



NONPROFIT ADVISOR

For DAV Departments and Chapters

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EIGHT WAYS TO GET ON THE RADAR OF THE IRS

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The Internal Revenue Service (IRS) has responsibility for regulating and monitoring tax-exempt organizations. This is appropriate, since such organizations receive substantial financial benefits (no federal income tax and, in some cases, receipt of deductible contributions) that reduce government revenue.

No organization wishes to be in the crosshairs of the IRS, since tax difficulties can be a financially expensive and emotionally draining process for all involved. How does the IRS find its tax-exempt targets? In many ways, but two of the most common are through media reports and complaints from the public. When a tax-exempt organization misbehaves, someone is sure to notice. IRS also gleans interesting information from reports and returns that exempt organizations are required to file.

Certain kinds of misbehavior are especially interesting to IRS.

Scandalous Acts.

While the IRS is not the morality police, the organization that spices up its annual golf outing with a bevy of exotic dancers will surely trigger a complaint from an irate onlooker or a media story by a sensationalism-seeking reporter. Such complaints or reports may suggest to IRS that the organization is taking its exempt purpose lightly and is more interested in recreation than in its mission.

Poor Governance.

Although the tax laws do not specify much in the area of how a tax-exempt organization ought to be governed, IRS has long taken the reasonable position that the poorly-governed organization is probably careless about its mission as well. Poor governance is demonstrated in many ways, but two of the most common are by boards of directors (“executive committees,” in DAV parlance) that are too small to support a democratic process or too large to get anything done.

Impermissible Conflicts of Interest.

IRS is always interested in cases where a “control person” (such as a commander or adjutant) in a tax-exempt organization appears to benefit personally from having that control. Examples of such benefit are: (1) no-show jobs for relatives; (2) sales of real estate or other property by the control person to the organization; and (3) payment by the organization of personal expenses of the control person. These kinds of violations can bring severe penalties to the organization, to the offending officials and to other persons within the organization who had the means to correct the abuse but failed to do so.

Excessive Compensation.

Certainly, those who perform non-volunteer services for a tax-exempt organization are entitled to be fairly compensated for their labors. However, when the compensation received is far beyond the value of the services provided, the IRS takes the position that



money intended for charitable programs is being improperly diverted for personal purposes. Even beyond that, the amount of compensation paid must be reasonable in light of the assets of the charity. For example, if a department with a total net worth of \$750,000 were to hire a former President of the United States as a paid employee at a salary of \$1,000,000 annually, that compensation would certainly be excessive even if it could be argued that the services to be rendered would be worth that much in a different context.

Excessive Unrelated Business Activities or Income.

If a tax-exempt organization engages in business activities that are unrelated to its exempt purpose, the organization must pay tax on any income derived from those activities. More importantly, if those activities reach the point that they are either (1) providing a substantial part of the revenue of the organization or (2) occupying a substantial part of the time of the organization, IRS may conclude that the entity has become a business and is no longer entitled to tax-exempt status.

Few Mission-Related Accomplishments.

More and more, whether on federal and state filings or in other documents, tax-exempt organizations are being challenged to articulate with precision what their missions are and how they are using tax-exempt dollars to accomplish it. Vague statements about “helping veterans” are no longer sufficient. Regulators, and the public, wish to know, for example, how many veterans were helped, how they were helped, and what the cost of the help was. The organization that cannot (or will not) provide that

information is sending up a red flag to IRS and other regulators.

Failure to Make Required Government Filings or Payments.

Although nonprofits will sometimes be required to reveal adverse information in government filings, failure to make those filings (such as IRS Form 990) is an invitation to regulators to conduct an in-depth examination of every aspect of an organization’s activities. So too, an organization exempt from federal income tax payments is still required to remit a host of taxes and fees to the government. Examples include income tax and other payroll withholding, as well as certain sales and excise taxes. Failure to make these payments will not only alert IRS to a pattern of noncompliance, but can generate separate civil and criminal penalties.

Fundraising Violations.

It is rare that a tax-exempt organization can raise money, even on a local level, without some type of permit. It is the responsibility of DAV departments and chapters to ascertain that all fundraising activities comply not only with DAV’s own regulations, but with applicable law. Even though IRS does not become involved with fundraising regulation *per se*, input to the agency from state or local fundraising officials has increased exponentially. Whereas it used to be uncommon for IRS and state officials to share information, such cross-pollination now occurs on a regular basis. State regulators openly acknowledge that they refer “problem” charities to IRS, which has greater investigative and enforcement mechanisms.

Nonprofit Advisor is prepared by the Office of the DAV’s General Counsel and is published quarterly for the informational use of DAV Departments and Chapters. This newsletter is not intended to replace legal advice that may be required to address individual situations.