

Memorandum

From: Hillary Coley, Chief Financial Officer
Duncan Blair, Director of Volunteer Operations

To: TU Chapter and Council Officers

Re: 501(c)(3) Tax Issues

TU's 501(c)(3) tax exemption is central to everything that we do. Without it, we could not function financially – our revenues would be subject to taxation, and our donors would not be able to deduct their donations from their income taxes. TU chapters and councils do not have independent 501(c)(3) status from the Internal Revenue Service (IRS) even if they are separately incorporated, but rather benefit from TU National's tax exemption. In order to keep this exemption, it is critical that we comply both with the tax code and with the terms of the exemption we have received from the IRS. If chapters fail to act consistently with the exemption, they could jeopardize their own ability to use National's tax exemption, and potentially also jeopardize the overall exemption relied upon by TU National and all TU chapters and councils.

Nonprofit governance and tax issues are an area of significantly increased focus by the IRS and Congress. Because of this, and because of the increased size and breadth of our TU activities, we have an increased need to ensure that we are complying with the terms of our 501(c)(3) status.

Last year, TU CEO Charles Gauvin distributed a memo regarding restrictions against political activity by 501(c)(3) organizations, including the strict prohibition against endorsing or opposing a candidate for political office as well as limits on lobbying expenditures. However, there are other limitations that stem from TU's tax exempt status that are less obvious. The overarching principle is that everything we do, and all the money we spend, must further our stated tax exempt purpose, or mission, to conserve, protect, and restore North America's trout and salmon fisheries and their watersheds. Over the last several years, three practices have come to our attention that may pose a problem.

1. *Donating Money to Other Organizations.*

TU (including its chapters and councils) can donate money to other entities **only if doing so furthers our tax exempt purpose and if that entity itself is exempt under section 501(c)(3) or is a governmental entity organized under 501(c)(1).** For example, a TU chapter could in principle donate money to a local watershed council for a stream restoration project if the project were consistent with our tax exempt purpose. However, if the watershed council did not have 501(c)(3) or 501(c)(1) status with the IRS, this donation would potentially violate IRS rules. This is because the funds given to the chapter are eligible for an income tax deduction by TU donors, but if the funds were given directly by the donor to the watershed council, the donor would not be able to take

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a deduction. Similarly, if a local individual brought a lawsuit trying to stop pollution of a local trout stream, TU could not pay that person's legal fees. The IRS would view doing so as using tax exempt donations to benefit an individual, even if the lawsuit is consistent with TU's exempt purpose. This especially holds true if the trout stream is adjacent to the individual's property. To expend money in support of a lawsuit, TU itself should be a party to the lawsuit. In a slightly different example, TU could not donate funds to the local hospital for a new treatment center even though the hospital is a 501(c)(3), because medical treatment is not part of TU's stated exempt purpose.

It is perfectly acceptable, however, for TU chapters to pay entities that are not tax exempt for services rendered so long as the expenditure corresponds to TU's exempt purpose. For example, TU can pay contractors for work done on stream restoration projects. In the example given above, the TU chapter could comply with IRS rules by partnering with the watershed council on the project, and directly paying for specific goods or services associated with the project. A TU chapter could also pay a lawyer for representing TU in a lawsuit challenging pollution in a local trout stream.

If your chapter or council wants to make a donation to another nonprofit, at a minimum you should obtain confirmation that the organization has section 501(c)(3) or 501(c)(1) status by obtaining a copy of the organization's IRS exemption letter. You should also be satisfied that the donation is consistent with TU's mission. If your chapter or council has given money to an organization that you know is not a 501(c)(1) or 501(c)(3) nonprofit, you should contact Hillary Coley to determine what steps need to be taken to protect TU's tax exempt status. You should also contact Hillary if you have any question or uncertainty about any donation you wish to make.

2. Unrelated Business Income

Nonprofit corporations must pay taxes on "unrelated business income." Unrelated business income as defined by IRS is the gross revenue earned by any trade or business that is not directly related to the exempt purpose of the organization. In deciding whether income meets that definition, the IRS is not concerned with how the money is spent but how it is earned by an organization. Whether revenue falls into this category is determined on a case-by-case basis, but for TU the most common activity that may meet this definition is the sale of advertising, merchandise, or services. So, for example, even though TROUT Magazine generally helps further TU's nonprofit purpose, TU pays unrelated business income tax on revenue generated by advertisements in TROUT, because advertising in the magazine is unrelated to TU's nonprofit purpose.

As you know, if your chapter or council's annual gross revenues exceed \$25,000, your chapter or council is required to file a separate IRS Form 990. The requirements for reporting unrelated business income are independent of the reporting requirements for Form 990. If the annual gross proceeds from unrelated business income exceed \$1,000, your chapter or council must report this income to the IRS using Form 990-T. If you think that your chapter or council conducts a revenue-generating business over this \$1,000 threshold, you should consult an accountant regarding the status of this revenue.

Typical Unrelated Business Income Activities

- Advertising income from sale of ads in an organization's publication.
- Revenue generated from fishing trips that are not educational or conservation-oriented
- Fees collected for the use of facilities or land owned by the organization where the use of the property is not directly related to the exempt purpose of the organization (this includes facilities and land that are used strictly for fishing).
- Sponsorship payments to the organization that include any of the following benefits: advertising rights in an organization's publication, a hyperlink on the organization's website, or an endorsement from the organization.

Typical Activities that are not Unrelated Business Income

- Ticket sales for banquets or raffles.
- Income from sales of donated merchandise.
- Dividends and interest produced from investments held by the organization.
- Donations to the organization where the donor receives nothing in return.
- Sponsorship payments to the organization that exclude advertising and endorsement benefits.

If you have any questions about the tax consequences of sponsorship arrangements, please call Hillary Coley. Also, no TU chapter or council should endorse a company without approval from TU National.

3. Scholarships

The IRS has very strict rules for tax exempt organizations that give scholarships. 501(c)(3) organizations must receive special approval from the IRS before awarding scholarships to individuals. TU has no such approval from the IRS, so currently the only permissible avenue for a chapter or council to create a scholarship is to give the money directly to the college, university or other institution and allow it to choose the recipient. No TU chapter or council may pay the tuition bill of a student in lieu of the above procedure.

A TU chapter or council may give research fellowship grants. Fellowship grants are different from scholarships because they do not reimburse tuition costs. They are grants that are directly related to the recipient's education and our exempt purpose. For example, a TU chapter can give a fellowship grant to a biology student who analyzes the water samples taken from the local stream that the chapter is restoring. The key to a permissible fellowship grant is that the recipient must render services to the chapter or council that further both the recipient's education and our exempt purpose.

Conclusion

If you have any questions about any of the above policies or any other topic relating to TU's tax exempt status, please do not hesitate to contact Hillary, Duncan or another member of the TU National staff. We will have a series of ongoing training sessions and tools to assist our chapters and councils in complying with these requirements. In today's climate of heightened scrutiny of the business practices in the for-profit and non-profit sectors, it is crucial that the activities of all parts of TU remain above reproach. Thanks for reviewing this memo and for working with us to maintain TU's tax exemption.