The Benefits of IRS § 501 (c) 3 Tax Exempt Status as it relates to Non-Profit Continuing Care Retirement Communities - in comparison to For Profit Organizations

Research Paper One
Field Experience Acct. 494
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Submitted April 2, 2001
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A Continuing Care Retirement Community is an organization that provides all levels of care: skilled care; personal care; residential apartments and independent living cottages. By definition, for any organization that offers all levels of care and charges an entrance fee upon admission to the facility is referred to by the state as a Continuing Care Retirement Community (CCRC). A CCRC, like any other organization, can operate as a for-profit or a not-for-profit entity. The decision for either one must be determined by the organization's goals.

If nonprofit status is preferred, under IRS section 501(c)(3), a continuing care retirement community could file for and obtain tax-exempt status and not have to pay any federal income taxes. The requirements to obtain tax-exempt status are strict. However, once an organization obtains this status, there can be many advantages for both the organization and the community as well.

But first - to file for tax-exempt status with the federal government - the organization has to incorporate itself within its own state by filing papers to become a non-profit or not-for-profit entity - the terms of which are used interchangeably. The organization's status as a non-profit corporation should not be confused with the tax-exempt status obtained from the Internal Revenue Service -

both are separate and distinct from each other and are attained at completely different levels. In the organization's articles of incorporation it must include legal verbiage using words that limit the corporation's [1]"purpose to one or more of the exempt purposes set forth in § 501(c)(3)." The purpose of a non-profit continuing care retirement community is almost always under what the IRS describes as a [2]"charitable organization … and must be organized and operated exclusively for this purpose as set forth in § 501(c)(3)." For greater clarity, the IRS presents the following definition. [3]"The term charitable is used in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; lessening the burdens of government; lessening of neighborhood tensions; and defense of human and civil rights secured by law." Continuing care retirement communities, by nature, are designed to do just that. As part of fulfilling their tax-exempt purpose, these organizations have contracts with third-party payers such as Medicare and Medicaid to provide services to the public at less than the full daily rate that is charged to private pay residents. Some CCRC's admit Medicaid patients directly into the skilled nursing without having paid an entrance fee. However, outside of low occupancy, unless the facility is a state facility that has mostly Medicaid residents, those residents who have paid an entrance fee and have signed a continuing care contract have first priority to any skilled bed.

Once a resident pays an entrance fee upon admission, they can not be denied care even when the resident's personal funds become exhausted. And because the average life expectancy is around 10 years for residents moving into CCRC's, eventually some residents become in need of assistance – Medicaid for those residents in skilled nursing and benevolent care donation subsidies for residents in personal care. As revealed above, CCRC's operate in an arena whereby they stand to loose lots of money. And so this is where a tax-exempt status would greatly help them to stay in business per the following quote. [4]"The U.S. in all its vastness does not have the resources to meet all of the social needs of our population. To do so it looks to the nonprofit sector to alleviate the burden. To encourage that sector to develop, the government bestows an exempt certification upon it. This certification exempts the organization…from federal taxes and allows supporters of the organization to deduct contributions from their gross income." However, there are only certain types of tax-exempt organizations that can receive tax-deductible donations. [5]"When the public thinks of "tax-exempt" groups, they often equate same with charities and … writing off donations to same. But only groups who receive a 501 (c)(3) determination letter from the Internal Revenue Service … qualify to receive tax-deductible dollars from the public." And because entities can receive large tax-deductible contributions, CCRC's with a high Medicaid census are able to break even on their expenses and are therefore able to continue to provide care to the elderly. Furthermore, upon the donor's restrictions, the organization has the possibility of accumulating a large endowment fund whereby the interest earned from that fund is unrestricted and could be used to offset losses for many years to come.

Another advantage of obtaining section 501(c)(3) status is that any profits earned by the organization stays with the organization, instead of being distributed to stockholders in the form of dividends as would be the case with a for profit entity. In addition, a non-profit organization would not have the legal accountability to stockholders that a for-profit public company would have. Furthermore, a non-profit entity is not subject to any of the SEC regulations or disclosure requirements that a public company is required to adhere to - because it has no shareholders. Regulations and reporting requirements imposed on public companies by the Securities and Exchange Commission (SEC) can be very burdensome. All public companies that register their securities with the SEC are required to file quarterly as well as annual statements with the SEC. In addition, [6]"the SEC requires that Form 8-K be filed within 5-15 days of any of the following events: change in control, … entering bankruptcy proceedings, resignation of registrant's director because of a disagreement, … or change in fiscal year. The SEC's Division of Enforcement has responsibility for overseeing the capital markets and investigating possible violations of securities law. Where violations are suspected, the division may … subpoena records and take testimony under oath. At the conclusion of an investigation, the division reports its findings to the commission … with a recommended course of action. … Specifically, the commission became concerned during the late 1990's over a perceived erosion in the quality of earnings and a corresponding reduction in the quality of financial reporting." Because of the pressure of public companies to look good to their shareholders, management is pressured into the temptation to falsify their books to make earnings look better and therefore subject themselves to liability – possibly even ceasing to practice on a temporary or permanent basis.

When an organization does not have to pay federal income taxes, they only have to maintain one set of books, as opposed to maintaining a set of internal books plus a set of books specifically for income tax purposes. This could end up to be some large savings for an organization in terms of the time it takes to maintain them as well as the cost.

On a different level, employees of a section 501 (c)(3) organization also benefit from their employer's tax-exempt status in that non-profit employers can offer their employees pre-tax deductions to a Tax-Sheltered-Annuity (TSA) plan. A TSA plan is only made available to employees of a non-profit organization and provides two benefits. First, employees can contribute pre-tax dollars to a variety of investments including fixed and variable rate investments and many different mutual funds with a higher return. Second, the maximum amount allowed for a TSA is higher than the $2,000 per individual per year that a regular IRA plan limits a person to. So both the employer and employees benefit from tax-exempt status from a federal level. Benefits can also be obtained at the state level as well, depending on the specific laws particular to that state.

For example, Pennsylvania allows certain benefits for organizations that already have an IRS determination letter granting tax-exempt status. However, the requirements for Pennsylvania are even more stringent than the IRS. Organizations that desire to solicit contributions within the state of Pennsylvania must register with the Bureau of Charitable Organizations within 30 days of receiving contributions from any source in excess of $25,000.00 and every year thereafter to obtain a certificate that authorizes them to do so.

Tax-exempt organizations can also purchase goods and services for use in their entity and not have to pay sales tax under Act 55 of 1997. [7]"On November 26, 1997, Pennsylvania Governor Thomas J. Ridge signed into law Act 55 of 1997, the "Institutions of Purely Public Charity Act." This new legislation refines the criteria that nonprofit organizations must meet in order to qualify for charitable tax exemption in Pennsylvania. The requirements … were first announced a dozen years earlier by the Pennsylvania Supreme Court in the case of Hospital Utilization Project v. Commonwealth (precedents set by this case are called the HUP test). The new act provides detailed quantitative requirements to augment the qualitative elements of the HUP tests." The organization must apply to the state of PA and meet the above-mentioned HUP tests to be able to make tax-free purchases. But once the exemption is approved, the non-profit organization could a significant amount of money. For instance, a company buys $500,000 of supplies and services in Pennsylvania that are related to the organization's tax-exempt purpose. With a sales tax of six (6) percent, the company is saving $30,000 per year that it otherwise would have to pay.

One more possible tax-exempt benefit that could be acquired at other than the federal level is that of exemption from having to pay property real estate taxes. This exemption is obtained through the local jurisdiction in accordance with state laws - but only to the extent that it relates to the organization's tax-exempt purpose. As an example, an organization is not exempt from paying real estate property taxes on its independent living cottages because this service does not relieve the government of any burden or [8]"benefit a substantial and indefinite class of persons who are legitimate subjects of charity." By contrast, a building that is used to provide services to

Medicaid residents would satisfy the requirement for the two HUP tests quoted above.

As discussed, there are many advantages in obtaining section 501(c)(3) status that amount to significant dollar savings for an exempt organization each year. On the other side of the analysis, there are however some disadvantages. [9]"The major benefit conveyed by section 501(c)(3) status – that of eligibility for receiving pre-tax dollars – brings with it substantial scrutiny and burdens. Congress has imposed many detailed restrictions on 501(c)(3) groups to ensure that the public policy of furthering charitable programs does not unduly advance other activities by funding same with tax-deductible dollars." Basically, tax-exempt organizations can not have too much involvement in lobbying activities; no contributions to candidates for elected office, or misrepresent the amount deductible from donors. [10]"Lobbying is supporting or opposing a piece of legislation at any level of government. An organization that spends more than 20% of its budget on lobbying will owe the IRS a penalty tax."

Another disadvantage is the lengthy and more complicated IRS form 990 that is required to be filed annually and is six pages long. A supplemental form called Schedule A is also required to be filed along with the 990 and discloses information about the organization's board of directors, amounts paid to vendors, and a lot of other financial data. The due date is the fifteenth day of the fifth following the tax year's end. Furthermore, the burden has been increased by the Taxpayer Bill of Rights 2 of 1996, which expanded OBRA 1997 and requires that the 990 are made available for public inspection – and copies must be provided to the requestor for the most recent three years. More specifically, the 990's must be made available immediately if the requestor comes directly to the healthcare organization and requests the same. [11]"The rules are intended to increase availability, accessibility, and uniformity to the format of documents … to allow users to make comparisons among tax-exempt organizations more easily. Healthcare financial managers will need to deal with increased document exposure, increased labor required to comply with the rules, and new deadlines for responding to requests for documents. Finally, the penalties for noncompliance will personally affect financial managers, since such penalties may be imposed first on the officer … failing to make the disclosure, not on the organization." One last disadvantage of being a section 501(c)(3) organization is that assets accumulated by a non-profit corporation must stay with the organization. And when a non-profit corporation is dissolved, all of the assets must be given to another 501(c)(3) corporation.

In conclusion, it is very clear that - for a continuing care retirement community - there are many advantages of operating under section 501(c)(3) status. Consequently, if there were not so many advantages to being tax-exempt, then there would not be nearly as many organizations filing for 501(c)(3) status. As long as the organization is in business for a purpose other than for profit and it relieves the government of some of its burden; the organization may file for tax-exempt status and therefor reap the benefits in furthering its exempt purposes.

ENDNOTES

[1] Internal Revenue Code Sec. 501(c)(3)

[2] Internal Revenue Code Sec. 501(c)(3)

[3] Internal Revenue Code Sec. 501(c)(3)

[4] George Noreika, "Not-for-profits: A tax guide," Fund Raising Management, (May 2000) [on-line]. Available from <http://mdusa.lib.umd.edu/proxy/fs/umi/pdqweb>; accessed 17 March 2001.

[5] Eve Borenstein, "Legal Needs Relative to Non-Profit and/or Tax-Exempt Status Of New Organizations," Free Management Library, (1998) [on-line]. Available from <http://www.mapnp.org/library/legal/lgl_need.htm>; accessed 4 March 2001.

[6] E. Richard Brownlee, Kenneth R. Ferris, and Mark E. Haskins, Corporate Financial reporting, 4th ed. (New York: Mcgraw-Hill/Irwin, 2001)

[7] Jeffrey Petrell, "The "institutions of purely public charity act" refines Pennsylvania's charitable exemption standards," Pennsylvania CPA Journal, (Spring 1999)[on-line]. Available from <http://mdusa.lib.umd.edu/proxy/fs/umi/pdqweb>; accessed 17 March 2001

[8] Jeffrey Petrell, "The "institutions of purely public charity act" refines Pennsylvania's charitable exemption standards," Pennsylvania CPA Journal, (Spring 1999)[on-line]. Available from <http://mdusa.lib.umd.edu/proxy/fs/umi/pdqweb>; accessed 17 March 2001

[9] Eve Borenstein, "Legal Needs Relative to Non-Profit and/or Tax-Exempt Status Of New Organizations," Free Management Library, (1998) [on-line]. Available from <http://www.mapnp.org/library/legal/lgl_need.htm>; accessed 4 March 2001.

[10] Ruth Anderson, "Here's a summary of IRS Rules on Lobbying," NONPROFIT, (17 July 1998) [on-line]. Available from <http://nonprofit.about.com/careers/nonprofit/gi/dynamic/offsite.htm>; accessed 17 March 2001.

[11] R.W. Luecke and K.J. Shortill, "IRS issues new disclosure rules for tax-exempt organizations," Healthcare Financial Management, (December 1999) [on-line]. Available from http://mdusa.lib.umd.edu/proxy/fs/umi/pdqweb; accessed 17 March 2001.

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Internal Revenue Code Sec. 501(c)(3)

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