Nonprofit Navigator

Spring 2013

About Us

Our not-for-profit niche at Henry & Horne, LLP was officially formed 28 years ago, but we have been serving the not-for-profit community since we opened our doors in 1957. We are dedicated to Arizona's nonprofit community, and as a local firm with such a long history, we truly understand what is important to our nonprofit clients. Our team members receive quality continuing education specifically in nonprofit topics and are continually researching various nonprofit issues, which results in a very broad level of nonprofit expertise.

Henry & Horne, LLP
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Special UBIT Issues With Rental Income

By Colette Kamps, CPA

In general, nonprofit organizations pay tax on income generated from activities that are regularly carried on, not substantially related to the tax exempt mission, and operated as a business. However, there are also a number of exceptions and special nuances to this general rule. One of these is with rental income. Rental income from real estate is generally not taxable if the real property being rented is not mortgaged. However, if rental income is received by a tax exempt organization from an entity that is controlled by the organization, then that rental income is taxable as UBTI, regardless of any mortgage on the property. So what exactly does it mean to be controlled by a tax exempt entity? A tax exempt entity controls another entity if it owns (by value or by vote) more than 50% of the entity. So, for example, an entity could have a wholly owned taxable subsidiary, or an entity could have the power to appoint 75% of the directors of another tax exempt entity. In either case, control exists.

The basis behind this rule of taxability of the rent stems from the situation where a tax exempt entity has an unrelated activity generating income and then creates a wholly owned subsidiary to "house" this activity separately. The taxable subsidiary files its own tax return and pays tax on any net income from the activity. However, if the tax exempt owner charges rent to the taxable subsidiary, there is the possibility of manipulation of the rent amount charged, in order to reduce the taxable income of the subsidiary and potentially reduce the tax paid by that entity. This type of situation can also apply when one tax exempt entity has control over another tax exempt entity if the controlled organization has unrelated taxable income, and rent being paid reduces that income. In that situation, the controlling organization has to allocate a portion of the rental income to UBIT and a portion to related activities.

This rule of UBIT with a controlled organization also applies to royalties, interest and annuities. However, it does not apply to dividends, since dividends are paid after tax.

Rental income is also subject to UBIT when it is calculated as a percentage of the tenant-lessee's net income or the payment includes compensation for services rendered to the lessee. Also, if personal property (such as equipment) is included in the lease of real property and if it makes up more than 50% of the total rent, then it will also be subject to UBIT.

If you have any questions Colette can be reached at (480) 839-4900 or ColetteK@hhcpa.com.



Coordinates

According to Chronicle of Philanthropy, among the top five philanthropists last year, three were couples under 40.

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According to the National Center for Charitable Statistics, public charities that filed annual 990 forms with the IRS in 2010 derived about a third of their revenue from government sources, including grants and fees for services.

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The Philanthropy Journal is launching a national contest to recognize outstanding volunteers whose service to nonprofits makes it possible for good works to occur in local communities.

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According to the Philanthropy Journal, last year, more than 56,000 people shaved their heads at events for the St. Baldrick's Foundation to raise funds to benefit research into childhood cancers, raising $33.5 million.

Raffles Have Potential Tax Impact

By Katie Thomas, CPA

While raffles can be a great vehicle for fundraising, there are some potential tax impacts that you should be aware of before you sell your first ticket. The first is that you are not permitted to use a third-party raffle company. You either have to have a staff member coordinate it, or have one of your volunteers take on this task. The second, and this is one that shocks most people, is that raffle ticket purchase are not tax deductible. When someone buys a raffle ticket, the IRS has ruled that they are effectively buying a chance to win something, and thus this is a reciprocal transaction. While you cannot control what those purchasing the tickets do, your organization needs to be very careful to not give any indication to those purchasing tickets that it is a tax deduction. One more thing on the tickets – do not put them in the mail. There is a federal law that prohibits the mailing of raffle tickets. If you sell a ticket to someone who cannot pick it up in person, your best bet is to go ahead and call or email them with the ticket information.

Now that you've got the groundwork laid to sell the tickets, you also need to consider whether you will need to collect taxes from the winner and file tax forms. If you are like most people, you just read that last sentence and thought to yourself "WHAT?? What taxes would someone have to pay?" If the prize awarded in the raffle is valued at more than $5,000 (or 600 times the wager if valued less than $5,000), you are required to collect taxes (or withhold) before giving the prize. If you choose not to withhold/collect taxes, you, as an organization, are responsible for paying the taxes. Regardless of who pays the taxes, if required, your organization will be responsible for filing a Form W-2G. Many organizations are reluctant to ask raffle winners to pay taxes on the prizes. Consider this, if you win a brand new house in some of the larger raffles we've seen become more popular lately, they actually have a bank representative at the signing for you to take out a mortgage to pay the taxes on the house you just won.

The moral of the story is this, when you hold a raffle with a prize valued at more than $5,000, be sure to have the winner bring their checkbook to cut a check for the taxes at 28% of the fair value of the prize and also have them fill out Form 5754 which provides you all the information you will need to file that W-2G. And then make a note on your calendar to prepare a Form W-2G at the same time you prepare your annual Forms 1099 and regular Forms W-2.

If you have any questions Katie can be reached at (480) 839-4900 or KatieT@hhcpa.com.

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