

Alert | Tax-Exempt Organizations



January 2020

2019 Tax Act Effects on Tax-Exempt Organizations; Required Section 501(c)(4) Notices

Repeal of Tax on Fringe Benefits Gives Tax Exempts a Right to Refund

The Tax Cuts and Jobs Act included a provision increasing taxes on tax-exempt organizations. New Internal Revenue Code Section 512(a)(7) required that tax-exempt organizations include in computing unrelated business taxable income any amount incurred by the tax-exempt organization (i) for any qualified transportation fringe benefit for an employee (generally, costs of mass transit passes and parking near the employer place of business), (ii) any parking facility used by employees, or (iii) any on-premises athletic facility used by employees, in each case to the extent that such amounts would not have been deductible by the tax-exempt organization if it were a for-profit organization.

The impact of Code Section 512(a)(7) was to impose tax on the amount of these fringe benefits provided to employees on organizations that might otherwise be exempt from income tax. Religious organizations that previously were not required to file federal income tax returns were required under this Code provision to file income tax returns to report and pay tax. Many tax-exempt organizations lobbied extensively to have this tax repealed. Organizations argued that this was unfair to charitable organizations and diverted money away from charitable activities.

This lobbying by tax-exempt organizations was successful. The recently enacted Taxpayer Certainty and Disaster Tax Relief Act of 2019 (the “2019 Act”) repealed Section 512(a)(7) retroactively. Tax-exempt organizations that paid the tax in prior years are entitled to a refund of those taxes.

On January 21, 2020, the IRS posted [guidance](#) on its website that organizations seeking refunds or credits for the tax paid in prior years are instructed to file an amended Form 990-T, “Exempt Organization Business Income Tax Return,” for the year(s) in which the tax was paid (2017 and/or 2018). Filers are directed to write “Amended Return” at the top of their form.

Tax Rate on Private Foundation Investment Income Changes

In the past, an excise tax of 2% was imposed on the net investment income of private foundations. Private foundations could reduce the rate to 1% by employing a pattern of increasing distributions. The 2019 Act simplified the private foundation excise tax by creating a single rate of 1.39%. The new tax rate is effective for private foundations with tax years beginning on and after January 1, 2020. Because of the change in the tax rate, some private foundations will pay a higher rate tax on net investment income, but the change will allow all private foundations to make distribution decisions without having to consider the impact on the private foundation’s excise tax rate.

Failure to Provide Notice of Intent to Operate Under Section 501(c)(4)

It has recently been revealed that thousands of new organizations may have failed to notify the IRS of their intent to operate as Section 501(c)(4) organizations within 60 days of their formation (by filing a Form 8976), as is required by a 2015 law. The notice requirement was intended to provide the IRS with information about the formation of new Section 501(c)(4) organizations. Prior to the notice requirement, because Section 501(c)(4) organizations are not required to obtain determination letters, frequently the IRS had no knowledge of the existence of a new Section 501(c)(4) entity. The issue was significant because of the use of Section 501(c)(4) organizations for political and lobbying purposes.

Because of the failures to file the required notices, these organizations could owe more than \$48.4 million in penalties. Further, the responsible parties affiliated with these organizations could be subject to an additional \$47.5 million in penalties. Senate Finance Committee ranking member Ron Wyden (D-OR) has stated that “the IRS is once again asleep at the wheel on enforcing rules for politically-active nonprofits.” The IRS has disputed the report in which these findings were published.

New Section 501(c)(4) organizations formed this year in contemplation of election activities should comply with the notice requirement to avoid penalties and ensure that they obtain the benefits of Section 501(c)(4) status.

Authors

This GT Alert was prepared by **Harry J. Friedman** and **Claire Arritola**. Questions about this information can be directed to:

- [Harry J. Friedman](#) | +1 954.768.8212 | friedmanh@gtlaw.com
- [Claire Arritola](#) | +1 954.468.1748 | arritolac@gtlaw.com
- Or your [Greenberg Traurig attorney](#)

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