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UPDATE FOR ACCOUNTANTS AND FINANCIAL PLANNERS



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2

Liens & Levies: What IRS and Maryland Comptroller Can and Cannot Do

Moderated by: David S. De Jong

Presented by: Eric J. Rollinger &
Michael Y. Goldberg

IRS Lien v. Levy

3

- IRS Tax Lien: The government's legal claim against the taxpayer's real estate, personal property, and financial assets. (<https://www.irs.gov/businesses/small-businesses-self-employed/understanding-a-federal-tax-lien>)
- IRS Tax Levy: the legal seizure of the taxpayer's property to satisfy a tax debt. This can include the garnishment of wages, seizure of funds from the taxpayer's bank or other financial institution, or the seizure and sale of the taxpayer's vehicle(s), real estate, and other personal property. (<https://www.irs.gov/businesses/small-businesses-self-employed/levy>)

Federal Tax Liens

4

- An automatic lien arises if the taxpayer does not pay amount of assessment (including interest and penalties)
 - ▣ Attaches to all of taxpayer's property, including after-acquired property
 - ▣ Relates back to the date of assessment
- Effect
 - ▣ Creates issues on sale of property without IRS receiving payment
 - ▣ Establishes priority against other creditors
 - ▣ Encourages taxpayer response
- Does not directly require property to be sold or transferred
- Can attach to Husband-Wife tenants by the entirety property even if only one party has a liability (U.S. v. Craft, 535 US 274 (2002))

Priority of Federal Tax Lien

5

- IRC § 6321
 - Lien arises as a matter of law; no filing is required for lien to exist (“silent lien”)
- IRC § 6323
 - A lien under §6321 shall not be valid against any purchaser, holder of a security interest, mechanic’s lienor, or judgment lien creditor until notice has been filed by the Secretary
 - Notice must be filed according to state law in the state or county where:
 - The property is located (real property)
 - The taxpayer resides (personal property)
 - Even with notice, lien is not valid against:
 - Certain purchasers without actual notice or knowledge of the existence of the lien
 - Certain lienors entitled to priority under local law

United States v. Craft, 523 US 274 (2002)

6

- Craft and his wife owned property as tenants by the entirety. Craft had outstanding federal tax liabilities. The IRS filed a notice of federal tax lien on the property owned by Craft and his wife. After the notice was filed, Craft and his wife executed a quitclaim deed transferring his interest to her. The IRS agreed to release the lien and allow the Crafts to sell the property if half of the net proceeds would be held in escrow
- Issue: Whether a tenant by the entirety possesses property or rights to property to which a federal tax lien may attach?

United States v. Craft, 523 US 274 (2002)

7

- Answer: Yes
- Each tenant possesses individual rights to the property sufficient to constitute “property” or “rights to property” for the purposes of the lien
- Under Michigan law, Craft had right to use property, receive income produced by it, the right to exclude others from it, the non-unilateral right to alienate the property, and the right of survivorship
- State law determines the rights an individual has in property but federal law determines whether a federal tax lien may attach

Relief from Federal Tax Liens

8

- Four different types of relief from federal tax liens:
 1. Release (automatic or request by letter)
 2. Discharge (IRS Form 14135)
 3. Subordination (IRS Form 14134)
 4. Withdrawal (IRS Form 12277)

Release of a Federal Tax Lien

- Section 6325(a) provides that IRS must issue a certificate of release of lien if:
 - ▣ The balance owed has been satisfied
 - ▣ The balance owed has become legally unenforceable
 - ▣ The IRS accepts a bond that is conditioned on the payment of the balance owed
- The IRS must issue a certificate of release within 30 days of:
 - ▣ The balance owed being satisfied (paid)
 - ▣ The balance owed becoming unenforceable (SOL runs)
 - ▣ The IRS accepting Taxpayer's bond
- Per Reg §301.6325-1(a)(7) the Taxpayer is supposed to request a release of tax lien in writing with Taxpayer's name and address to the Area director for the Area in which the lien was filed, but in practice the IRS seems to ignore this requirement

Discharge of a Federal Tax Lien

10

- A certificate of discharge differs from a certificate of release in that a certificate of discharge only discharges specific property from the tax lien
- A lien continues to exist after a discharge, but the specific property is relieved from the tax lien
- Section 6325(b) provides that the IRS can issue a certificate of discharge if one of the following applies:
 - The value of the Taxpayer's other property that remains subject to the lien is equal to double the unsatisfied liability;
 - The Taxpayer furnishes a bond of equal value with the IRS;
 - The Taxpayer pays the IRS an amount not less than the value of the IRS's interest in the property discharged;
 - The IRS's interest in the property has no value; or
 - The Taxpayer sells the property and the proceeds from the sale are held, pursuant to a written agreement, in a fund in which the federal lien and all other competing interests maintain the same priority that they had in the discharged property
 - In practice the IRS does not usually allow this remedy unless there is a priority dispute between IRS and a competing creditor

Subordination of Federal Tax Lien

- In certain circumstances the IRS may agree to surrender the priority of its lien on specific property if subordinating the lien will facilitate collection of the tax owed
- A lien continues to exist after a subordination, but the IRS priority of its lien on specific property is subordinated to a specific creditor
- Section 6325(d) provides that the IRS can issue a subordination of lien if:
 - The IRS is paid an amount equal to the value of its interest in the subject property
 - The IRS believes that the amount it will ultimately realize from the property or from any other property subject to the lien will be increased by the issuance of the certificate of subordination
 - The IRS determines that the special estate tax lien for special use valuation property is still adequately secured after subordination of that lien.

Withdrawal of Federal Tax Lien

12

- The IRS can withdraw a notice of tax lien and treat the tax as if the lien notice had been issued in error if it is determined that:
 - The lien notice was filed prematurely or not in accordance with IRS administrative procedures;
 - The Taxpayer has entered into an installment agreement for payment of the underlying tax liability, unless the agreement provides otherwise;
 - The withdrawal of the lien will facilitate collection of the tax liability; or
 - With the consent of the Taxpayer or the Taxpayer Advocate, the withdrawal of the lien notice is determined to be in the best interests of the Taxpayer and the Government
- Per IRC § 6323(j) the IRS may withdraw a tax lien if it determines:
 - A. the filing of such notice was premature or otherwise not in accordance with administrative procedures of the Secretary,
 - B. the has entered into an agreement under [section 6159](#) to satisfy the tax liability for which taxpayer the lien was imposed by means of installment payments, unless such agreement provides otherwise,
 - C. the withdrawal of such notice will facilitate the collection of the tax liability, or
 - D. with the consent of the taxpayer or the National Taxpayer Advocate, the withdrawal of such notice would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) and the United States

Federal Tax Levy

13

- IRC § 6331
- The legal seizure of property to satisfy a tax debt
 - ▣ Real or personal property
 - IRS can use or sell property
 - Taxpayer has advance notice of sale and can stop sale by posting bond or making payment
 - Taxpayer has right to redeem property even after sale
 - ▣ Garnishment of wages, social security payments, or funds held in bank accounts
 - Can be a continuing levy which impacts future wages/payments until released
- Written notice required
 - ▣ 30 days before date of levy
 - ▣ Given in person, left at dwelling or usual place of business, or sent by certified/registered mail to taxpayer's last known address

Federal Tax Levy

14

- Single levy: a one-time seizure of assets
- Continuous levy: attaches to future payments until the levy is released
 - ▣ Occurs when the levy reaches a payment in which the taxpayer has a fixed and determinable right
 - ▣ Payment is not dependent upon the performance of future services
 - ▣ Can include salaries, wages, certain retirement payments, royalties, etc.
- State laws limiting the amount of wages that can be garnished are NOT controlling on federal tax levies

Levy of Jointly Held Property

15

- The IRS CAN levy joint bank accounts if the taxpayer has an unrestricted right to withdraw funds even if multiple persons have signature authority for that account (at least if a one signature account)
 - ▣ See Treasury Reg § 301.6332-1
 - ▣ IRM 5.11.4.3
- The IRS CAN remove funds up to the amount of the tax, interest and penalties owed, REGARDLESS of who deposits the funds
- A non-liable third party may claim ownership of funds in a bank account when multiple people hold signature authority for that bank account
 - ▣ This is the same process as a wrongful levy

Levy of Jointly Held Property

16

- I.R.M 5.17.3.9.1.1 – 4
- IRS can levy jointly held property
 - Levy and sale only applies to the taxpayer's property rights
 - Unless the tax liability is outstanding against all joint owners
 - Unless one of two tenants dies, and the tax assessment is outstanding against the surviving tenant who holds the property with right of survivorship
 - As mentioned above, a federal tax lien CAN attach to property held as tenancy by the entirety
 - If a spouse has separate debt, the entire property can be levied upon the non-liable spouse's death

Property Exempt from Levy

17

- IRC § 6334(a) provides a complete list of exemptions:
 - clothing and schoolbooks necessary for the taxpayer or members of their family
 - Fuel, provisions, furniture, and personal effects that do not exceed \$6,250 in value
 - Books and tools of a trade, business or profession that do not exceed \$3,125 in value
 - Unemployment benefits
 - Undelivered mail
 - Certain annuity and pension payments under the Railroad Retirement Act
 - Note: Does NOT include social security payments
 - Workmen's Compensation
 - Judgments for support of minor children in which the taxpayer is required by judgment of a court entered prior to a levy
 - Minimum exemption for wages salary and other income
 - Certain service-connected disability payments
 - Certain public assistance payments
 - Assistance under Job Training Partnership Act
 - Residences exempt in small deficiency cases and principal residences and certain business assets

Minimum Exemptions for Wages, Salary, and Other Income

18

- Amounts levied under IRC § 6334(a)(9) are subjects to limits:
 - Exempt amounts for individuals paid on a weekly basis
 - The sum of the standard deduction and the aggregate amount of deductions for personal exemptions allowed under section 151 in the taxable year in which such levy occurs divided by 52
 - Unless the taxpayer submits a written verified statement specifying the facts necessary to determine the proper amount of wages to be levied under subpart (a), subpart (a) shall be applied as if the taxpayer is a married individual filing a separate return with only one exemption
 - Exempt amounts for individuals paid on a basis other than weekly
 - Equal to the amount that as nearly as possible will result in the same total exemption from levy that an individual paid weekly

Seizure of Principal Residence

19

- IRC § 6334
- Generally, the principal residence is exempt from levy unless a judge or magistrate approves the levy in writing
 - ▣ Test for principal residence is the same as for gain exclusion under §121
 - ▣ District courts have exclusive jurisdiction to approve a levy under § 6334(a)
 - ▣ At the hearing, the IRS will be required to demonstrate that they have met the required administrative procedures, that the liability is owed, and no reasonable alternative for the collection of taxpayer's debts exist (basically the Court will balance the equities).
- Residences are exempt from levy if the deficiency is less than \$5,000
- IRS will only proceed against a principal residence in the most egregious cases

Seizure of Business Interests

20

- IRM 5.17.3.10.18, 21, &22
- The government CAN seize a partner's rights to a proportionate share of the distribution of partnership profits or surplus
- The government can NOT seize and sell partnership property to collect taxes of an individual partner
- The IRS CAN levy and sell a partner's partnership interest or a member's LLC interest.
- The IRS CAN levy and sell a taxpayer's shares in corporations and mutual funds
 - IRC § 6331(f) prohibits uneconomical levies. If the shares are not publicly traded securities, the risk of uneconomical levies increases

Seizure of Pension & Retirement Benefits

21

- IRM 5.17.3.10.19
- Taxpayer's interest in a retirement plan is NOT exempt from levy under IRC § 6334
- If the plan is currently being paid out or if a present right to future payment exists, it CAN be levied
 - ▣ Can seize entire vested balance
 - ▣ IRS administrative policy requires approval to levy the corpus of the retirement account
 - ▣ Taxpayer does not have to retire but does have to be eligible to take a distribution
 - ▣ An IRS seizure encouraged by a Taxpayer avoids the 10 percent penalty on voluntary withdrawals by a delinquent under age 59½

Seizure of Social Security Benefits

22

- IRM 5.11.6.2.1
- IRM 5.17.3.10.19
- IRS has the option of service either a levy under IRC §6331(a) or a continuous levy under IRC §6331(h)
 - If the IRS levies under (h) they can only seize up to 15% of payments
 - There is no 15% limitation to levies under (a).
 - Levies under (a) are not continuous, but they do reach a future stream of Social Security Payments.

Federal Statute of Limitations on Levies

23

- Continuous levies under §6331(h) are released at the end of the CSED
- However, the IRS has taken the position that levies under IRC §6331(a) are not subject to the statute. A levy on a fixed and determinable right to payment which includes payments to be made after the period of limitations expires does not become unenforceable upon the expiration of the period of limitation and will not be released under this condition unless the liability is satisfied.
- This means that levies of Social Security can continue after the statute of limitations expires.
- See: CCA 202129006

Delays in Enforcement Through Defenses

24

- Can stop or prevent a levy by filing:
 - ▣ Installment agreement
 - ▣ Offer in Compromise
 - ▣ Application for innocent spouse relief
 - ▣ Request for currently not collectible due to hardship
 - ▣ Request for CDP or CAP hearing
- The IRS will suspend collection actions while considering these requests
- Note: These actions also suspend the statute of limitations on collections (discussed later)

Collection Due Process Appeals Program

25

- Code section 6330
- I.R.M. 8.22.4
- Provides protection for taxpayer to allow an independent review of collection action
 - Mission to resolve tax controversies on a basis which is fair and impartial to the Government and the taxpayer
 - Standard of review: Abuse of Discretion
 - Court considers whether appeals' factual and legal conclusions reached at a CDP hearing are reasonable (not whether they are correct) and the reasonableness of Appeals' ultimate decision

Issues Eligible for CDP Hearing

26

- The taxpayer may raise any non-frivolous procedural issue relating to the Notice of Federal Tax lien or proposed levy UNLESS he or she has already participated meaningfully in any previous administrative or judicial proceeding where the issue was already raised and considered
- However, substantive issues as to whether all or a portion of the tax may be owed may not be raised if the taxpayer has had an opportunity to raise the issue before which includes communications received but ignored (including 30-day letter, 90-day letter (Statutory Notice of Deficiency) or prior CDP Notice)
- The taxpayer can seek judicial review of the Notice of Determination by filing a petition in the US Tax Court
- CDP hearing officer retains jurisdiction to review any subsequent filings for collection alternatives
- Can request subordination, discharge, or withdrawal of liens
- Can seek innocent spouse relief

CDP Process

27

- Eligible for CDP hearing after receipt of:
 - ▣ Notice of Federal Tax Lien
 - ▣ Notice of levy and Notice of Right to a Hearing
 - ▣ ACS LT 73 or 75
 - ▣ Letter 1058
 - ▣ CP 77, 90, 92, 242, and 297
 - ▣ Letter 2439 Notice of Jeopardy and Right to appeal
- Taxpayer has 30 days from date of the Final Notice to request a hearing by filing form 12153
 - ▣ If not requested within 30 days, taxpayer can request an equivalent hearing within a year.
 - Limitations of CDP Equivalent Hearing
 - Does not prohibit the IRS from pursuing collections actions
 - Does not toll the CSED
 - Cannot get judicial review of Appeals' determination

Collection Appeals Program (CAP)

28

- CAP is an IRS “fast track” procedure used to appeal a number of collection actions including, most commonly, wage garnishments and rejection or termination of an installment agreement
- CAP should ordinarily not be used to appeal most liens and levies as issues presented in CAP may not be reviewed again in a subsequent CDP hearing and CAP decisions cannot be appealed to the Tax Court

Revocation of Passport

29

- IRC §7345
- Taxpayers with seriously delinquent tax debt can be referred to the Secretary of State for action with respect to denial, revocation, or limitation of a passport
 - ▣ Unpaid, legally enforceable, previously assessed liability greater than \$54,000 (indexed for COLA); and
 - ▣ Notice of Federal Tax lien or levy has been filed.
- Except:
 - ▣ Taxpayers in installment agreements
 - ▣ Taxpayers completing an offer in compromise
 - ▣ Tax debts in which collection is suspended because a due process hearing is requested, or innocent spouse relief was requested.
- Valid until:
 - ▣ Debt has been fully satisfied;
 - ▣ Debt becomes legally unenforceable;
 - ▣ Debt is proven to be erroneous;
 - ▣ Taxpayer is granted innocent spouse relief;
 - ▣ Taxpayer enters into installment agreement or offer in compromise.

Federal Statute of Limitations on Collections

30

- The IRS normally has ten years per IRC §6502(a)(1) from the date of assessment of a deficiency to take collection action or to sue for a judgment upon which case the time period for collection is determined under state law
- Exceptions to the 10-year rule include:
 - Submission of a request for an Installment Agreement
 - Extends the time period during the pendency of the request
 - The rejection or termination of an installment agreement extends the time period during any appeal but for no less than 30 days
 - Submission of an Offer in Compromise
 - Extends the time period for its pendency plus 30 days
 - Filing of a bankruptcy or other court proceeding
 - Extends the time period for its pendency plus six months
 - Filing a Collection Due Process (CDP) Appeal
 - Extends the time period for its pendency
 - Signing a Consent to Extend the Time to Assess Taxes
 - Extends the time for the period specified in the consent

Private Debt Collection

31

Federal

- IRC §6306: Nothing in any provision of law shall be construed to prevent the Secretary from entering into a qualified tax collection contract
- IRS will send Notice CP40 letting the taxpayer know their debt has been sent to a private collection agency.
- The private agency will then send a letter to the taxpayer on how to resolve the overdue taxes.
- Both letters contain the same taxpayer authentication number to confirm the taxpayer's identity and to verify the validity of the private agency
- Federally approved Agencies: CBE Group, Coast Professional Inc., ConServe

Maryland

- Referral to External Collection Agency
 - Additional fees may apply
 - Once referred, payments must be made through external agency
 - Only by agencies listed on Maryland Comptroller website
 - Penn Credit
 - Harris and Harris Ltd.

Maryland Collection Tools

32

- Unique to Maryland
 - ▣ Motor Vehicle License and Registration Nonrenewal
 - ▣ Business and Professional License Hold
 - ▣ Caught in the Web Program
 - ▣ Tools shared with IRS
 - ▣ Federal or State refunds will be seized
 - ▣ External Collection Agency Referral (Currently IRS as well)

Maryland Tax Liens

33

- §13-805
- Unpaid tax, interest, and penalties constitute a lien, in favor of the State, extending to all property and rights to property belonging to:
 - ▣ The person required to pay the tax; or
 - ▣ The fiduciary estate on which the tax is imposed
- For unpaid inheritance tax, the lien can extend to assets of a small business for which an alternative payment schedule was granted and any other property on which inheritance tax is due
- Estate and Maryland GST tax liens extend to any property subject to the respective taxes.

Maryland Tax Liens (Continued)

34

- §13-807: May be filed with the clerk of the circuit court for the county where the property that is subject to a lien is located
- §13-808: From the date filed, the lien has full force and effect of a judgement lien

Priority of Maryland Tax Lien

35

- §13-809
- A tax lien shall be first paid and satisfied from the proceeds of a sale of any property of any person liable for tax
- Exceptions:
 - Not valid against any purchaser, holder of a security interest, mechanic's lienor, or judgment lien creditor until notice of tax lien has been filed
 - Not valid against any claimant described in IRC §6323 (certain purchasers without actual notice or knowledge of the lien; certain lienors entitled to priority under local law)

Relief from Maryland Federal Tax Lien

36

- §13-806: Unless otherwise specified, the lien arises on the date of notice that the tax is due and continues until the earlier of:
 - The date the lien is satisfied
 - released because lien is unenforceable or uncollectible.
 - 20 years after the date of assessment
- Liens for unpaid inheritance tax arises on the date of distribution and continue for 20 years
- §13-810: If a lien is not satisfied or released on or before the 15th day after notice of the lien is filed, the state may bring an action in court to enforce the lien
 - Merits of all claims or liens decided by the court (no jury)
 - If Maryland prevails, the court may order the sale of the property and the distribution on any proceeds of sale in accordance with the interests of the parties and the State of Maryland

Maryland Tax Levy

37

- §13-812
- The comptroller may send notice of a tax lien to any financial institution that the Comptroller reasonably believes holds property subject to a tax lien
 - ▣ Notice must be sent via first class mail, an electronic format agreed on by the Comptroller and the financial institution, or any other reasonable manner as agreed by the Comptroller and the financial institution
 - ▣ Notice must identify the name of the obligor, the amount of the lien, the last known address of the obligor, the tax identification number of the obligor, and provide notice to immediately seize amounts from one or more accounts
- Comptroller can seize the lesser of the entire amount of the lien or the total amounts of all accounts held at the institution
- Unlike IRS, Maryland apparently cannot seize husband-wife tenants by the entirety property

Maryland Salary Lien

38

- Salary Lien § 13-811
 - Extends to all salaries, wages, or other compensation for personal services due or payable on or after the time the lien arises
 - MD must give notice to employer via certified mail or personal service
 - Statutory amount is exempt from lien:
 - Greater of 75% of disposable wages due or \$145 times the number of weeks in which the wages were earned (§15-601.1 Commercial Law Article)
 - Some counties have different amounts exempt from lien
 - Medical insurance payment deducted from employee's wages by the employer
 - Calculated per Pay Period

Unique Maryland Collection Tools

39

- Motor Vehicle License and Registration Nonrenewal
 - If you owe Maryland taxes and are not in an approved payment plan
- Business and Professional License Hold
 - Certain state and local agencies will delay the renewal of your business license until all tax liabilities have been paid
 - Includes licenses issued by the Comptroller of Maryland, Clerks of the Circuit Court, Maryland Department of Labor, Department of Health and Mental Hygiene, Motor Vehicles Administration, and the Department of Natural Resources, Department of the Environment
- Federal or State refunds will be seized
- Caught in the Web
 - Maryland publishes the names of businesses, individuals, and corporate officers having large unresolved liabilities

Maryland Statute of Limitations on Collections

40

- The Comptroller has seven years per §13-1103 from the date the tax is due
 - ▣ If a receiver or trustee is appointed within the seven-year period, the period for collecting tax extends an additional 2 years from the appointment of the trustee or receiver
 - ▣ If the tax has been assessed, the applicable period of limitations is seven years from the date of the assessment
 - ▣ Any judgment entered may be enforced or renewed as any other judgment
- The seven-year SOL does NOT apply to property with a properly recorded tax lien!
 - ▣ If a lien has been filed within the seven-year collection period, the statute extends to 20 years from the date of assessment

501(c)(3) Organizations: Tax Compliance and Consequences

Presented by: Rebecca A. O'Neill &
Mark W. Schweighofer

IRC 501(c)(3) - Tax Classifications

42

Overview:

- For federal income tax purposes, 501(c)(3)s fall into two principal categories under the IRC: “public charities” and “private foundations”, a distinction based on the amount and sources of the 501(c)(3)’s funding, and its charitable purpose/activities
- PFs usually engage in passive grantmaking and are not required to be publicly funded to any extent
- Organizations are eligible to be PCs (vs. PFs) if organized & operated for certain charitable purposes (i.e., church, hospital, school), or if organized & operated for otherwise charitable purposes & publicly-funded to a specified extent under IRC rules
- PF is the default classification; an org must request PC status on IRS application (Form 1023) & provide supporting operational & financial information

IRC 501(c)(3) - Tax Classifications

43

Types of Private Foundation:

- Focus of presentation will be:
 - Standard Private Foundations:
 - As mentioned: default tax classification; passive grantmaking; no public support required
 - Private Operating Foundations:
 - Can be thought of as a hybrid PC/PF: engage directly in charitable activity like PC, but public support not (usually*) required because substantially all assets/income must be put toward charitable activities
 - Like PC, must request POF status on Form 1023, and must provide supporting financial and operational information

* More on this, later

IRC 501(c)(3) - Tax Classifications

44

Charitable Contribution Deductions - Overview:

- For taxpayers who itemize deductions
- IRC 170(b): adjusted gross income (AGI) limitations on charitable deductions

Donation Type:	Public Charity	Private Operating Foundation	Private Foundation
Cash Only	60% AGI * ■	60% AGI * ■	30% AGI
Appreciated CG Assets	30% AGI	30% AGI	20% AGI

* The CARES Act temporarily increased 60% limitation to 100% AGI for certain 2020 and 2021 cash donations (election)

- 50% pre-Tax Cuts & Jobs Act of 2017 (TCJA); under TCJA 60% limitation for 2018 – 2025 for cash only, but if cash and assets, still use 50% AGI

Pending IRS Application

45

- Form 1023/-EZ applications generally take several months to a year + to process
- Pending approval, organizations should operate as the desired 501(c)(3) type, including filing annual returns for tax-exempt entity (more on this later)
- Donations made during this time are tentatively tax-deductible to the donor & tax-exempt to the recipient organization
 - If IRS approves application, generally tax-exempt status will be retroactive to the date organization was formed (if filed within 27-months after formation)
 - If IRS makes final determination to reject application, the organization was never tax-exempt, and any donation will not be deductible to the donor or tax-exempt to the organization

Public Charities

Types of Public Charity:

- There are several different types of public charities, which are described in IRC §§509(a)(1) – (a)(4) and IRC §§170(b)(1)(A)(i) – (vi); (viii) & (ix)
- Certain PCs Must Pass Public Support Tests, including:
 - IRC §170(b)(1)(A)(iv) endowment funds for colleges/universities owned/operated by government; and
 - “Publicly-Supported” PCs:
 - IRC § 509(a)(1) & §170(b)(1)(A)(vi) PCs funded significantly by public donations or government grants;
 - IRC §509(a)(2) PCs funded significantly by income earned through public donations, member dues, and charitable activities

Public Charities

Public Support Tests:

- IRC §§170(b)(i)(a)(iv) & (vi) TEST:
 - 33 $\frac{1}{3}$ % support comes from the general public
 - No single donation in excess of 2% total support counts toward the 33 $\frac{1}{3}$ %
 - OR: at least 10% support comes from general public and facts & circumstances show general public support
- IRC §509(a)(2) ALTERNATE TEST:
 - 33 $\frac{1}{3}$ % support comes from donations, membership fees and gross receipts from admissions, sale of merchandise, performance of services or furnishing of facilities related to charitable function
 - No single donation in excess of greater of \$5k or 1% total support counted
 - No donation from a “disqualified person” (i.e., insider) counted
 - No more than 33 $\frac{1}{3}$ % support from gross investment income and unrelated business taxable income (more on this later)

Public Charities

48

- After IRS' initial tax classification as PC, must continue to qualify as PC under applicable PC test or be reclassified as standard PF.
- Public support is tested starting in a 501(c)(3)'s 6th year and continues each year thereafter, but looks at current and 4 prior years in the aggregate for the public support calculation
- If an org qualifies as a PC in one year, it will qualify for the immediately following year
 - Calculation is performed & reported on Schedule A of Form 990 (more on this later)

Private Operating Foundations

49

Mandatory Income Test

- Annually, POF must make “qualifying distributions” of substantially all (i.e., 85%) of the **lesser** of:
 - ▣ (i) adjusted net income; or
 - ▣ (ii) “minimum investment return” (assumed rate of return on POF’s investment assets)
- Plus POF Must Meet 1 of 3 Alternative Tests:
 - ▣ Endowment Test
 - ▣ Asset Test
 - ▣ Public Support Test

Private Operating Foundations

50

Mandatory Income Test:

- “Qualifying distributions” are expenditures made directly for the active conduct of the POF’s exempt purpose, or to acquire assets held or used for such purposes (IRC §4942(g); Treas. Reg. §53.4942(a)-3(a)(2))
- “Minimum investment return” means 5% of the value of the POF’s assets *not* directly used for charitable purposes (less acquisition indebtedness under IRC §514(c)(1)) (IRC §4942(e)(1)(A)):
 - Direct Use Assets: office supplies, real property owned by the POF if directly used, such as a museum building, and assets such as a museum’s displayed works of art
 - Non-Direct Use Assets: stocks bonds, interest-bearing notes, endowment funds, leased real estate
 - Cash: a direct use asset, but only partially excluded from min. investment return

Private Operating Foundations

51

- Endowment Test:
 - ▣ Qualifying distributions of at least $\frac{2}{3}$ MIR (i.e., $\frac{2}{3} \times 5\% = 3\frac{1}{3}\%$ of the value of assets *not* directly used for tax-exempt purpose)
- Asset Test:
 - ▣ Substantially more than half (i.e., 65%) of the POF's assets must be held for use in the POF's tax-exempt activities (valuation rules differ per type of property)
- Support Test:
 - ▣ At least 85% of POF's non-investment support must be from general public and no fewer than 5 tax-exempt orgs – **donations over 1% of non-investment support do not count**
 - ▣ No single tax-exempt org may provide 25% or more of the total non-investment support
 - ▣ Gross investment income cannot make up 50% of the total financial support

Private Operating Foundations

52

- After IRS' initial tax classification as POF, must continue to qualify under applicable POF tests or be reclassified as standard PF
- Tested on the annual tax return (Form 990-PF)

Annual Returns

53

- All 501(c)(3)s
 - ▣ Must file an annual return by due the 15th day of the 5th month after the 501(c)(3)'s year end
 - ▣ Tax-exemption automatically revoked by IRS on failure to file 3 yrs. in a row; must re-apply for tax-exempt status (streamlined procedure available in some cases)
 - ▣ Must file Form 990-T to report “unrelated business taxable income” (more on next slide)
- Public Charities:
 - ▣ Form 990/990-EZ/990-N
- Private Foundations (including POFs):
 - ▣ Form 990-PF (no short form)

Unrelated Business Income Tax (UBIT) & Unrelated Business Taxable Income (UBTI)

54

Tax-exempt organizations must operate primarily in furtherance of their tax-exempt purpose. If an organization ventures into other revenue generating activities that are not in furtherance of the organization's tax-exempt purpose, such revenue will likely be classified as unrelated business taxable income which will cause the organization to pay tax on the profits of such activities and, in extreme cases, can jeopardize the organization's exempt status

UBIT and UBTI

55

UBIT

- Section 511 of the code imposes a tax in accordance with Section 11 of the Internal Revenue Code
 - ▣ Applies to organization described in Section 401(a) and 501(c), generally
 - ▣ If tax applies, taxed at normal corporate rates

UBIT and UBTI

56

UBTI

- Section 512 defines unrelated business taxable income
 - The gross income derived by any organization from any unrelated trade or business regularly carried on by it, less the deductions allowed by this chapter which are directly connected with the carrying on of such trade or business

UBIT and UBTI

57

UBTI

- Section 513 defines “unrelated trade or business”
 - any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section 501

UBIT and UBTI

58

UBTI

- Section 513 defines “trade or business”
 - ▣ Includes any activity which is carried on for the production of income from the sale of goods or the performance of services

UBIT and UBTI

59

UBTI

- Exclusions:
 - Certain types of income and deductions are excluded in calculating UBTI
 - Major categories of modifications
 - Passive income
 - Work Performed by Volunteers
 - Dividends
 - Interest
 - Royalties
 - Rents

UBIT and UBTI

60

UBTI

- Income from activities that is not “substantially related” to the organization’s exempt purpose
 - ▣ Is there a direct line between the income that is generated and the organization’s exempt purpose?
 - This can be a matter of properly framing the activity that gives rise to the income
 - ▣ Large universe of private letter rulings on this issue

UBIT and UBTI

61

UBTI

- Trade or Business
 - Does the activity rise to the level of a trade or business within the meaning of Section 162?
 - Concern is that tax-exempt organization could have an unfair advantage as compared to traditional, for-profit enterprises
 - Is there a profit motive in the activity?
 - Is it a trade or business or investment?

UBIT and UBTI

62

UBTI

- Regularly Carried On
 - With what degree of frequency and continuity does the organization carry on the activity?
 - IRS will examine and compare the activity to similar activities of for-profit organizations
 - IRS will also examine the activity in question against other activities of the organization that are clearly related to the organization's exempt purpose
 - Note that in certain situations, intermittent activities can still be considered regularly carried on
 - One-time events generally not regularly carried on

UBIT and UBTI

63

UBTI — Common Exceptions

- Volunteers
 - Not an unrelated trade or business if substantially all of the work is performed without compensation
 - E.g. operation of a retail store by an orphanage that sells merchandise to the general public
 - Generally circumstantial, but 77% has been found to be too low

UBIT and UBTI

64

Qualified Sponsorship Payments

- Not UBTI if there is no arrangement or expectation that such person will receive any substantial return benefit other than the use or acknowledgment of the name, logo, or product lines of the person's trade or business in connection with the activities of the recipient exempt organization

UBIT and UBTI

65

Qualified Sponsorship Payments

- Substantial Return Benefit:
 - Defined by exclusion
 - Any benefit other than
 - Use or acknowledgement of name, logo or product line
 - Return benefits to the payor that do not exceed 2% of the payment (determined by FMV)
 - Note that “Benefits” include advertising
 - Qualitative messages, endorsements, inducements to purchase

UBIT and UBTI

66

Passive Income

- Dividends and deductions attributed with such dividends are excluded
 - Be careful with passthrough entities and 100% owned for profit subsidiaries
- Interest
- Royalties

UBIT and UBTI

67

Passive Income

□ Rent

- Many, but not all, rental income is excluded from definition of UBTI — all rental activity must be carefully evaluated
- Watch for debt-financed income
 - Portion of rent attributed to debt-financing will be considered UBTI
 - Several exceptions and planning opportunities

UBIT and UBTI

68

Filing Requirements

- UBTI is generally taxed at corporate rates under Section 11 of the Code
- Most deductions that are directly attributable to the activity giving rise to UBTI are allowed
- Reported on a Form 990-T

UBIT and UBTI

69

Filing Requirements

■ Form 990-T

- Required if the gross income in the tax computation is \$1,000 or more
- Simplified filing if unrelated trade or business gross income is less than \$10,000
- Generally due May 15 for most calendar year filers and eligible for extensions
- Open to public inspection just like regular Form 990
- Must still file Form 990 (or 990-PF)

UBIT and UBTI

70

How Much is Too Much (and consequences)

- Again, existence of UBTI is not usually fatal to the organization's exempt purpose
- Circumstantial analysis
 - Rev. Rul. 57-313 allowed an organization to keep its exempt status even if 75% of its gross revenue came from unrelated activities
 - At least one case permitted an organization to keep its exempt status despite 50% of gross revenue coming from unrelated activities

UBIT and UBTI

71

How Much is Too Much (and consequences)

- Bottom line—no bright line rule
- IRS states that charitable activities need to be reasonably commensurate with its resources
- If UBTI is present (and it usually will be to some extent), organizations should engage in periodic review of authorities and keep records of deliberations regarding same

□

Compliance – All 501(c)(3)s

72

□ Lobbying

- PCs: “no substantial part”
 - 501(h) election; Form 5768
- PFs: total prohibition

□ Political Activities

- Cannot participate/intervene with campaigns on behalf of or in opposition to candidates for public office

□ Private Inurement

- No part of a corporation’s net earnings (usually interpreted broadly to mean any of the 501(c)(3)’s assets) may inure to the benefit of any private individual

Compliance - PCs

73

Intermediate Sanctions: (IRC §4958)

- Excise tax imposed on “disqualified persons” who engage in “excess benefit transaction” with PC
 - Disqualified person receives more than fair market value for goods/ services from PC (§4958(c)(1)(A))
 - Disqualified persons are insiders: board members, officers, founders, substantial contributors, entities owned 35% or more by any of the foregoing or their family members
 - Common example: excessive compensation paid to disqualified person (includes fringe benefits)
 - Safe harbor: (1) the transaction is approved by an independent board or committee; (2) the board or committee approves the transaction in reliance on appropriate comparability data; and (3) the board or committee adequately and contemporaneously documents the transaction (Treas. Reg. §§53.4958-6(a))

Compliance - PFs

74

IRC §§4940 – 4945 – Restrictions and 2-Tier Excise Taxes

- IRC §4940: Net Investment Income Tax - 1.39% on investment income
- IRC § 4943: Excess Business Holdings - No more than 20% vote (corp) or interest in profits (psp) owned by PF and disqualified person (exceptions for certain passive entities, large gifts/bequests)
- IRC § 4944: Jeopardy Investments - Cannot invest in risky or speculative investments; IRS does not identify any per se jeopardy investments
- IRC § 4941: Self-Dealing – Affects many transactions between PF and “disqualified persons”
- IRC § 4942: Minimum Distribution Requirement - Annual charitable grants must be paid to qualified recipients – subject to excise tax if not paid in full (**does not apply to POFs**)
- IRC § 4945: Taxable Expenditures - Grants to non-qualified recipients do not count toward minimum distribution requirement

Compliance - PFs

75

Self-Dealing – Transactions: (§4941)

- Sales, Exchanges or Leases of Property
 - ▣ PF assumption of mortgage is self-dealing
 - ▣ Exception: lease that does not charge rent to PF
- Loans; Extensions of Credit:
 - ▣ Exception: for loan to PF with no interest/other charges
- Compensation/Reimbursement:
 - ▣ Exception: compensation for personal managerial services reasonable & necessary to carry out exempt purpose & and not excessive
- Furnishing Goods, Services or Facilities:
 - ▣ Exception: if no charge to PF & for charitable use; if offered by PF on arm's-length terms
- Transfer/Use of Income/Assets: - Example: PF grant to disqualified person
- Payment to Certain Government Officials:

Compliance - PFs

76

Minimum Distribution & Taxable Expenditures: (§4942)

- PFs must make annual “qualifying distributions” of at least 5% of PF’s minimum investment return (same as POF definition).
- “Qualifying distributions” are expenditures made for PF’s exempt purpose, like charitable grants or acquiring charitable-use assets (IRC §4942(g); Treas. Reg. §53.4942(a)-3(a)(2))
- Non-qualifying distributions (“taxable expenditures”) do not count toward minimum distribution requirement, and include:
 - Grants to individuals for travel, study or similar purposes (exceptions for certain scholarships/fellowships); and
 - Generally, **grants to orgs other than PCs** – but such grants count toward MDR if PFs exercise “expenditure responsibility”: pre-grant inquiry (management, activities, practices, history), written grant agreement, reports from grantee (at least annual & final), report to IRS on Form 990-PF as “expenditure responsibility grant”

77

Getting Back to Business in a Vaccinated World

Presented by: Darla J. McClure

Bringing Employees Back to the Office

78

- Vaccine Mandate or Weekly Testing (President Biden's COVID-19 Plan)
- Vaccine Mandate
- No Vaccine Mandate but implementation of safety protocols

Vaccine Mandate or Weekly Testing

79

- “Path out of the Pandemic”
 - On September 9, 2021, President Biden announces new rule to be issued by the Occupational Safety & Health Administration (OSHA) providing for all employers with 100 or more employees to either ensure their employees are vaccinated or require unvaccinated employees to produce a weekly negative test result before coming to the office
 - OSHA’s new rule called an Emergency Temporary Standard (ETS) is issued in situations where “grave danger” to employee safety is present
 - An ETS lasts 6 months and then must be replaced with a permanent OSHA standard

Important Points Under the New ETS

- All employers covered by OSHA with 100 or more employees will be required to comply with the ETS
- ETS is likely to be announced in the next week or so with an effective date 75 days following its announcement. Some state governors have already stated that they intend to challenge the ETS, which could halt the effective date until legal concerns have been resolved
- It is likely that remote employees will not be covered under the ETS but will be counted toward the 100-employee threshold
- Employers will likely need to collect verification of vaccination status
- The ETS will establish guidelines for the type of testing required (i.e. antigen, PCR)

Costs, Expenses and Penalties Under the New ETS

81

- Employer will likely need to provide paid time off for employees to get vaccinated, including any time away from work due to side effects of the vaccine. It has been suggested that the new ETS will allow employers to require employees to use paid time off that has already been accrued but unused
- It is currently unclear whether the employer will be required to pay for the tests, however, it is likely that the employer will be required to compensate non-exempt employees for time spent getting tested
- Employers who fail to comply with the new ETS could face penalties of up to \$14,000 per violation

Vaccine Mandate

82

- Develop a Vaccine Mandate Policy
 - Determine an effective date
 - Include language that alerts employees to exemptions for medical or religious reasons
 - Provide employees with a medical and religious exemption forms
 - Notify employees that they will be required to provide evidence of vaccination. Be sure to affirmatively state that employees should not include any medical information and that you will ensure confidentiality
 - Determine if you are going to provide PTO or require employees to use accrued but unused PTO

Medical and Religious Exemptions

- When requested, an employer shall provide an exemption/reasonable accommodation for any known medical condition or disability of an employee which prevents the employee from receiving a COVID-19 vaccine, provided the requested accommodation is reasonable and does not create an undue hardship for the employer and/or pose a direct threat to the health or safety of others in the workplace
- When requested, the employer shall provide an exemption/reasonable accommodation for employees' religious beliefs and practices which prohibit an employee from receiving a COVID-19 vaccine, provided the requested accommodation is reasonable and does not create an undue hardship for the Company or pose a direct threat to the health and/or safety of others in the workplace
- Types of reasonable accommodation include remote working, weekly testing, use of masks, reassignment

No Vaccine Mandate

84

- Follow local, state and federal laws with regard to safety protocols
- Consider a hybrid model consisting of telework and in-office work
- Implement use of masks, require employees to maintain social distancing and limit large gatherings
- Provide hand sanitizer to employee
- Clean and disinfect hard surfaces more frequently
- Increase ventilation

THANK YOU!



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86

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