



UPPER PENINSULA LAND CONSERVANCY

Policy 2C: Tax Exemption

Standard 2C, 2021 Land Trust Alliance Standards and Practices

Board Approved: **May 9, 2017**

Board Revision Approved: *April 12, 2022*

PURPOSE

The purpose of this policy is to maintain status as a tax exempt organization under section 501(c)3 of the Internal Revenue Code (IRC). This policy outlines requirements so that they align with Land Trust Alliance **Standard 2C: Federal Tax Exemption:**

1. *Maintain status as a tax-exempt organization under section 501(c)(3) of the Internal Revenue Code (IRC)*
 - a. *File a complete and accurate annual information return (Form 990 or equivalent) with the Internal Revenue Services (IRS)*
 - b. *Do not knowingly engage in prohibited activities, such as private inurement or impermissible private benefit*
 - c. *Comply with federal lobbying limitation and reporting requirements*
 - d. *Do not engage in political campaigns on behalf of or in oppositions to any candidate for public office*

INTRODUCTION

Federal and most state governments provide an exemption from income tax for qualified nonprofit organizations and allow the deductibility of contributions to them. This subsidy of the nonprofit organization is offered in return for the organization's operation in the public interest. The Internal Revenue Service (IRS) requires that tax-exempt organizations operating as public charities meet certain tests both at the time of application for tax-exempt status and on a continuing basis. These include avoiding private inurement and excess private benefit, a prohibition on political campaign activity, complying with limitations on lobbying, paying tax on unrelated business income, and meeting the public support test.

DEFINITIONS

Private Inurement: *When the net earning of a tax-exemption organization comes to the benefit of any private stakeholder or individual.*

Unrelated Business Income: *The gross income derived from any unrelated trade or business regularly conducted by the tax-exempt organization.*



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POLICY

Summary: It is the policy of the Upper Peninsula Land Conservancy to comply with requirements for retaining federal tax-exempt status under Section 501(c)(3), including prohibitions on private inurement and political campaign activity, and limitations and reporting on lobbying and unrelated business income. If the UPLC holds, or intends to hold, conservation easements, it also meets the Internal Revenue Code's (IRC) public support test for public charities. Where applicable, state tax-exemption requirements are met.

1. Benefit of Federal Tax Exemption
2. Retaining Tax Exemption Status
3. Avoiding Private Inurement / Private Benefit
4. Unrelated Business Income Tax
5. Meeting Public Support Test
6. State Tax Exemption Requirements

Benefits of Federal Tax Exemption

Applying for and maintaining federal tax-exempt status under Section 501(c)(3) places special operating burdens and filing requirements on the UPLC. But the benefits are great. They include:

- **Exemption from federal taxes.** Tax-exempt organizations are exempt from paying federal income tax on most types of income, as well as from certain federal excise and unemployment taxes.
- **Assistance with state and local tax exemptions.** Most states and localities mirror the federal statute and also exempt qualifying organizations from income tax and often from state sales tax. Federal tax-exempt status also can help in establishing the organization's charitable intent and operation in applying for local property tax exemption.
- **Deductibility of donations.** Donations of cash, securities or interests in property to tax-exempt organizations are deductible on the donor's federal (and state) income tax returns. However, UPLC does not guarantee any tax benefits to donors.
- **Eligibility for grants.** Tax-exempt organizations that are public charities are eligible for certain grants from private foundations and government agencies that are not available to for-profit organizations.



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- **Potential eligibility to receive tax-deductible donations of conservation easements.** In addition to other requirements, an organization must be a tax-exempt organization to qualify as a donee for tax-deductible conservation easements.

Retaining Tax Exemption Status

The IRS requires that public charities meet certain operating tests both at the time of application for public charity status and on a continuing basis. They include:

- **Avoiding private inurement.** Among the key conditions of tax-exempt status is that the UPLC be “organized and operated exclusively for [charitable] purposes...no part of the net earnings of which inures to the benefit of any private shareholder or individual.” What is key here is the proscription against private inurement (see further information below).
- **Prohibition on political campaign activity.** The UPLC may not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.
- **Complying with limitations on lobbying.** Lobbying may constitute only an “insubstantial part” of UPLC’s activities. This can be as much as 20 percent of annual exempt purpose expenditures if the UPLC has elected to have the provisions of Section 501(h) apply to it.
- **Paying tax on unrelated business income.** The UPLC must report and pay unrelated business income tax on any unrelated business taxable income in excess of \$1,000 (see further information below).
- **Meeting the public support test.** The UPLC must continue to show that it meets the public support test if it intends to qualify for public charity status as a publicly supported organization (see further information below).

Avoiding Private Inurement / Private Benefit

The statutory ban on inurement is a considerable threat to the tax-exempt status of any charitable organization, like the UPLC, that is engaged in financial transactions with individuals and/or for-profit entities. Taken at its most obvious meaning, the statute bars participation in profits by any officer, board member or member of the organization. But it also *generally* prohibits the following:





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- The payment of excessive compensation for professional services or merchandise.
- The disposition or rental of property, other than to another nonprofit or government entity, at less than fair market value.
- The provision of services by the UPLC to individuals and nonexempt organizations without a fair return.

Situations that the UPLC is likely to run into that could raise the issue of private inurement or private benefit include the following:

- Allowing the free use of its office space or staff support for a nonexempt lobbying organization.
- Giving away equipment the UPLC no longer needs to individuals, except in circumstances where such activity is mission-related
- Selling land or renting a house on a property the UPLC owns at less than fair market value, except in circumstances where such activity is mission related.

Some private benefit may be tolerated where it is incidental to the accomplishment of the UPLC's charitable purposes and insiders to the organization are not involved. The amount of private benefit that the courts have allowed has depended on the *magnitude* of the private benefit in relation to the public benefit derived from the organization's activities, and whether the private benefit is necessary in order to effectuate the organization's exempt purpose. For example, the UPLC may be able to lease property to a farmer at less than what a summer resident might pay if one of the trust's exempt purposes is to protect agricultural land. Or it may be able to provide conservation services free of charge or at below market price in the course of a land protection project, such as developing a land-use plan for a property on which the owner is donating a conservation easement.

Private inurement can result in fines on the members of the board or senior staff that allowed it to happen and may even cause the organization to lose its tax-exempt status. (Most court findings of inurement have been limited to transactions involving insiders such as board members, officers or members. See standard 4 on conflict of interest for further discussion.)

UPLC should be very wary of any situation that might involve private inurement or excess private benefit and seek the advice of counsel. UPLC can establish the reasonableness of a salary, payment or transaction by:



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- Having appropriate data to support reasonableness of the transaction.
- Making sure the board approves the transaction.
- Documenting the basis for the decision in the organization records.

Note that UPLC must be able to provide documentation for transactions proving UPLC did not knowingly engage in prohibited activities such as private inurement or impermissible private benefit, such as through transactions with insiders, issuing gift acknowledgments, accepting donations or purchasing land or conservation easements, selling land or easements, enforcing easements or amending easements.

Unrelated Business Income Tax

The UPLC must be careful about any business activities in which it engages. To qualify as an exempt organization under Section 501(c)(3), the UPLC must be organized and operated exclusively for exempt purposes. Any business activities it operates that are not primarily in furtherance of its exempt purpose must not be a substantial part of its operations. In addition, it must pay tax, at standard corporate income tax rates, on any net income after the first \$1,000 from unrelated business activities. The tax is intended to eliminate unfair competition with taxable businesses.

Unrelated business income is reported on [Form 990-T, “Exempt Organization Business Income Tax Return”](#). [Internal Revenue Service Publication 598, Tax on Unrelated Business Income of Exempt Organizations](#), details the regulations regarding unrelated business income.

What is unrelated business income?

There are three criteria for determining an unrelated trade or business.

1. The activity must be a trade or business.
2. The activity must be conducted on a regular basis.
3. It must not be substantially related to the purpose of the tax-exempt organization.

Some trade and business activities are excluded from the unrelated business income tax. These include:

- Businesses that are conducted by volunteers who work without compensation;
- Thrift shops in which merchandise is received by the organization as a gift;



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- Qualified trade shows;
- Qualified public entertainment;
- Bingo games; and
- Income from the distribution of certain low-cost items.

Some examples of activities UPLC might undertake that might yield unrelated business income include rental of their mailing lists to commercial retailers and sale of advertising in the UPLC newsletter. Activities that probably would not be considered as yielding unrelated business income include resale of a restricted property or consulting on land use plans for conservation easements. Income from commercial timber harvesting on property owned by UPLC probably would not be considered as yielding unrelated business income as long as such harvests are conducted primarily for conservation and educational purposes.

There are extensive rules governing what qualifies as unrelated business income. If the UPLC is uncertain whether an activity might fall in this category, and the activity will generate more than \$1,000 annually, it should consult an attorney familiar with nonprofit law. The UPLC also should keep in mind that a large amount of unrelated business income might indicate to the IRS that the trust is engaging in nonexempt activities to a substantial degree and thus jeopardize the UPLC's tax-exempt status.

Meeting Public Support Test

To qualify for public charity status as a publicly supported organization under Section 509(a)(1) or 509(a)(2) of the Internal Revenue Code (IRC), UPLC must show that a certain proportion of its receipts comes from the general public. This includes grants from government agencies and other public charities, and contributions from individuals and nonexempt organizations. This requirement is often called the "public support test".

Failing to meet the public support test can cause the UPLC to lose its public charity status. If that happens, the UPLC will become a private foundation, which can effectively eliminate its ability to carry out its land protection mission. It is vital that someone associated with the UPLC (a board member, staff person or outside financial advisor) be assigned the responsibility for understanding the public support test, monitoring the UPLC's performance against it and alerting the UPLC if it appears to be running the risk of falling short of its requirements. This allows the UPLC time to fundraise to meet the test's requirements.

How much public support is required?

Generally an organization meets the public support test if it:





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1. **Normally receives at least one-third of its total support** from government agencies and the general public (“favorable” support); **or**
2. **Receives at least 10 percent of its support** from these sources and meets an “attraction of public support” requirement. This is often called the facts and circumstances test.

Facts and circumstances test

If the UPLC fails to meet the one-third support test, it may still qualify under the more flexible facts and circumstances test. To qualify under this test, the UPLC *must meet* the following two requirements:

1. **Ten percent of support.** The organization must receive *at least* 10 percent of its support from government agencies and the general public. Favorable support is calculated in the same way as it is for the one-third test; however, the lower percentage of public support required makes meeting the standard easier. If the organization’s favorable support is less than 10 percent, it will not qualify.
 2. **Attraction of public support.** To meet this requirement, the UPLC must show that it has a continuous and bona fide program of solicitation of funds from the public, government or other charitable organizations. The UPLC seeking to meet this test may find it especially advantageous to have a large and broad membership.
- **The percent of public support.** Obviously this figure will lie somewhere between 10 percent (the non-qualifying level) and 33 1/3 percent (the level sufficient by itself for public charity status). The lower the percentage, the stronger the combination of remaining factors must be. If a large portion of income derives from endowment interest (which is not considered public support), the origin of the endowment will be considered.
 - **Sources of support.** Broad support, a variety of potential donors and significant governmental contributions work in the UPLC’s favor.
 - **Representative governing body.** A governing body (e.g., the UPLC board) that includes a cross section of interests such as public officials, experts and community leaders weighs in the UPLC’s favor.
 - **Public facilities or services.** Benefiting the public directly through programs or services is considered evidence of public support.



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- **Miscellaneous factors.** Breadth of solicitation, restrictiveness of dues and broad appeal of activities are also considered.

Calculating public support

To calculate the percentage of public support, the IRS instructs the organization to set up a mathematical equation with public support in the numerator and total support in the denominator. To do this, the UPLC must understand what types of income, and how much of each, are to be included in each category. See Figures 4.1 and 4.2.

1. Total support: the denominator. Total support includes most of the UPLC’s income but *does not include* the following:

- Exempt income—Income from a function or activity that advances the trust’s exempt purposes (e.g., fees for land planning or consulting, sales of conservation publications, income from seminars).
- Capital gains.
- Private donations of services—The general rule of thumb is that only those in-kind forms of support that are tax deductible to the donor should be considered in the UPLC’s total support calculation.
- Unusual grants—Unusual grants from disinterested parties may be excluded from the support calculation under certain conditions (see discussion below).

2. General public (“favorable”) support: the numerator. Public support can be broken down into two categories.

- One hundred percent. Government grants, government donations of services or facilities, and grants from public charities count 100 percent toward public support.
- Two percent limit. Grants from private individuals, private foundations and other organizations count toward public support also, but not more than an amount equal to 2 percent of total support may count as public support from any single source. For this purpose, all contributions made by a donor and any related person or persons are aggregated.



Note that investment income (such as interest from an endowment or revolving fund) is included in total support, but does not count toward public support.

Unusual grants: dealing with large gifts

Large gifts from private sources, such as donations of valuable land, easements or a large bequest, can make it difficult for the UPLC to meet the public support test. Such gifts count 100 percent toward total support, but are limited in their application toward public support to 2 percent of total support.

However, such grants may be completely eliminated from the support calculations if they meet certain requirements. Under IRS regulations, “unusual grants” from “disinterested parties” may be excluded from the support calculation if they (1) are attracted by reason of the publicly supported nature of the UPLC; (2) are unusual or unexpected with respect to the amount of the contribution; and (3) would, if required to be included, adversely affect the status of the UPLC. Generally speaking, “all pertinent facts and circumstances” are taken into consideration in determining whether the exclusionary circumstances are present.

The IRS has published guidance ([Revenue Procedure 81-7, 1981-1 C.B. 621](#)) listing six factors that taken together qualify a grant as “unusual.”

1. A person other than a creator of the organization or a person who had attained “substantial contributor” status prior to the contribution makes the contribution. (A “substantial contributor” is a person who, as of the end of any year, has made total [historical] contributions in excess of \$5,000 and whose total contributions exceed 2 percent of the UPLC’s total [historical] support to that date.) Persons related to creators and substantial contributors, within the meaning of certain detailed attribution rules, are also disqualified.

Because the UPLC may wish to exclude donations of land or easements from the support calculation by classifying them as unusual grants, it may wish to discourage such potential donors from participating in UPLC’s creation and from making other substantial contributions prior to protecting their land.

2. The contribution is not made by a manager of the nonprofit (e.g., a board member or officer) or by anyone who otherwise is able to exercise control over the organization, nor by a person who attains such a position of authority on account of the contribution itself. The same related-party proscription mentioned in paragraph 1 applies here.



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3. The contribution is in the form of cash, readily marketable securities or assets that directly further the exempt purposes of the organization. (The IRS has ruled privately that a conservation easement donation to the UPLC satisfies this factor.)
4. The UPLC has received either an advance or final ruling classifying it as a public charity and, once beyond its advance-ruling period, is “actively engaged” in a program of activities in pursuit of its exempt purposes.
5. No material restrictions or conditions have been imposed by the contributor upon the UPLC in connection with the grant or contribution. (The attributes of ownership retained by the donor of a conservation easement are not deemed to be restrictions or conditions on the easement gift.)
6. If the contribution is intended to underwrite operating expenses, as opposed to financing capital expenditures, the contribution covers no more than one year’s operations.

Fundraising to meet the support test

The UPLC may be able to fundraise to meet the test without too much trouble, as long as it plans ahead. For example, the UPLC with total support of \$200,000 over four years could raise \$2,000 each (which is below the 2 percent limit) from 34 people over that period and automatically meet the test ($\$68,000/\$200,000 = 34$ percent).

State Tax Exemption Requirements

The UPLC that is tax exempt under state law must be sure to understand and comply with the requirements of that law. UPLC should consult with appropriate advisors on the tax law that governs their state.

REVISIONS

This policy should be reviewed by the Board on a biannual basis. Any amendments must be approved by vote of the Board of Directors and will require a simple majority to be changed.