

LEGAL CONSIDERATIONS FOR NONPROFITS TAKING ON NEW ROLES

Illinois Main Street
April 29, 2015

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Heyl Royster's Areas of Practice



- Agribusiness
- Appellate Advocacy
- Arson, Fraud and First-Party Property Claims
- Business and Commercial Litigation
- Business and Corporate Organizations
- Civil Rights Litigation/Section 1983
- Class Actions/Mass Tort
- Construction
- Drug and Medical Devices
- Education
- Elder Law
- Employment & Labor
- Environmental
- Estate, Wealth and Succession Planning
- Governmental
- Healthcare
- Insurance Coverage
- Liquor Liability/Dramshop
- Long Term Care/Nursing Homes
- Medical Malpractice Defense
- Not-for-Profit Organizations
- Product Liability
- Professional Liability
- Professional Regulation/Licensure
- Railroad Litigation
- Real Estate and Title Services
- Religious/Clergy
- Toxic Torts & Asbestos
- Trucking/Motor Carrier Litigation
- Trusts and Probate
- Workers' Compensation

Heyl Royster's Six Illinois Locations

Peoria • Chicago • Edwardsville • Rockford • Springfield • Urbana

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Types of Tax-Exempt Organizations

- Charitable organizations
- Social welfare organizations
- Agricultural or horticultural organizations
- Labor organizations
- Business league (trade associations)
- Social clubs
- Fraternal societies
- Employee benefit associations or funds
- Veterans organizations

Charitable Organizations - 501(c)(3)

- To qualify as 501(c)(3) organization, must be both organized and operated exclusively for one or more of the recognized exempt purposes.
- Publicly Supported Organization versus Private Foundation

501(c)(3) Exempt Purposes

- Religious
- Charitable
- Scientific
- Testing for public safety
- Literary
- Educational
- Fostering national or international amateur sports competition
- Prevention of cruelty to children or animals

Maintaining Tax Exempt Status

- Avoid providing private benefits
- Keep lobbying to insubstantial level
- Steer clear of political campaign activity
- Minimize unrelated business income
- Satisfy annual reporting obligation
- Operate according to stated exempt purpose(s)

Excess Benefit Transactions

- Monetary penalties if nonprofit engages in excess benefit transaction.
- Excess benefit transaction means nonprofit engaged in transaction with a “disqualified person.”
 - Person who is in a position to exercise substantial influence over the affairs of the organization and includes a person who was in such a position during the 5 year period preceding the transaction.
 - Consider directors, officers, executive staff, and other persons of influence, and their family members.

What does tax exemption really mean?

- Tax exemption is not absolute.
- Generally, not subject to federal income tax on:
 - Contributions, assessments, or dues received
 - Income derived from any activities related to an organization's exempt purpose(s)
 - Certain types of investment income
- However, does NOT extend to income derived from:
 - Activity unrelated to an organization's exempt purposes
 - Investment income in some situations

Investment Income

- Payments on annuities, royalties, rents, and gains or losses from the sale of property are generally exempt
- Rental income exceptions to exemption (i.e. taxable):
 - Personal property if not leased with real property
 - Real property leased with personal property where 50% or more of rent attributable to the personal property
 - If services are performed that are not customarily performed by a landlord in connection with a lease
 - Income from debt-financed property

Unrelated Business Income Tax

- Defined as activity that:
 - Constitutes trade or business,
 - Is regularly carried on, and
 - Is not substantially related to an organization's exempt purpose.

Unrelated Business Income Tax

- Exceptions
 - Business where substantially all of the work is performed without compensation
 - Activity carried out by 501(c)(3) or university primarily for convenience of members, students, patients, or employees
 - Selling of merchandise substantially all of which has been received as gifts or contributions

Unrelated Business Income Tax

- Exceptions Example:
 - An orphanage operating a retail store and selling to the general public, where substantially all the work in carrying on such business is performed for the organization by volunteers without compensation.



Unrelated Business Income Tax

- Exceptions Example:
 - Laundry operated by a college for the purpose of laundering dormitory linens and the clothing of students.



Unrelated Business Income Tax

- Exceptions Example:

- Thrift shop operated by a tax exempt organization where those desiring to benefit such organization contribute old clothes, books, furniture, etc. to be sold to the general public with the proceeds going to the exempt organization.

Partnering with Others

- Potential partners:
 - Other nonprofit organizations
 - For profit organizations
 - Government bodies
- In every case, need to consider:
 - Purpose and unrelated business income
 - Conflicts of interest or private benefits
 - Appropriate document in place governing relationship



Peoria Riverfront Museum

- Formerly Known As Lakeview Museum
- Peoria County agreed to finance the construction of new building downtown by issuing sales tax bonds.
- Peoria County and Museum entered into long term lease for Museum use of the building.
- Cooperative relationship set forth through the lease and the Museum's by-laws.



Anytown Ambulance Company

- Nonprofits want to collaborate to ensure ambulance services provided to community.
- Jointly create new nonprofit.
 - Each nonprofit is a member.
 - Each nonprofit elects the same number of directors.
 - Limitations on board authority:
 - Debt
 - Sale
 - Dissolution
 - Merger



Affiliations with For Profit Entities

- Can create a for-profit subsidiary that would conduct the “unrelated business” of the tax exempt organization
 - Protects tax exempt status, but subsidiary must:
 - Have a valid business purpose;
 - Deal at arm’s length with exempt organization; and
 - Observe corporate formalities.

FUNDING REAL ESTATE DEVELOPMENT



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Donations

- Precise record keeping required
- “Making the ask” carries some risk
 - Consider nonsolicitation and privacy laws
 - Money going where you promised it would go
- Caution: Real Estate Donations
 - Due diligence required

Grants

- Grants can be leveraged together to maximize funding and matches
- Grants have specific uses, different requirements, and application processes
- Fully executed grant agreements are required and must be complied with
- Grants may be revoked

Government Financing Options

- Taxation
- Standard Loans
- Bonds
- MFT Funding
- Grants
- Special Assessments/Special Service Areas
- Tax Increment Financing (TIF)

Grants For Capital Projects Available to Government Bodies

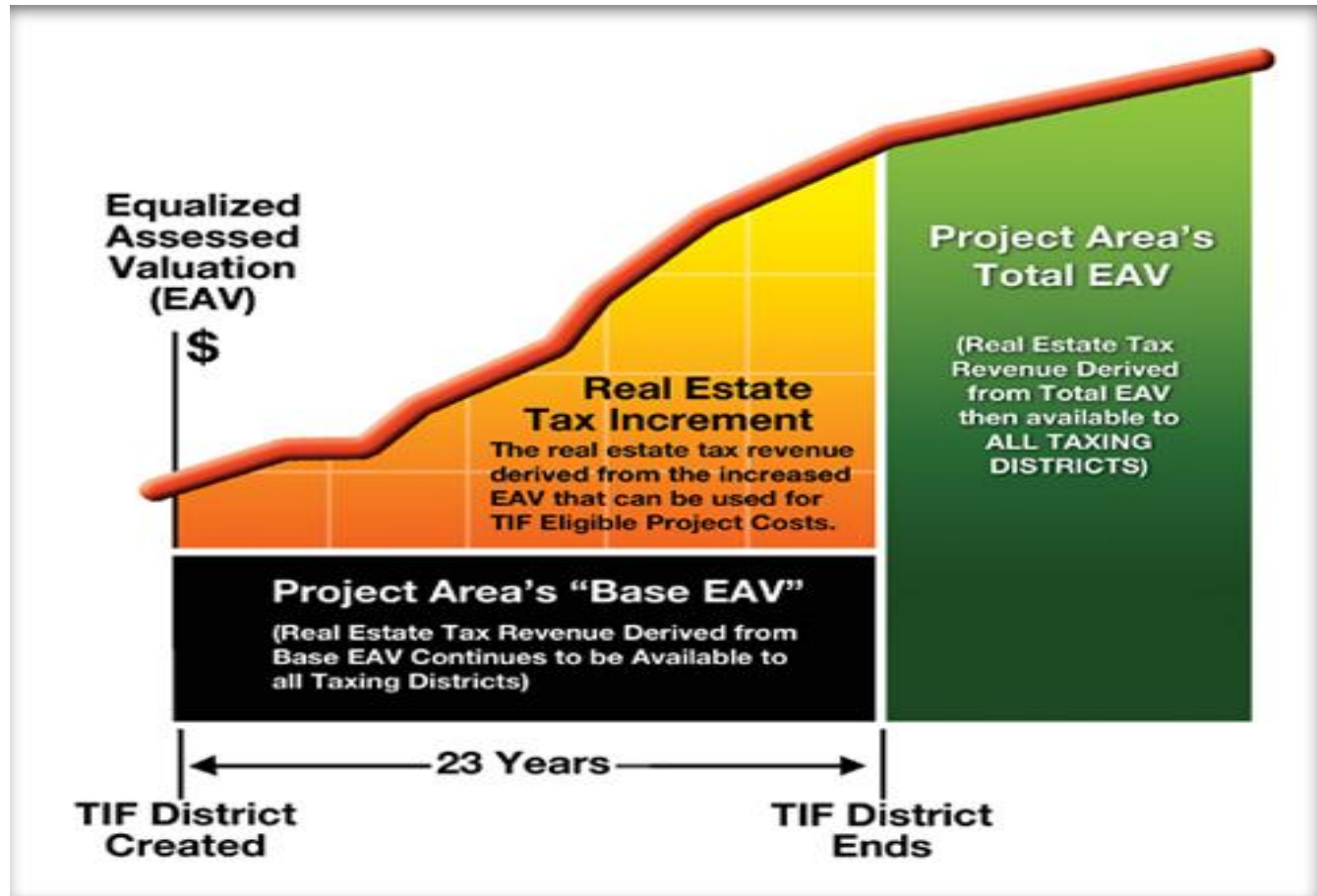
- TIGER
- CDBG
- State Capital Bill
- 319 IEPA
- STAG
- ITEP
- HSIP
- Major Bridge Funds
- Department of Energy
- Homeland Security
- IHDA
- State Revolving Fund



Tax Increment Finance (TIF)

- What is tax increment financing?
 - It is the difference between the amount of property tax revenue generated before a TIF district is established and the amount of property tax revenue generated after the TIF district has new development. TIF does not reduce base property tax revenues available to other taxing bodies.
- It is not a new taxing body.
- It is not a tax increase.
- It is not a tax abatement.

The Concept of a TIF



<http://tomjacobgroup.com/faq.html>



The Law of TIF

- Tax Increment Allocation Redevelopment Act (65 ILCS 5/11-74.4)
 - The “TIF Act”
- Industrial Jobs Recovery Law (65 ILCS 5/11-74.6)
 - Environmentally contaminated areas with vacant or industrial sites.
- County Economic Development Project Area Property Tax/Tax Increment Allocation Act (55 ILCS 85 and 55 ILCS 90)
 - The “County TIF Act”
- Economic Development Project Area Tax Increment Allocation Act of 1995 (65 ILCS 110)
 - Closed military bases.



Eligibility Requirements

- Identification of the area (1.5 acre minimum).
- “Blighting” requirements must be met: present, documented, meaningful, and throughout the area.
 - Need not be found *reasonably distributed* on every parcel in the area.
- “But for” the public investment the area will not improve on its own.
 - Along with blight, the “but for” requirement demonstrates public purpose.

Four Categories of TIF/Blighting Factors

- For developed property: 5/13 factors required (65 ILCS 5/11-74.4-3(a-1))
 - Most often used category.
- For undeveloped property: 2/6 blighting factors from a first group, or 1/6 from a second. (65 ILCS 5/11-74.4-3(a-2))
- For conservation areas: 3/13 factors and 50% or more of the structures must be 35 years or older. (65 ILCS 5/11-74.4-3(b))
- For industrial park conservation areas, must be “labor surplus municipality,” contiguous to blight, annexed before report, and zoned for industrial use prior to designation.
 - Least often used. (65 ILCS 5/11-74.4-3(c-e))

Improved Area: Blighting Factors



(65 ILCS 5/11-74.4-3(a-1)A-M)

Dilapidation.	Inadequate utilities.
Obsolescence.	Excessive land coverage and overcrowding of structures and community facilities.
Deterioration.	Deleterious land use or layout.
Presence of structures below minimum code standards.	Environmental clean-up per IEPA or USEPA regulations.
Illegal use of individual structures.	Lack of community planning.
Excessive vacancies.	Decline in total equalized assessed value 3 of last 5 years.
Lack of ventilation, light or sanitary facilities.	



Undeveloped Area: Blighting Factors



(65 ILCS 5/11-74.4-3(a-2)A-F) *2 factors required	(65 ILCS 5/11-74.4-3(a-3)A-F) *1 factor required
Obsolete platting.	Area has one or more unused quarries, mines or strip mine ponds.
Diversity of ownership of parcels of vacant land	Unused rail yards, rail tracks or railroad rights-of way.
Tax and special assessment delinquencies.	Subject to chronic flooding.
Deterioration of structure or site improvements.	Unused or illegal disposal sites.
Need for environmental remediation under IEPA or USEPA regulations.	Qualified as a blighted improved area immediately prior to becoming vacant.
Decline in equalized assessed value 3 of last 5 years.	



Additional TIF Requirements

- Feasibility Study (required if more than 75 occupied residential units or more than 9 relocations)
- Redevelopment Plan and Program
- Housing Impact Study
- Notification of property owners
- Interested Parties Registry
- Joint Review Board review and opinion
- Publication of notices and public hearing
- Public ordinance

TIF Eligible Costs

- The administration of the TIF
- Property acquisition
- Rehabilitation or renovation of existing public and private buildings
- Construction of public works or improvements
- Job training
- Relocation
- Financing costs, including interest assistance
- Studies, surveys and plans
- Marketing sites within the TIF
- Professional services
- Demolition and site preparation
- Day care (municipalities over 100,000)

Special Service Area



- A contiguous area within a municipality, village or county in which special governmental services are provided. Must have common borders.
- Enables municipalities to construct improvements or provide services to a limited area of the community and to levy a tax only in the area which benefits from the special service.
- Generally based on the EAV of each parcel, but can be based upon other criteria which provides “a rational basis between the amount of the tax levied...and the special service benefit rendered.”

Special Service Area

- Eligible Redevelopment Expenditures
 - Public Infrastructure: streets, storm water detention, flood basins, water/sewer mains, sidewalks, bicycle paths, landscaping, lighting, signage, parking lots or garages, etc.
 - Services: parking enforcement, snow removal and landscaping; tourism and marketing in commercial areas
 - Ongoing or recurring costs; capital costs; pledged to pay for bonds issued for public improvements

Additional Development Tools



- Business District (65 ILCS 5/11-74.3-6)
 - Additional Sales Tax and/or Hotel/Motel Tax of up to 1.00% in 0.25% increments on retail goods and hotels within a contiguous area designated by the Municipality.
- Special Assessment
 - The cost of the improvement is assessed against individual properties in an amount not greater than the benefit to the property assessed.
 - Cities and villages (65 ILCS 5/9-2-1, *et seq.*)
 - Counties (55 ILCS 5/5-32001, *et seq.*)

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