Miscellaneous Tax Issues for Special Districts

Special Districts, 501(c)(3)’s and other Misconceptions
Sources of Tax Law Issues

Federal Tax Law
- IRS and FSLG Office
- Income Tax Exemption
- Tax-deductible Contributions
- Information Return Reporting
- Employment (FICA) Taxes
- Communications Excise Tax

Colorado State Tax Law
- Colorado Department of Revenue
- Sales and Use Tax Exemption
- Property Tax Exemption
- State Income Tax Exemption
- Fuel Tax Exemption
Charitable contributions to *governmental units* are tax-deductible under section 170(c)(1) of the Internal Revenue Code if made for a *public purpose.*
Tax-Deductible Contributions

Contributions to non-governmental units:

To be deductible, charitable contributions must be made to a “qualified organization.”
Qualified Organizations

Common purposes:

• Religious
• Charitable
• Educational
• Scientific
• Literary
• Prevention of cruelty to animals or children
Qualified Organization Examples

• *Religious* organizations, such as churches, synagogues, and mosques;
• Nonprofit *charitable* organizations, such as the Red Cross or United Way;
• Nonprofit *educational* organizations, such as Boy (and Girls) Scouts, museums, colleges;
• Nonprofit volunteer fire companies;
• Public parks and recreation facilities.
Qualified Organizations

Other than churches or governments, most organizations must apply to the IRS for recognition of their tax-exempt status. (IRS issue “determination letter.”)

Publication 78, Search for Exempt Organizations
This is an online cumulative list of organizations that are exempt from federal taxation to assist donors in determining how much of their contribution to such organizations is tax-deductible.
Receipts/Records for Tax-Deductible Contributions

Donor is responsible for maintaining a record of the contribution:

• cancelled check or other bank record; or
• communication from recipient organization including name of organization, date, and amount received (receipt or acknowledgement).

• Donor assigns value to any non-monetary gift.
Receipts/Records for Tax-Deductible Contributions

For donations over $250:

• Recipient must issue a contemporaneous written acknowledgement, including whether any goods or services were provided in exchange for the gift.
“Governmental Information Letter”

- Special service to governmental entities by the IRS.
- Describes government entity exemption from federal income tax; and
- Cites applicable Internal Revenue Code sections pertaining to deductible contributions and income exclusion.
- Most organizations and individuals will accept the governmental information letter as the substantiation they need.
- Call 877-829-5500. Free of charge. Delivery in 10-14 business days.
Information Return Reporting

1099 Series – Information Return Reporting

Payments made by local government agencies in the course of their “trade or business.”

- 1099-MISC – Miscellaneous Income
- 1099-INT – Interest Income
- 1099-S - Proceeds of Real Estate Transactions
1099-MISC

Report payments to:
• individuals, partnerships, estates.

Do not report payments:
• to corporations (except for legal or medical service providers);
• to exempt organizations, including units of government;
• for merchandise.
1099-MISC – Miscellaneous Income

Box 1 – Rents

Report rentals paid of $600 or more, including:

• Real estate rentals, such as office space
• Equipment rentals, such as copy machines, bulldozers
• Parking lot space rentals
1099-MISC

Box 7 – Nonemployee Compensation

Report payments of $600 or more, for services performed for your trade or business by recipients who are not employees.
Examples of services from nonemployees:

- Architects
- Accountants
- Advertising
- Appraisal services
- Attorneys (include payments to corporations)
- Auto repair
- Construction
- Consultant fees
- Custodial and maintenance services
- Engineers
- Landscapers
- Trash removal
1099-MISC

Box 7 – Nonemployee Compensation

Beware of Instructions for Form 1009-MISC which say to report “Directors’ Fees” and other renumeration in Box 7.

These instructions refer to payments made to directors of private corporations.

According to the IRS, payments to elected or appointed public officials belong on a W-2 and should not be reported on a 1099-MISC.

More on this at Slides 25-27.
1099-INT  Interest Income

Issue this form to each person to whom the district paid interest ($600 or more) on bonds, including tax-exempt local government bonds.
1099-S - Proceeds of real estate transactions

For example, if a governmental entity makes payments to an individual or an individual’s estate for an easement on their property.
Form W-9

Request for Taxpayer Identification Number and Certification

Obtain a Form W-9 from every (non-employee) vendor/entity which provides services to your district, before payment is made.
Form W-9

W-9 indicates the vendor’s:
• Name
• Address
• Taxpayer Identification Number (TIN)

You will need this information to file 1099 Report w/ IRS. Otherwise, you must collect backup withholding.
EIN or TIN or SSN or Tax-Exempt Number??

Taxpayer Identification Number ("TIN")

- Persons = Social Security Number ("SSN")
  
  xxx-xx-xxxx

- Entities/Businesses = Employer Identification Number ("EIN") or Federal Employer Identification Number ("FEIN")

  xx-xxxxxxxx
EIN or TIN or SSN  or Tax-Exempt Number??

EIN - Employer Identification Number

• Issued by IRS as a unique identifier.
• EIN says nothing about an organization’s status for federal income tax purposes.
• Used by entity in connection with payment of employment taxes.
• Governmental units may be issued an EIN.
EIN or TIN or SSN or Tax-Exempt Number??

**Tax-Exempt Number**
- State law concept – the IRS does not issue numbers specifically for exempt organizations.
- Colorado – issued tax exemption number indicates qualification for benefits such as exemption from state sales, property and/or income taxes.
- Applicable for organizations (frequently nonprofit corporations) which qualify as tax-exempt under section 501(c) of the Internal Revenue Code.
- Governmental entities may use their EIN for identification purposes.
Information Return Reporting-
Series 1099

Due dates to provide report:

• To Recipient, by last day of January;
• To IRS, by last day of February, if file on paper;
• To IRS, by last day of March, if file electronically;

Penalties increasing for 2011 for gov’t entities which fail to file by deadlines.
Elected Public Officials

The IRS firmly holds the position that elected and appointed public officials, such as the board members of Colorado special districts, are employees of the district for federal income tax purposes under section 3401(c) of the Internal Revenue Code.
Elected Public Officials

The IRS has concluded that elected public officials are employees based on these factors:

• Authority to exercise a portion of the sovereign powers of the government
• Acts as Agent of the government
• Exercises governmental duty pursuant to public law
• Public office created by law
• Exercise powers for the benefit of the public
• Subject to degree of control by government
• Responsible to public – power to not reelect or to recall
1099 or W-2?

Because the IRS holds that board members are employees, payments to special district board members pursuant to section 32-1-902, C.R.S., are wages and should be reported on a Form W-2 Wage and Tax Statement, with proper withholding of FICA and employment taxes.
Form 941

Employer’s Quarterly Federal Tax Return

• filed by governmental entities which paid wages during the quarter.

• IRS no longer automatically mails to you, you need to obtain form from IRS website.
SDA recognizes that some attorneys disagree with the IRS’ position concerning board member compensation. If your district reports board member compensation using Form 1099-MISC, please consult with your attorney and follow his/her advice.
FSLG Office

Federal, State and Local Governments – “FSLG”
FSLG is an office within the IRS to help governments comply with:
• federal employment tax laws and
• Information Return Reporting

Opened in 2000
Office for Western Region located in Sheridan, Wyoming.
Contact is Mr. Dwayne Jacobs. 307-672-7425 x 33.
Communications Excise Tax

Pursuant to section 4253(i) of the Internal Revenue Code, political subdivisions of a state (such as Colorado special districts), may claim an exemption from the communications excise tax assessed by communications (telephone, radio, cable) companies.
Communications Excise Tax

To claim this exemption, the district must furnish to the communications services provider a statement certifying that the district is entitled to the exemption. (See section 4253(k)(1), IRC.)
Communications Excise Tax

The IRS does not provide any certificate that an entity is entitled to the communications tax exemption.

Many telephone companies have their own certificate form which they use and retain in their files. Ask your provider.

A blanket certificate may be acceptable for a period not to exceed one year.
Communications Excise Tax

Sample Certificate (not an official IRS form)
Certificate of Exemption from Federal Excise Tax on Charges for Communication Services Paid from the Funds of the United States, States, Territories, or their Political Subdivisions.

The ___________________ District (the “District”) claims exemption from the tax imposed by Section 4251 of the Internal Revenue Code on all telephone service billed or to be billed the District for the account or billing number identified below.

The District certifies that such exemption is allowable by law for the reason that such service is being and will be furnished to and charges will be paid from funds of the District, as a political subdivision of the State of Colorado. Exemption is claimed under Section 4253(i) of the Internal Revenue Code.

The District agrees to notify ___________________, the provider of services, in writing when/if the basis for tax exemption indicated above changes or ceases to exist.

The District certifies that the exemption claimed is allowable under applicable laws and understands that the fraudulent use of this Certificate for the purpose of securing this exemption will subject each and all guilty parties to a fine of not more than $100,000 ($500,000 for corporations) or to imprisonment for not more than five years or both, together with the costs of prosecution (IRC section 7201).

Billing Account Number: _______________________________
Billing Name: ________________________________________
Address:  ___________________________________________
Signature:____________________________________________
Title: ______________________________________________
Date: _______________________________________________
State Tax Issues

Colorado Department of Revenue
1375 Sherman Street
Denver, CO 80261

303-238-7378 - Press 4, then 5, then 0
(good luck getting through!)
Sales and Use Tax
– political subdivisions

Special Districts, as political subdivisions of the State of Colorado, are exempt from paying state and state-collected sales and use tax, in their governmental capacities only.

Sales and Use Tax
– political subdivisions

Purchases made by government agencies are exempt from sales tax if:

• The order for goods is made on a prescribed government form or purchase order, and

• Payment is made *directly* to the seller by warrant or check drawn directly from governmental funds, or via credit card in the name of the exempt governmental agency.

• Also see *Sales 63*: Government Purchases Exemptions
Government Credit Card

When using a credit card, verification that the purchase is for governmental purposes and will be paid for by the governmental agency may be required.

A letter on the governmental entity’s letterhead is acceptable for this purpose.

Vendors with questions about local government credit cards should contact the local government directly.
Sales and Use Tax
-political subdivisions

- Purchases by governmental employee/agent with personal funds, even if reimbursed by government, are **not** tax-exempt.
- If invoice post-purchase: bill directly to governmental agency, **not** the individual making the purchase.
- Construction contractors making purchases on behalf of a governmental entity can piggyback on exemption.
Sales and Use Tax

This exemption does not apply to locally-collected sales tax levied by home-rule cities.

Home-rule jurisdictions make their own tax regulations and they must be contacted directly for information.
Sales and Use Tax Exemption
– charitable organizations

Colorado law also allows charitable organizations an exemption from state-collected sales tax for purchases made in the conduct of their regular charitable functions and activities. (See section 39-26-718(1)(a), C.R.S.)
Sales and Use Tax Exemption – charitable organizations

- Colorado Department of Revenue will issue a “Certificate of Exemption” to Charitable Organizations and other sales-tax exempt entities.
- Colorado-issued tax-exemption numbers in “98-xxxxx-xxxx” format.
- Governmental entities, such as districts, do not need to obtain a tax-exempt certificate or tax-exempt number to claim exemption.
Sales and Use Tax Exemption
– charitable organizations

The threshold for sales tax exempt status in Colorado is exemption from income tax under Section 501(c)(3) of the Internal Revenue Code, although the Colorado Department of Revenue is not bound by the IRS determination.
Sales and Use Tax Exemption and Tax-Deductibility of Contributions – charitable organizations

Exempt status for Colorado sales tax purposes does not necessarily mean that donations to the organization are tax deductible for person making such donations. The tax deductibility of contributions is an income tax matter and is subject to determination by the IRS.
Property Tax Exemption

Property (real and personal) owned by the state, counties, cities, towns and other municipal corporations and public libraries, is exempt from ad valorem taxation. (See Colorado Constitution, article X, section 4.)
Fuel Tax Exemption

Refund of fuel tax paid for:

• Gasoline
• Special Fuels (diesel, LPG, CNG, kerosene)

For operating any motor vehicle or machine owned or operated by the State of Colorado or its political subdivisions, in the conduct of government business.
Fuel Tax Exemption

• Worth looking into, taxes on fuel can account for 25% of the per gallon price at the pump.
Fuel Tax Exemption

• Apply to Department of Revenue for Fuel Tax Exemption Certificate.
• Upon approval, Department of Revenue will send you your permit/account number.

See - Government Agencies Fuel Tax Exemption Form DR 0241 for more details.
Fuel Tax Exemption

Bulk Fuel Purchases:
• Supplier removes taxes from bill.

Gas Station Purchases:
• File Form DR 7118 for refund check.
• File refund claim forms quarterly.
• Claims for refund must be made within 12 months following date of purchase.
Fuel Tax Exemption

Recordkeeping:

maintain copies of invoices and claims for 3 years.
Not-So-Hypothetical Scenarios

• Contributions to districts

• Contributions by districts
  i. to qualified organizations
  ii. to corporations
  iii. to individuals
  iv. to other governmental entities

• Paperwork
Not-So-Hypothetical Scenarios

Citizen contributes cash to the fire district to be used as a reward for information about an arson.

• Citizen wants to know if it will be tax-deductible on his/her federal income tax?
Answer

The fire district is a qualified organization, the reward is a public purpose, the contribution is deductible.
Not-So-Hypothetical Scenarios

Someone asks the district for its Articles of Incorporation.

• Where can you find these?
Answer

District doesn’t have Articles of Incorporation.

Nonprofit corporations:

• Formed pursuant to Colorado state law.
• Articles of Incorporation filed with Colorado Secretary of State.
• Incorporators choose Directors (one or more).
• No public elections, no open meetings law, no open records, no term limits, no TABOR, etc.
Nonprofit is not the same as 501(c)(3) status:

- Nonprofit status is conferred by state law, 501(c)(3) status is an issue of federal income tax law.
- Organization must apply to IRS for recognition of tax exemption for federal income tax purposes – receive “determination letter.”
- If receive 501(c)(3) status, contributions to organization are generally deductible on donor’s federal income tax return.
- Tax-exempt organizations must file Form 990 with IRS.
Not-So-Hypothetical Scenarios

Fire district wants to donate money to local school.

• Is donation tax deductible?
Answer

Trick question.
Tax deductibility is a concern when calculating and filing income taxes.
Special districts not generally subject to federal income tax.
Not –So-Hypothetical Scenarios

Is it ok for the district to donate money to the school?
Answer

• The district is a special purpose government.
• Does the donation advance the purpose of the district in some way?
• Stay within your statement of purpose (mission).
• For example, link donation to improving fire safety program or equipment at school.
Not-So-Hypothetical Scenarios

District wants to donate money to Boy Scouts or other charitable entity.

• Is that ok?
Answer

Same analysis.
Remember, these are taxpayer dollars we’re talking about.
What will your constituents say?
Not-So-Hypothetical Scenarios

The child of a district employee (or volunteer) has leukemia and a fund has been set up to help the family pay the medical expenses. The district would like to make a donation to the fund as a sign of support for the employee.

Is this ok?
Answer

Better for interested persons to donate from their personal funds.
Not-So-Hypothetical Scenarios

• Christmas Party or other End-of-Year Appreciation for District Employees
Answer

• Legitimate morale-boosting function.

• Gift Cards – IRS maintains that retailer gift cards are “cash equivalents” and, as such, are reportable, taxable wages. (Party poopers. 😊 )

• Give a ham instead – not a “cash equivalent.”
Not-So-Hypothetical Scenarios

Application for a grant from a private foundation or charitable organization asks district for proof of 501(c) status.
Answer

• Explain governmental status.
• Get a Governmental Information Letter from IRS. (See Slide 10.)
• May be able to use EIN.
Not-So-Hypothetical Scenarios

Vendors ask for documentation that district is exempt from sales tax.
Answer

• Explanatory letter on District Letterhead.
• Use District Credit Card.
• May be able to get a Tax-Exempt Number from the Colorado Department of Revenue, though governmental entities are not legally required to have a tax exempt number in order to claim the exemption.
Not-So-Hypothetical Scenarios

Donor to district wants substantiation that donor’s contribution is tax deductible.
Answer

District may provide receipt, but don’t take responsibility for guaranteeing deductibility.
Provide governmental information letter.
Donor should consult his/her tax advisor.
Not-So-Hypothetical Scenarios

District would like to donate equipment/property to another district.

(For example, donate a used fire truck to a smaller district.)
Answer

Ok to give financial support to another political subdivision. (See Colo. Const. Art. XI, section 7- Section 7, State and political subdivisions may give assistance to any political subdivision)

However, keep in mind:

• Your district’s stated purposes,
• Value of equipment or property,
• Other markets for property/equipment,
• Tangible and intangible benefits.

Have an open discussion and make findings for the record.
Not-So-Hypothetical Scenarios

District would like to donate equipment/property to a local business.
Answer

Colorado Constitution, Article XI, section 2, prohibits the State or any municipality or school district from making any donation or grant to, or in aid of, any (private) corporation or company.

See Section 2. No aid to corporations - no joint ownership by state, county, city, town, or school district.

• Special districts not specifically included
• Spirit of the law
• “Public Purpose” exception has evolved over time.
• Sale of public property for a grossly inadequate price = gift of public funds.
Not-So-Hypothetical Scenarios

We don’t have to withhold taxes from the payments we make to our volunteer firefighters because they’re volunteers, right?
Answer

See Issues for Firefighters - IRS Publication explaining FICA Tax on volunteer compensation
Resources

IRS Forms and Publications:

• **Information Letter Concerning Tax-Exempt Status**
  Need a letter stating that you are tax-exempt as a government organization?

• **Information Return Reporting for State and Local Governments**
  Guidance on information return requirements for state and local governments.

• **FSLG Webcast – 1099-MISC Filing Requirements**
  View a recorded presentation on 1099-MISC filing and reporting requirements. (March 30, 2010)
Resources

IRS Forms and Publications:

- **Classification of Elected and Appointed Officials**
  Explanation of special employment tax status of elected and appointed officials.

- **Government Workers: Employees or Independent Contractors?**

- Classification of workers as employees or independent contractors. (See **Publication 963, Federal-State Reference Guide**, Chapter 4)

- Public employers and employment taxes and withholding (See **Publication 15-A, Employer’s Supplemental Tax Guide**
Resources

IRS Forms and Publications:

- **Communications Tax Exemption for Government Entities**
  Explanation of the requirements and procedures for governments to claim exemption from the telephone excise tax.

- **2010 Publication 526** - Charitable Contributions

Resources

Colorado Tax Forms and Publications

Sales Tax Exemptions:

• **Sales 1**: How to Document Sales to Retailers, Tax-Exempt Organizations, and Direct Pay Permit Holders

• **Sales 63**: Government Purchases Exemptions

• **Sales 2**: Sales Tax Exempt Status for Charitable Organizations: Application Requirements
Resources

Colorado Tax Forms and Publications

Sales Tax Exemption Forms:

- **DR 0137** Claim For Refund of Sales Tax Paid
- **DR 1367** Affidavit of Sale Paid by Government Credit Card
Resources

Colorado Tax Forms and Publications

Fuel Tax Exemption:

• **Excise 7**: Tax Refunds for Exempt Use of Fuel
• **Form DR 0241** - Government Agencies Fuel Tax Exemption
• **Form DR 7118** - claim for refund check
• **Form DR 7189** – Fuel Tax Refund Permit Application (for non-governmental entities?)
Resources

Colorado Department of Revenue
(www.taxcolorado.com)

FYI Publications
The purpose of this presentation has been to share with you the research I have done in connection with various issues concerning special districts and Colorado and federal tax law.

The information contained in this presentation is not intended as tax advice for any particular district or any particular fact situation.

I am not a tax attorney, and I do not legally represent the districts which are members of SDA.

If this presentation has raised any questions or concerns for you about any of the practices at your district, please consult the attorney for your district.
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