

NOT-FOR-PROFIT NEWSLETTER

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Expand Your Reach

With the new administration in Washington, DC, many not-for-profits have concerns about policy and funding changes and their impact on operations. We've compiled the most pressing updates, from a ruling on the classification of consulting services to ways to manage risk while engaging in lobbying and political activities to potential legislation that could have a direct impact on higher education spending.

Manage Risk While Engaging in Lobbying and Political Activities

by Wendy Campos, Partner, and
Sarah Buhl, Senior, Not-for-Profit Practice

With the severe funding cuts outlined in President Donald Trump's proposed budget, it's more important than ever for not-for-profits to advocate for themselves on the federal stage.

Before engaging in lobbying or political activities, not-for-profits will want to determine which activities are allowed, given the different tax implications. Entities can manage risk and protect their tax-exempt status by understanding the complex rules that govern their lobbying and political activities.

Understanding Lobbying Restrictions

Lobbying is an activity in support of or in opposition to legislation. It's different

from *political activities*, which are activities supporting or opposing a candidate for elective office.

As lobbying efforts ramp up, not-for-profits will want to be aware of how different tax-exempt entities' activities are limited by regulatory agencies—including the IRS, Federal Election Commission (FEC), and state or local agencies. They also need to be aware of the restrictions on different tax-exempt organizations.

- **501(c)(3) organizations.** These are groups that operate for religious, charitable, scientific, or educational purposes and can't engage in a substantial amount of lobbying activity. It's important to note that unlike a 501(c)(3) organization treated as a public charity, private foundations within the meaning of IRC Section 509(a) may not make expenditures for lobbying.
- **501(c)(4) organizations.** These are commonly called social welfare organizations. They may engage in lobbying and other political activities, as long as these activities don't become their primary purpose.

- **501(c)(5) organizations.** These are labor and agricultural groups. They may engage in lobbying and other political activities, as long as these activities don't become their primary purpose.
- **501(c)(6) organizations.** These are business leagues, chambers of commerce, real estate boards, and boards of trade. They may engage in lobbying and other political activities, as long as these activities don't become their primary purpose. A violation of these prohibitions may result in the denial or revocation of an organization's tax-exempt status and the imposition of certain excise taxes.



501(c)(3) Organizations

501(c)(3) organizations can mitigate the risk of having their tax-exempt status revoked by filing Form 5768, *Election/Revocation of Election by an Eligible Section 501(c)(3) Organization to Make Expenditures to Influence Legislation*. An organization making this election will, however, be subject to an excise tax under Section 4911 if it spends more than the amount permitted by that section. The election also creates a higher threshold for what the IRS deems insubstantial lobbying.

This election requires the organization to file Schedule C Part II-A with its annual Form 990 filing to report actual and permitted lobbying and grassroots expenditure amounts.

501(c)(3) public charities are only allowed to engage in an insubstantial amount of

lobbying activity, however some voter registration activities are permitted, such as nonpartisan voter education, voter registration, and general promotion of the electoral process.

501(c)(4), (5), & (6) Organizations

501(c)(4), (5), and (6) organizations are allowed to engage in the following activities:

- **Creation of separate segregated funds.** A political committee that's established and administered by corporations, labor unions, membership organizations, or trade associations. They can only solicit contributions from individuals associated with connected or sponsoring organizations.
- **Creation of nonconnected committees.** An unsponsored political committee designed to be financially independent. They're capable of soliciting contributions from the public.
- **Political activity expenditures.** These are allowed only as long as they're not the organization's primary activity.
- **Lobbying.** Any activity in support of or in opposition to legislation.

527 Organizations

Section 527 of the Internal Revenue Code (IRC) grants tax-exempt status to parties, candidates, committees, or associations organized for the purpose of influencing an issue, policy, appointment, or election, be it federal, state, or local. These political organizations can raise unlimited funds from individuals, corporations, or labor unions.

A political action committee (PAC) is a popular term for a political committee organized for the purpose of raising and spending money to elect and defeat candidates. All political committees that register and file reports with the FEC are 527 organizations, but not all 527 organizations are required to file with the FEC.

At the time of formation, a 527 organization may be required to register with the FEC or IRS using Form 8871. Depending on the organization, it may be subject to one or more filing requirements, such as FEC filings, Form 1120-POL, Form 8872, or Form 990. Political organization will benefit from careful consideration of these filing requirements.

Filing Form 1120-POL

Politically active 501(c) entities often run into the question of whether they need to file Form 1120-POL, *US Income Tax Return for Certain Political Organizations*.

A 501(c)(4), (5), or (6) organization is required to file a Form 1120-POL if it has political organization taxable income under IRC Section 527(f)(1). Taxable income for these exempt organizations is the smaller of the net investment income of the organization for the tax year or the amount spent on an exempt function during the tax year—either directly or indirectly through another organization.

Learn Why Consulting Services May Not Be Classified as Unrelated Business Income

by Emina Cresswell, Tax Manager,
Not-for-Profit Practice

The IRS recently issued Private Letter Ruling (PLR) 201701002, which considered consulting services provided to other not-for-profits to be related to the organization's exempt purpose. This means it's possible that other not-for-profits wouldn't be subject to unrelated business income (UBI) tax for providing similar services.

What Is Unrelated Business Income?
Income is generally considered UBI only if three elements are present for the income-generating activity:

- Activities rise to the level of a trade or business, demonstrating a profit motive
- The trade or business is regularly conducted
- Activities are substantially unrelated to the organization's exempt purpose

Legal Precedent

PLR 201701002 looked at the 2008 Community Foundation rulings and *B.S.W. Group, Inc. v. Commissioner*.

2008 Community Foundation Rulings

In this pair of rulings, the IRS addressed whether payments made to a community foundation for providing grant-making, administrative, and clerical services to charities were taxable.

The grant-making was ruled as substantially related to the organization's exempt purpose, but the administrative and clerical services weren't, which resulted in them being subject to UBI tax (UBIT).

B.S.W. Group, Inc. v. Commissioner

In this 1978 Tax Court case, the IRS ruled that technical assistance services performed by the tax-exempt organization on behalf of social sector organizations—defined as not-for-profits, foundations, governmental agencies, and community organizations—were substantially related to the organization's exempt purpose and not subject to UBIT.

Ruling's Key Factors

The following elements were present to help make the UBI determination:

- The services were an element of the organization's exempt purpose.
- The projects accepted by the organization provided research and data to help serve its own charitable mission of improving the lives of low-income children and their families.
- The organization made the results of its projects available to the public on its Web site.

- The organization required that the results weren't sold or used for anything but the organization's exempt purpose.
- The organization had raw data that other entities didn't have access to, and the services were performed by employees who had specific skills and knowledge regarding their exempt purpose.
- The organization determined fees on a case-by-case basis and occasionally didn't charge for services that took fewer than four hours.

Based on this and other rulings, it's possible for consulting services to be considered related income not subject to UBIT. However, the facts described above are specific to one tax-exempt organization's circumstances, which means your facts and circumstances should be closely examined to determine the proper tax treatment.



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An Overview of Potential Legislation Affecting Higher Education Endowment Spending and Tuition Fees

by Patty Mayer, Senior Manager, Not-for-Profit

In December 2016, a member of President Trump's transition team—Congressman Tom Reed—unveiled a comprehensive plan to reduce higher education costs for students.

The plan calls for colleges to be more accountable for the quality and cost of the education they provide. It includes three pieces of legislation, all of which have yet to be introduced:

- Reducing Excessive Debt and Unfair Costs of Education (REDUCE) Act
- Accountability of College Costs through Exposing School Spending (ACCESS) Act
- Promoting Lifelong Accountability Now! (PLAN) Act

These potential bills are worth following to see how Congress will address endowment-spending regulation and rising tuition fees.

REDUCE Act

Reed intends to introduce a bill named the REDUCE Act. The REDUCE Act requires colleges with endowment funds in excess of \$1 billion to use at least 25 percent of their investment gains to reduce the cost of attendance for students from middle- and working-class families. The bill would likely affect the majority of the Ivy League schools as well as large state colleges and universities.

According to a study conducted by the National Association of College and University Business Officers (NACUBO) in Washington, DC, 91 American colleges and universities reported endowment funds in excess of \$1 billion in 2016. The schools that fail to use the set percentage of their investment income toward reducing the cost of education will face various penalties:

- **Hefty taxes.** An immediate 30 percent tax will be applied to all investment income with the possibility of as much as 100 percent tax for continued violations.
- **Loss of tax-exempt status.** Colleges and universities that continue to fail to comply will lose the ability to receive charitable contributions



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ACCESS Act

The ACCESS Act requires colleges and universities—as a condition of maintaining their ability to receive charitable tax deductions—to report employee expenses not currently required by Form 990. This information includes:

- Salaries
- Use of school vehicles
- Housing reimbursement
- Club membership
- Other miscellaneous fringe perks received by school employees

The act requires higher education institutions to make such information readily available to the public—for example, on the school's website.

PLAN Act

The PLAN Act aims to reduce rising tuition costs by tying tuition hikes to inflation rates. Schools would be required to submit cost containment plans to the US Department of Education every five years. Schools that manage to stay below the inflation rate will be rewarded, while the schools that don't will be penalized.

The bill is still in development, and it's unclear at this point how colleges and universities will be rewarded or penalized.

A Growing Trend

Congressman Reed's bills aren't the first time in recent years that Congress has scrutinized college and university spending.

On May 21, 2015, the College Affordability and Innovation Act of 2015 bill was introduced in the House by Representative Jim Himes. The bill would've established the Commission on Higher Education Accountability Standards and required higher education institutions to establish affordability, accessibility, and value accountability standards based on the commission's recommendations. Schools that didn't meet compliance thresholds would have been penalized through the distribution of Title IV funds.

We're Here to Help

If you have questions about how these legislative and regulatory updates may impact your not-for-profit organization, contact your Moss Adams professional.