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Navigating the Legal Landscape: Tax-Exempt Organizations in Today's Climate

Tuesday, December 2, 2025

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Discussion Topics

– Mergers, Consolidations, and Shared Services Agreements
– Hot Topics for Exempt Organizations – Tax and NYS Nonprofit Law
– What's on the Horizon for Exempt Organizations in 2026?

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Mergers, Consolidations and Shared Services

Alternatives for Nonprofits Facing Financial Volatility

Statutes-Mergers/Consolidations

- Article 9 of the N-PCL
  - Approval of Supreme Court on notice to AG – §907-a
  - Approval of AG - §907-b
  - https://ag.ny.gov/sites/default/files/2023-02/mergers-consolidations.pdf

Merger and Consolidation Math

- N-PCL 901 (Power of merger)
- Merger vs. Consolidation:
  - OPTION A: NFP A, Inc. merges with and into NFP B, Inc. with NFP B, Inc. as the survivor.
  - OPTION B: NFP A, Inc. and NFP B, Inc. consolidate into a single corporation which is a new to be formed corporation pursuant to the consolidation.

Merger

- "Merger" (N-PCL 901(a)(1)) is when 2 or more nonprofit corporations merge with and into a single constituent corporation (an existing corporation). The constituent corporation into which one or more other constituent corporations are merged is called the "surviving corporation."
- Example: NFP A, Inc. merges with and into NFP B, Inc. with NFP B, Inc. as the surviving corporation.
- Assets and liabilities of NFP A become the assets and liabilities of NFP B.

Consolidation

- "Consolidation" (N-PCL 901(a)(2)) is when 2 or more nonprofit corporations consolidate into a single new corporation.
- Example: NFP A, Inc. merges with and into NFP B, Inc. with NFP C, Inc. as the surviving corporation.
- Assets and liabilities of NFP A and NFP B become the assets and liabilities of NFP C.

Attorney General Approval Required

- The N-PCL authorizes a merger or consolidation of two corporations only upon a “finding that the interests of the constituent corporations and the public interest **will not be adversely affected** by the merger.” See, N-PCL Section 907-a(e) 907-b(f). Factors on next slide.
- AG or Court approval is required for mergers if:
  - 1. One or more NY charitable corporations merge with one or more foreign (non-NY) corporations;

    OR
  - 2. One ore more religious corporations merges with one or more corporations formed for religious purposes to which the N-PCL applies by virtue of N-PCL 103(a)
- Other governmental approval may be necessary.

Factors AG Considers to Determine Whether Interests of Constituent Corporations are Adversely Affected:

- whether the existing New York corporation is in compliance with New York statutes and regulations;
- whether the existing foreign corporation is in compliance with applicable New York statutes and regulations;
- whether there is a pending federal or state inquiry or investigation into the conduct of either corporation, or of its officers, directors, donors, members or key persons;
- whether there is any order, judgment, settlement, or agreement that requires the foreign corporation to engage in, or prohibits it from conducting, activity affecting the surviving corporation's ability to fulfill its purposes;
- whether either corporation has made a false or incomplete filing with the Office of Attorney General or any other state or federal agency;
- whether either corporation is insolvent or unable to pay its current obligations;
- whether either corporation has filed for bankruptcy;
- whether the New York corporation has significant charitable assets currently subject to the oversight of the Attorney General pursuant to the Estates, Powers, and Trusts Law, or any other statute;
- whether the New York Corporation has significant institutional funds or restricted assets subject to the New York Prudent Management of Institutional Funds Act (N-PCL Article 5-A);
- whether the charitable purposes of the New York Corporation, as articulated in its certificate of incorporation, by-laws, or Forms IRS 990 are substantially connected to New York State, a region in New York State, or a local community in New York State;
- whether the certificate of incorporation of the New York Corporation is subject to the Approvals, Notices and/or Consents set forth in N-PCL Section 404;
- whether the foreign corporation is incorporated in a jurisdiction which is unlikely to permit application by the New York Attorney General of the provisions of Article 13 of the N-PCL to the surviving corporation;
- whether the foreign corporation is incorporated in a jurisdiction lacking an effective not-for-profit corporation law or regulatory scheme, including lacking the standards for governance set forth in Article 7 of the N-PCL, the standards for disclosure and reporting set forth in the Executive Law, or provisions allowing for dissolution by the Attorney General similar to the provisions of Article 11 of the N-PCL.
- whether there is an objection to the merger by creditors, members, directors, or beneficiaries.

Steps for Merger/Consolidation

1. PLAN OF MERGER: Board of each corporation work together to create a Plan of Merger or Consolidation. This generally outlines the terms and conditions of the proposed merger, identifies the parties and the surviving corporation.

2. BOARD APPROVAL OF PLAN OF MERGER.

3. CERTIFICATE OF MERGER.

4. APPROVALS BY GOVERNMENTAL BODIES OR OFFICERS.

5. AG OR COURT APPROVAL. *Consolidations of educational corporations chartered by the SUNY Board of Regents are not reviewed by the OAG*

6. FILE CERTIFICATE OF MERGER WITH NY DEPARTMENT OF STATE (COPY TO OAG).

Important Considerations

- Before embarking on any partnership, consolidation, merger, or acquisition, nonprofits should consider:
  - Mission alignment, compatibility of organizational values, culture, and complimentary programming;
  - Clear communication and collaboration strategies to address potential conflicts and maintain stakeholder engagement;
  - Be honest about your intentions, keeping in mind that these nonprofit organizations are businesses;
  - Identify the goals and definition of success for all parties;
  - Financial and legal implications, including tax-exempt status, funding sources, and compliance with relevant regulations.
  - Ongoing governance structure and decision-making processes to ensure transparency, accountability, and equitable representation.

The Power of Partnerships: Alternatives to Mergers/Consolidations

- Shared Services Agreements
- Corporate Sponsorships
- Joint programming
- Fiscal sponsorships
- Joint venture opportunities with for-profit entities
  - Activities must serve a public, rather than a private interest.
  - Private benefit/inurement risks
  - Be mindful of UBIT!
- Sale of assets (*N-PCL 510/511 Petition to AG if disposing of all or substantially all of the assets)

Hot Topics for Exempt Organizations

Hot Topic: One Big Beautiful Bill Act (OBBB)

- Singed into law on July 4, 2024, includes vast changes to Internal Revenue Code
- 5 key provisions impacting exempt organizations:
    1. Expansion of Section 4960 Excise Tax on Executive Compensation
    2. Modification of Section 4968 Excise Tax on Investment Income of Private Colleges and Universities
    3. New Limitation on Corporate Deduction for Charitable Contributions
    4. New Limitation on Individual Deduction for Charitable Contributions
    5. New Tax Credit for Individual Contributors to Scholarship-Granting Organizations
- What was left out of OBBB?
    - Reinstatement of the "parking lot tax"
    - Revocation of tax-exempt status for "Terrorist Supporting Organizations"
    - Treatment of name and logo royalties as unrelated business income

Hot Topic: One Big Beautiful Bill Act (OBBB)

Code Section	Description	Relevant Prior Law	OBBB Change
Sec. 4960	21% excise tax on highly compensated "covered employee"	• "Covered employee" means any employee paid comp >$1m by an exempt organization • Limited to the 5 highest compensated employees	• Expanded definition of "covered employee" to remove '5 highest compensated employees' limitation, and include employees of related persons or government entities • Effective January 1, 2026

Sec. 4968	1.4% excise tax on net investment income of applicable private colleges and universities	• Flat 1.4% rate of tax, regardless of amount of net investment income	• Only for larger institutions (>3k students and at least $500k of assets per student), modified flat rate to a tiered rate based on net investment income amount:
			  • $500k - $750k: 1.4%
			  • >$750k - $2m: 4%
			  • >$2m: 8%
			• Effective January 1, 2026

Sec. 170	Charitable contribution deduction for corporations	• Corporations allowed a deduction for charitable contributions, capped at 10% of taxable income	• New 1% floor limitation, in addition to existing 10% ceiling • Effective January 1, 2026 • Unclear whether charitable deduction will be inclusive of the 1% floor amount, or only the amount contributed in excess
Sec. 170	Charitable contribution deduction for individuals	• Non-itemizers: no charitable contribution if taking standard deduction • Itemizers: allowed deduction for charitable contributions, capped at 60% of AGI	• Non-itemizers: can deduct up to $1k ($2k if MFJ) in addition to standard deduction • Itemizers: new 0.5% floor limitation, in addition to existing 60% ceiling • Effective January 1, 2026 • Same uncertainty as corporate floor
Sec. 25F	Tax credit for individual contributions to scholarship-granting exempt organizations	None	• Non-refundable tax credit (up to $1,700 cap) for individuals who make "qualified contributions" to certain scholarship granting public charities • States must opt in to participate and designate qualifying public charities based on list of criteria • Effective January 1, 2027

Hot Topic: Unrelated Business Income Tax (UBIT)

- Tax is imposed at corporate income tax rates on net income from an “unrelated trade or business”
  - A trade or business
  - Regularly carried on
  - Not substantially related to organization’s exempt purpose
- If unrelated business income is substantial, it may jeopardize tax exemption
  - What is considered “substantial”? Varies based on facts and circumstances…
- Certain **activities** are excepted from “unrelated trade or business”:
  - Activities conducted primarily by volunteers
  - Convenience exception: a trade or business provided for the convenience of the organization’s members, employees, etc. and types of income are excluded
- Certain types of **income** are excluded from “unrelated business income”:
  - Interest and dividends
  - Royalty income
  - Rental income
  - Gains and losses from the sale of property

  <u>**NOTE**</u>: there are exceptions to these exclusions.

Private Benefit/Inurement Risks

- IRC Section 501(c)(3): **No part** of an organization's net earnings may *inure* to the benefit of a private shareholder or individual.
- **Private inurement**: "Insider" receives a benefit in excess of FMV of goods or services provided.
- Inurement to insiders (e.g., board members, officers, key employees, etc.): **absolutely prohibited!**
- Private benefit applies to outsiders and must be **incidental.**

Excess Benefit Transactions

- IRC Section 4958 penalizes "insiders" and organization managers involved in "excess benefit transactions"
- **Excess Benefit Transactions**
  - Economic benefit provided (directly or indirectly) to an "insider", the value of which exceeds the value of the consideration received.
- **Insiders**: "Disqualified Persons"
  - Directors, officers, trustees;
  - Other persons with substantial influence;
  - Substantial contributors;
  - Family members of these individuals.

Excess Benefit Transactions

- **<u>3-prong "rebuttable presumption of reasonableness"</u>**: established if, in approving a transaction with insider:
  - Advance approval by board (interested parties are recused from voting on transaction);
  - Board relies on appropriate data of comparability (e.g., salary survey, appraisal);
  - Adequate contemporaneous documentation by board.

Excess Benefit Transactions

- Penalty imposed on disqualified person involved in an excess benefit transaction:
  - Repayment of excess, plus interest;
  - 25% excise tax on excess, or 200% if not corrected.
- Penalty may also be imposed on organization managers who knowingly participate in an excess benefit transaction:
  - 10% excise tax on excess.
- Will not be considered “knowingly” if manager:
  - Relied on a professional's written advice; or
  - Relied on the rebuttable presumption requirements having been satisfied.

Unusual Grants

- While publicly supported organizations generally welcome donations of any size, consideration must be given when an organization receives a donation that is larger than those it typically receives.
- A large donation *may* endanger an organization's tax-exempt status because of the effect such a contribution has on the organization's public support percentage, possibly causing the organization to "tip" into private foundation status.
  - An organization generally meets the public support test if the total amount of support it receives from the public and certain governmental sources equals at least 33 1/3% of the total support normally received by the organization.
  - This, and is reported on the organization's Form 990.

Unusual Grants

- A large donation, however, is excluded from an organization's public support percentage calculation (both the numerator and denominator of the public support fraction) if it constitutes an "Unusual Grant."
- An "Unusual Grant" is a contribution or bequest that:
  - (1) is attracted because of the recipient organization's publicly supported nature;
  - (2) is unusual or unexpected with respect to the amount thereof; and
  - (3) would, by reason of its size, adversely affect the status of the recipient organization as normally being publicly supported.

Unusual Grants

- Whether a contribution constitutes an Unusual Grant requires analysis of all relevant facts and circumstances. The following factors tend to show that a contribution is an Unusual Grant:
  - (1) the contribution is not made by a person who (or a relative of the person who) created the organization, previously contributed a substantial part of the organization's support, or stood in a position of authority in the organization;
  - (2) the contribution is a bequest, rather than an inter vivos transfer;
  - (3) the contribution is in the form of cash, readily marketable securities, or other assets that can be used by the organization in furtherance of its exempt purposes (for example, the donation of a painting to a museum);
  - (4) the organization has carried on an active program of public solicitation and exempt activities and has attracted significant public support;
  - (5) the organization can reasonably expect to attract a significant amount of public support after the contribution (continued reliance on unusual grants to fund current operating expenses may be evidence that the organization cannot expect to attract future support from the general public);
  - (6) the organization has not excluded unusual grants in prior years;
  - (7) the organization is controlled by a representative governing body rather than by the donor (or persons related to the donor); and
  - (8) the donor has not placed material restrictions on the contribution.

Unusual Grants

- An organization that has received any Unusual Grants in the five-year period reported on the Form 990 (*i.e.*, the current tax year and four preceding tax years) must keep certain records, including: the name of the grantor, the date and amount of the grant, and a brief description of the grant.
  - Such records are not filed with the annual Form 990.
- Certain information on Unusual Grants (not including the identities of the donor(s)), however, is reported on Schedule A, Part VI of the Form 990.

What’s on the Horizon for Exempt Organizations in 2026?

IRS Updates

IRS Priorities in Exempt Organization Compliance and Audits

- **Audit Focus:**
  - Form 990-N filers with significant gross receipts
  - Excise tax on excess compensation
  - Exempt hospitals
  - Exempt organizations using name, image, and likeness agreements
- **Other Noteworthy Items Regularly Examined by IRS:**
  - For-profit conversions
  - Self-dealing
  - Employment taxes
  - Unrelated business income
  - Unreported compensation

IRS Updates

IRS 2025-2026 Priority Guidance Plan

- Annual report to identify and prioritize tax issues to be addressed through IRS guidance for the fiscal year ending June 30, 2025.
- Largely perceived as aspirational because of vast number of included guidance projects (e.g., 231 items listed on FY24 priority guidance plan).
- FY25 plan, released October 1, 2025, far more focused and feasible—only 105 guidance projects, 11 of which already addressed.
- 6 general areas addressed in FY25 plan:
    1. One, Big, Beautiful Bill Act Implementation
    2. Deregulation and Burden Reduction
    3. Section 501(c)(3) Issues
    4. Tribal Tax Issues
    5. Digital Assets
    6. SECURE 2.0 Act and Other Guidance

IRS Updates

IRS 2025-2026 Priority Guidance Plan (cont'd.)

– 7 guidance projects aimed directly at exempt organizations:

One, Big, Beautiful Bill Act Implementation

- New section 25F tax credit for contributions of individuals to scholarship granting organizations.
- Section 4966 final regulations regarding DAFs, including excise taxes on sponsoring organizations and fund management.
- Section 4968 and section 4960 excise taxes.
- Regulations under section 6104 regarding public disclosure of certain materials relating to exempt organizations (e.g., Form 1023/1024, annual return, etc.).

Section 501(c)(3) Issues

- "Guidance on the statutory prohibition in section 501(c)(3) against participation or intervention in political campaigns (i.e., the Johnson Amendment)."
- "Guidance on the application of the fundamental public policy against racial discrimination, including consideration of recent caselaw, in determining the eligibility of private schools for recognition of tax-exempt status under section 501(c)(3)."

Diversity, Equity and Inclusion for Nonprofits

- Key Executive Orders Impacting DEI (there are many more):
  - **EO14151 : Ending Radical and Wasteful Government DEI Programs and Preferencing**
    - Terminates "all discriminatory programs, including illegal DEI and "diversity, equity, inclusion, and accessibility" (DEIA) mandates, policies, programs, preferences, and activities in the Federal Government, under whatever name they appear…"
    - Impacts Federal contractors and grantees – strict certification/recertification requirements
    - Although litigation is ongoing challenging OMB's response to this EO (freezing various federal funds), the US DOJ issued guidance to recipients of federal funding in July 2025: Memo from Attorney General Bondi: Guidance for Recipients of Federal Funding Regarding Unlawful Discrimination
  - Guidance for Recipients of Federal Funding
    - Preferential hiring practices/access to facilities and resources for certain races/subgroups prohibited.
    - Race Based Scholarships prohibited.
    - Unlawful proxies prohibited.
    - Unlawful segregation prohibited. Segregation on the basis of sex is prohibited – similarly, single sex spaces are also prohibited.

Diversity, Equity and Inclusion for Nonprofits

- **EO 14173: Ending Illegal Discrimination and Restoring Merit-Based Opportunities**
  - “Eliminating racial discrimination means eliminating all of it." *Students for Fair Admissions, Inc. v. President & Fellows of Harvard Coll., 600 U.S. 181, 206 (2023).*
  - On January 21, 2025, President Trump issued Executive Order 14173, Ending Illegal Discrimination and Restoring Merit-Based Opportunity, 90 Fed. Reg. 8633 (Jan. 21, 2025), making clear that policies relating to "diversity, equity, and inclusion" ("DEI") and "diversity, equity, inclusion, and accessibility" ("DEIA") "violate the text and spirit of our longstanding Federal civil-rights laws" and "undermine our national unity." Id. at 8633.
  - The US DOJ’s Civil Rights Division was empowered to investigate, eliminate, and penalize illegal DEI and DEIA preferences, mandates, policies, programs, and activities in the private sector and in educational institutions that receive federal funds. Educational agencies, colleges, and universities that receive federal funds may not "treat some students worse than others in part because of race." Students for Fair Admissions, 600 U.S. at 304 (Gorsuch, J., concurring).
  - Consistent with the January 21, 2025, Executive Order, the Department of Justice was directed to work with the Department of Education to issue directions, and the Civil Rights Division will pursue actions, regarding the measures and practices required to comply with *Students for Fair Admissions*. **We have yet to see these guidelines. Guidelines.** Became even more problematic following the dismantling of the US Department of Education.
  - Encompasses programs, initiatives, or policies that discriminate, exclude, or divide individuals based on race or sex. DOES NOT PROHIBIT: educational, cultural, or historical observances-such as Black History Month, International Holocaust Remembrance Day, or similar events-that celebrate diversity, recognize historical contributions, and promote awareness without engaging in exclusion or discrimination.

Diversity, Equity and Inclusion for Nonprofits

- **What should Nonprofits do?**
  - Different for federal grantees and recipients of federal funding.
  - Audit all policies, programs, public materials (including, but not limited to, websites, social media, brochures, solicitation letters, etc.).
  - Monitor National Council on Nonprofits (updated daily): Chart of Executive Orders
  - Be cognizant of 1023 applications and information disclosed in federal filings (i.e. Form 990)
  - Work with counsel to ensure – fine balance between staying true to your values and charitable purposes and violating Executive Orders. Set yourself up for success down the road in the event of future crackdowns.

Questions?

Contact for More

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