

Tax-Exempt Status

Session Objectives:

- State the main distinction between “tax-exempt” and “non-profit”
- List the major types of exempt organizations
- Identify the benefits of tax-exempt status
- Identify major categories of public charities
- Identify the actions that jeopardize tax-exempt status

What is an Exempt Organization?

An exempt organization is:

- A trust, association, or corporation *not* organized for profit (i.e., *nonprofit*) that is described in the Internal Revenue Code as *exempt* from *Federal Income Tax*.

Types of Exempt Organizations

Charitable	§ 501(c)(3)	Schools, churches, foundations, etc
Civic/Social Welfare	§ 504(c)(4)	Rotary clubs
Labor/Agricultural	§ 501(c)(5)	AFL-CIO
Business Leagues/ Professional	§ 501(c)(6)	Chambers of Commerce, ABA, AICPA
Social Clubs	§ 501(c)(7)	Country clubs, swim clubs

Benefits of 501(c)(3) Status

- Exempt from federal income tax and *some* federal employment taxes
- Exempt from *some* state taxes (e.g., income, sales, employment)
- Tax-deductible contributions
- Tax-exempt financing
- Reduced postal rates

§501(c)(3) - Three Prong Test

Must be *organized* and *operated* for an *exempt purpose*.

Organizational Test

Organizing document must:

- Limit purpose as stated in 501(c)(3)
- Distribute assets for 501(c)(3) purposes upon dissolution
- Not allow more than an insubstantial amount of non-exempt activity

Examples of organizing documents: Articles of Incorporation, Trust documents, Articles of Association, Constitution

Public Charity v. Private Foundation

Publicly supported
(e.g., United Way)

Not taxed on income

Community-based
board of directors

Privately supported (e.g.,
family or corporate
foundations)

Not taxed on income;
may be subject to excise
taxes

Family or corporate board
of directors

Jeopardizing § 501(c)(3) Status

- *Inurement/private benefit* activities prohibited and restricted
- *Lobbying* activities must be insubstantial
- *Political* activities are absolutely prohibited
- *Unrelated business* activities must not be primary purpose

Inurement/Private Benefit

- Inurement to insiders such as ministers, church board members, officers, employees, etc., is absolutely prohibited.
- Private benefit must be *incidental* to either insiders *or* outsiders.

Lobbying

Attempting to influence legislation

Measurement methods:

- “Substantial Part” test - violation results in excise tax and revocation of exemption,
- “Expenditure” test - violation results in excise tax and/or revocation of exemption
 - Must make election on Form 5768. Churches cannot make this election.

Political Activity

Direct and indirect candidate support:

- Contributions
- Participation in campaigns
- Public statements for/against a particular candidate

Absolute Prohibition!

Unrelated Business Income

- Trade or business activity
- Regularly carried on
- Not substantially related to organization's exempt purpose

For More Information

Specialized Assistance on Tax-Exempt Organizations through the Exempt Organizations (EO) division of the IRS:

IRS Web site: www.irs.gov/charities

Stay Exempt Online Workshop: www.stayexempt.org

TE/GE Customer Account Services: (877) 829-5500

Internal Revenue Service

TE/GE Customer Account Services

P.O. Box 2508

Cincinnati, OH 45201

Subscribe to EO Update:

- eoupdate@subscribe@lists.qai.irs.gov

IRS tax forms and publications specific to charities are available on the EO website

