
- Deviated from exempt purpose
- Filing incorrect 1023
- No public support from grants or donations
- Too much unrelated business activities
- Non-filing & non-compliance

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Exempt Purposes
P 160

- Charitable – Treas. Reg. 1.501(c)(3)-1(d)(2)
- Religious
- Educational
- Scientific
- Public Safety
- Preventing Cruelty to children or animals

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Treas. Reg. 1.501(c)(3)-1(d)(2)
P 160

Lessening the burdens of government in the definition of the term, charitable

↓

The organization must demonstrate its activities serve a public rather than a private interest

↓

Examples – lessening neighborhood tensions, eliminating prejudice & discrimination, defending human & civil rights secured by law, or combatting community deterioration & juvenile delinquency

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Religious Organizations P 160

The particular religious beliefs of the organization must be truly and sincerely held.

The practices and rituals associated with the organization's religious belief or creed cannot be illegal or contrary to clearly defined public policy.

Example 5.7 – Insubstantial Religious Purposes

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Educational Organizations   P 160

- Primary purpose is to promote and advance education may be exempt under section 501(c)(3).
- Instruction or training
- Purpose of improving or developing his or her capabilities, or
- the instruction of the public on subjects useful to the individual and beneficial to the community.
- This advancement of education may include grants, scholarships, and awards; promotion of the arts, humanities, and science; job training; publishing scientific journals; and advocacy.

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P 161-162

Organizational Formalities

- Articles of incorporation and bylaws for a corporation must
  - limit the organization's purposes to exempt purposes in section 501(c)(3); and
  - must not expressly empower it to engage, other than as an insubstantial part of its activities, in activities that are not in furtherance of one or more of those purposes [Treas. Reg. § 1.501(c)(3)-1(b)(1)(i)].
  - This requirement may be met if the purposes stated in the organizing documents are limited by reference to section 501(c)(3).
- The organizational documents should prohibit inurement of earnings to private shareholders or individuals, prohibit political activity, and limit legislative activity.

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Figure 5.7 – Dedication of Purpose

Article 5. The corporation is organized exclusively for charitable, religious, and educational purposes. No substantial part of the activities of the corporation shall be the carrying on of propaganda as it is defined within the meaning of I.R.C. § 501(c)(3), or otherwise attempting to influence legislation, and the corporation shall not participate in or intervene in (including the publishing or distribution of statements concerning) any political campaign on behalf of (or in opposition to) any candidate for public office. Notwithstanding any other provision of these articles of incorporation, the corporation shall not directly or indirectly carry on any activity that would prevent it from obtaining exemption from federal income taxation as a corporation described in I.R.C. § 501(c)(3), or cause it to lose such exempt status, or carry on any activity that is not permitted to be carried on by a corporation to which contributions are deductible under I.R.C. § 170(c)(2).

64

Dedication of Organizations Purpose P 162

- Treas. Reg 1.501(c)(3)-1(b)(1)(iv) -- An organization is not considered to be organized exclusively for one or more exempt purposes if
  - An organization have been exclusively in furtherance of one or more exempt purposes is not sufficient to allow the organization to meet the organizational test.
  - An organization does not meet the organizational test as a result of statements or other evidence that the members intend to operate only in furtherance of one or more exempt purposes

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Dedication of Organizations Purpose P 162

- Example 5.8 – Broad Purposes
- Example 5.9 – Vague Purposes
- Treas. Reg. 1.501(c)(3)-1(b)(4) -- An organization does not meet the organizational test if its articles or the law of the state in which it was created provide that its assets will, upon dissolution, be distributed to its members or shareholders

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Assets upon Dissolution P 162-163

- Assets must be permanently dedicated to an exempt purpose.
- If an organization dissolves, its assets must be distributed for an exempt purpose, to the federal government, or to a state or local government for a public purpose.
- Organizing documents should contain a provision ensuring their distribution for an exempt purpose in the event of dissolution.
- If a specific organization is designated to receive the organization's assets upon dissolution, the organizing document must state that the named organization must be a section 501(c)(3) organization when the assets are distributed.

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Figure 5.8 P 163

Article 6. The property of the corporation is irrevocably dedicated to the purposes meeting the requirements for exemption. No part of the net earnings of the corporation shall inure to the benefit of or be distributable to any director or officer of the corporation, or any other private person, except that the corporation shall be authorized and empowered to pay reasonable compensation for services rendered to or for the corporation and to make payments and distributions in furtherance of the purposes set forth in Article 5. In the event of dissolution or final liquidation of the corporation, all the remaining assets and property of the corporation shall, after paying or making provision for the payment of all of the liabilities and obligations of the corporation and for necessary expenses thereof, be distributed to such organization or organizations organized and operated exclusively for charitable or educational purposes meeting the requirements for exemption under I.R.C. § 501(c)(3), as the Board of Directors shall determine, or shall be distributed to the federal government, or to a state or local government, for a public purpose. In no event shall any of such assets or property be distributed to any director or officer, or any private individual.

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Dedication of Organizations Purpose P 163

- Treas. Reg. 1.501(c)(3)-1(b)(4) – An organization does not meet the organizational test if its articles or the law of the state in which it was created provide that its assets will, upon dissolution, be distributed to its members or shareholders
- Example 5.10 – Assets Not Dedicated to Exempt Purpose
- Practitioner Note – Amending Articles

69

Operational Test — P 163-164

Primary activities -- activities that accomplish one or more of the exempt purposes specified in section 501(c)(3).

Distribution of earnings -- net earnings do not inure in whole or in part to the benefit of private shareholders or individuals.

Action organizations -- not operated exclusively for one or more exempt purposes if a substantial part of its activities is attempting to influence legislation by propaganda or if it participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.

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Form 1023-EZ Ineligibility — P 164

Streamlined Application for Recognition of Exemption

Annual gross receipts of $50,000 or less and $250,000 or less in assets

The application must be submitted electronically on Pay.gov and must include the appropriate user fee.

File within 27 months from the date of their formation to be treated as described in section 501(c)(3) from the date formed.

If the organization does not file within 27 months of formation, the effective date of the exempt status will be the date of filing.

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Ineligibility for Form 1023-EZ — P 165

- Organizations gross revenue exceeds $ 50,000 in first 3 years
- Can retroactively revoke an organizations status for misstatement or omission of material information on Form 1023
- Rev. Proc. 2023-5, 2023-1 I.R.B. 265 §12 -- A misstatement of material information
- Example 5.11 – Ineligible to File Form 1023-EZ

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Maintaining Public Charity Status   P 165

- Public Charity – broad sources of support
- Public Foundation – very limited sources of support
- I.R.C. §508(b) – every organization is automatically classified as a private foundation unless it meets one of the exemptions list in I.R.C. §508(c) or §509(a)

73

Maintaining Public Charity Status   P 165

§509(a)

74

Public Support Tests   P 166

- At least one- third of its support from contributions from the general public; or
- Meet 10% percent facts and circumstances test.
  - receives more than 10% but less than **one-third** of its support from the general public or a governmental unit
  - It normally receives a substantial part of its support from governmental units or the general public.
- Example 5.12 – Significant Public Support

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P 166-167

Unrelated Business Taxable Income

- Income from a trade or business
- Regularly conducted by an exempt organization
- Not substantially related to the organization's performance of its exempt purpose or function.
- Use of the profits from an unrelated business in furtherance of an organization's exempt purpose
- A *trade or business* -- activity conducted with the intent to produce income from selling goods or performing services.
- Treas. Reg. 1.513-1(c) -- *regularly conducted* if they show a frequency and continuity and are pursued in a manner similar to comparable commercial activities of nonexempt organizations
- Example 5.13 – Not a Regularly Conducted Activity

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P 166-167

Unrelated Business Taxable Income

- Substantially related – if it contributes importantly to accomplishing that purpose
  - Facts & Circumstances – size & extent of the activities in relation to the nature & extent of the exempt function
  - Gross income derived from exempt function & unrelated trade/business are not the same
  - If a facility or asset required to conduct an exempt function is also used in commercial activities, its use for the exempt function does not alone make the commercial activities a related trade or business.
  - The test is whether the activities contribute importantly to the accomplishment of exempt purposes.

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P 166-167

Unrelated Business Taxable Income

- Example 5.14 – Multiple Uses Activity
- Treas. Reg. 1.513-1(d)(4)(ii) -- Selling products
- Treas. Reg. 1.513-1(e) – excluded trade or business activities
- Other excluded activities – gaming, convention or trade shows, distributions of low-cost articles & qualified sponsorship activities

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Filing Requirement   P 168

- Practitioner Note – UBTI Filing Requirements
  - Form 990-T
- Exempt Organization filing requirements –I.R.C §6033
- Form 990 Series
- Due 15th day of 5th month following close of calendar or fiscal year
- If fail to file a return for 3 consecutive years – tax-exempt status is automatically revoked
- §6033(a)(3), churches, religious orders, and certain other organization (other than a private foundation) with gross receipts in each tax year normally not more than $5,000 do not have to file an annual return.

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Filing Requirement   P 169

- *Form 990-N* -- gross receipts $50,000 or less can file a Form 990-N (e-Postcard), which is a notice, not a return.
- *Form 990-EZ* -- gross receipts that are less than $200,000 and total assets at the end of the tax year that are less than $500,000
- *Form 990* -- gross receipts greater than or equal to $200,000, or total assets greater than or equal to $500,000
- 6 month extension by filing Form 8868
- An organization is allowed only one 6-month extension for a tax year.

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Revocation of Exempt Status P 169

Failure to file a required Form 990 series notice or return for 3 consecutive years

The organization must then apply to reinstate tax-exempt status.

Under I.R.C. § 6033(j)(1), if a tax-exempt organization fails to file its required annual return or notice for 2 consecutive years, the IRS must notify the organization

That the IRS has no record of such a return or notice from the organization for 2 consecutive years, and	The IRS will revoke the organization's tax-exempt status if it fails to file the return or notice by the due date for the next return or notice required to be filed

Tax Exempt Organization Search Tool [www.irs.gov/charities-non-profits/search-for-tax-exempt-organizations]

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Reinstatement of Exempt Status   P 169-171

- Four reinstatement procedures
  - Streamlined Retroactive
  - Retroactive within 15 months
  - Retroactive after 15 months
  - Postmark date

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Issue 4

Change in Tax-Exempt Status

83

Rev. Proc.
2024-5, 2024-
1 I.R.B. 252

- Allows for change in exempt status
- Currently recognized under §501(c)(3)
- Organization must request status change

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When to Request a Determination Letter

P 172

- Rev. Proc. 2024-5 §3.01(1)
  - has distributed its assets to another section 501(c)(3) organization or government entity, and
  - otherwise meets the requirements for the section 501(c) status requested.
- Rev. Proc. 2024-5 automatically revoked under I.R.C.§ 6033(j)
- Example 5.15 – Change from §501(c)(3) to §501(c)(4)

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P 172-173

- File Form 1024 & 1024-A
- Indicate:
  - that its assets have been distributed as of the submission date of its application; and
  - provide a description of the assets distributed, the date of distribution and the name, employer identification number, and address of the recipient and agree to submission (postmark) date for recognition under the new paragraph of section 501(c).
- Practitioner Note – Optional Filing

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Issue 5

Electing Out of the Centralized Partnership Audit Regime

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P 174

Centralized Partnership Audit Regime

- Bipartisan Budget Act of 2015 (BBA), Pub. L. No. 115-123.
- Partnership returns filed for tax years beginning on or after January 2018 Partnerships must designate a partnership representative on the partnership return for these years.
- An eligible partnership can elect out of the new rules.

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Eligibility to Elect Out
P 174

A partnership must have issued 100 or fewer K-1s for the year.

Partners: Individual, a C corporation, a foreign entity that would be treated as a C corporation if it was domestic, an S corporation, or an estate of a deceased partner.

Not Eligible: partners partnerships, trusts, foreign entities that are not eligible foreign entities, disregarded entities, nominees or other similar persons that hold an interest on behalf of another person, and estates that are not estates of a deceased partner.

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How to Elect Out
P 174-175

- Made on a timely filed partnership return (including extensions) for the year the election is to be effective.
- A partnership must disclose to the IRS the names, correct taxpayer identification numbers (TINs), and federal tax classifications of all its partners and, if there is an S corporation partner, the names, correct TINs, and federal tax classifications of all persons to whom an S corporation partner is required to furnish statements during the S corporation partner's tax year ending with or within the partnership's tax year at issue
- A partnership electing out must notify each of its partners within 30 days of making the election

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Advantages to Electing Out
P 176

Individual partners retain control over the results.

Not just one selected person makes decisions that bind all partners.

Adjustments are made only to the specific partners of the reviewed year.

The adjustment-year partners who may not have been reviewed-year partners carry no burden, and the reviewed-year partners who may not be adjustment-year partners are responsible for the adjustments.

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Advantages to Electing Out
P 176

Audit adjustments are made in the audit year, not the year the audit is completed.

Once the examination is completed the partnership plays no further role.

Each partner receives a detailed computation of the proposed adjustments.

Each partner makes his or her own decision to protest or appeal the proposed adjustments.

Partners may obtain different results on appeal

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Advantages to Electing Out
P 176

The statute of limitations for making partnership adjustments to a partner's return is determined at the partner level.

The adjustment to smaller-interest partners may never be made due to IRS tolerance levels.

For a large partnership, it takes more resources for the IRS to audit the individual partners.

The aggregate tax liability of the partners after adjustment is more realistic than an unadjusted, imputed underpayment under the centralized rules, which could be excessive.

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Advantages to Electing Out
P 176

A partner's adjustments for any partnership audit are more straightforward. Only the reviewed year's partners are adjusted, and any intervening-year adjustments are made directly on the intervening years.

There is no need for a partnership representative, and no need to provide for complicated releases of liability for and indemnification of the partnership representative

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Disadvantages to Electing Out
P 176-177

There will be closer scrutiny of the individual partner's return when the IRS proposes the adjustments from the partnership examination.

All partners, including foreign partners, must have an identifying number to elect out.

The types of partners and number of partners is limited.

Protest and appeal of the partnership adjustments is done by each partner, raising the cost of appeal per partner and in the aggregate. Lower-income partners may not have the resources to appeal.

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Disadvantages to Electing Out
P 176-177

There may be different results on appeal for different partners, which may be inequitable or unfair.

Following the audit of each partner, the partnership may have to collect information about the audit and update its records.

There is nothing to protect a partnership if the IRS determines the election is invalid (e.g., if a partnership interest is subsequently issued to an ineligible partner, or the number of partners increases).

Revocation of the election requires IRS permission

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Partnership Representative
P 177

- Treas. Reg. 301.6223-1(e)(2)
  - Partnerships must designate a Partnership Representative
  - Designation must be made on Form 1065, U.S. Return of Partnership Income
  - Designation is made for year in which it relates and effective when return is filed
- Practitioner Note – Due Diligence & Partnership Returns
- Treas. Reg. 301.6223-2(a)
  - Partnership Representative has sole authority to act on behalf of the partnership
  - Their decision(s) is(are) binding on the partnership & the partners
  - **Binding decisions:** the authority to determine how the partnership will proceed with regard to a proposed adjustment, the authority to enter into a settlement agreement on behalf of the partnership, and the authority to make the election to pay the underpayment on behalf of the partners or push out the underpayment to the individual partners.

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Partnership Representative
P 177

- Treas. Reg. 301.6223-2(d)
  - No partner or any person, other than PR or DI, may participate in an administrative proceeding without IRS's permission
- Practitioner Note – Power of Attorney

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Changing the Partnership Rep.
P 178

- I.R.C. § 6223 regulations limit the times for changing a PR and the times for a PR to resign.
- A PR designation can be changed after the IRS mails a notice of administrative proceeding (NAP) or in conjunction with the filing of a valid administrative adjustment request (AAR) by the partnership under I.R.C. §6227.
- A PR or DI may submit a written notification of resignation only after the IRS issues a NAP.
- Treas. Reg. §301.6223-1(e)(2) allows the partnership to change the PR through revocation when the partnership is notified that the partnership return is selected for examination as part of an administrative proceeding.
- The partnership can change its PR before an administrative proceeding commences.

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Questions?

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