Stay Exempt

Course 1 Summary: Tax-Exempt Status

Benefits of 501(c)(3) Status

Tax exemption under Internal Revenue Code (the Code) section 501(c)(3) provides a number of benefits:

- Exemption from Federal income tax;
- Tax-deductible contributions;
- Possible exemption from state income, sales, and employment taxes;
- Reduced postal rates;
- Exemption from Federal unemployment tax; and
- Tax-exempt financing.

Tax-Exempt Organizations and 501(c)(3)s

A **tax-exempt organization** is a trust, unincorporated association, or nonprofit corporation described in the Internal Revenue Code as exempt from Federal income tax.

A **501(c)(3)** is a type of exempt organization. It must be organized and operated for one or more exempt purposes described in Code section 501(c)(3):

- Charitable,
- Educational,
- Religious,
- Scientific,
- Literary,
- Testing for public safety,
- Fostering national or international amateur sports competition, and/or
- Preventing cruelty to children or animals.

Public Charity Status

When an entity qualifies as a 501(c)(3), the IRS presumes it is a private foundation (except for statutory public charities, such as churches and schools) unless the organization can show it is a public charity.

To qualify as a public charity, the 501(c)(3) must demonstrate it is a type of organization classified as a public charity by statute such as a church, hospital or school, or that supports another public charity. In addition, an organization may be classified as a public charity if it is publicly supported and receives substantial support in the form of gifts, grants and contributions from the general public or a governmental unit and or income from activities related to their exempt activities like admissions.

If your 501(c)(3) is so new that it cannot show it is publicly supported, the IRS will treat you as a public charity for your first five years from the organization's formation if it demonstrates that it can reasonably be expected to be publicly supported.

Beginning with the organization's sixth year, the IRS will monitor your public charity status based on your public support as reported on Schedule A , Public Charity Status and Public Support of your Form 990.

If the organization cannot show broad financial support, the IRS will **reclassify** it as a private foundation.

Jeopardizing 501(c)(3) Status

There are four types of activities that can jeopardize your 501(c)(3)'s tax-exempt status:

- Private benefit/inurement,
- Lobbying,
- Political activity, and
- Excessive unrelated business income (UBI).

Private benefit: 501(c)(3)s must avoid all activities that will substantially benefit the private interest of any individual or organization.

Inurement: No part of an organization's net earnings may inure to the benefit of a private shareholder or individual. This means that a 501(c)(3) organization is prohibited from allowing its income or assets to accrue to insiders. The prohibition of inurement is **absolute**. **Any** amount will jeopardize the organization's 501(c)(3) status.

Lobbying: Lobbying is an activity designed to influence legislation. If its lobbying activities are **substantial**, a 501(c)(3) may risk losing its tax-exempt status. The IRS uses two tests to determine whether lobbying is substantial: the substantial part test and the expenditure test.

Political Campaign Activity: Political campaign activity involves directly or indirectly participating or intervening in any political campaign on behalf of or in opposition to any **candidate** for elective office. The prohibition of political campaign activity is **absolute**. **Any** violation may result in the loss of tax-exempt status and the imposition of excise taxes.

Excessive Unrelated Business Income (UBI): See Course 2, Unrelated Business Income.