

# Obtaining and Retaining Tax-Exempt Status

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# Agenda

1. Overview of Tax-Exempt Status
2. Requirements for a 501(c)(3) Charity
3. Public Charity vs. Private Foundation
4. Applying for 501(c)(3) Status
5. Conclusion



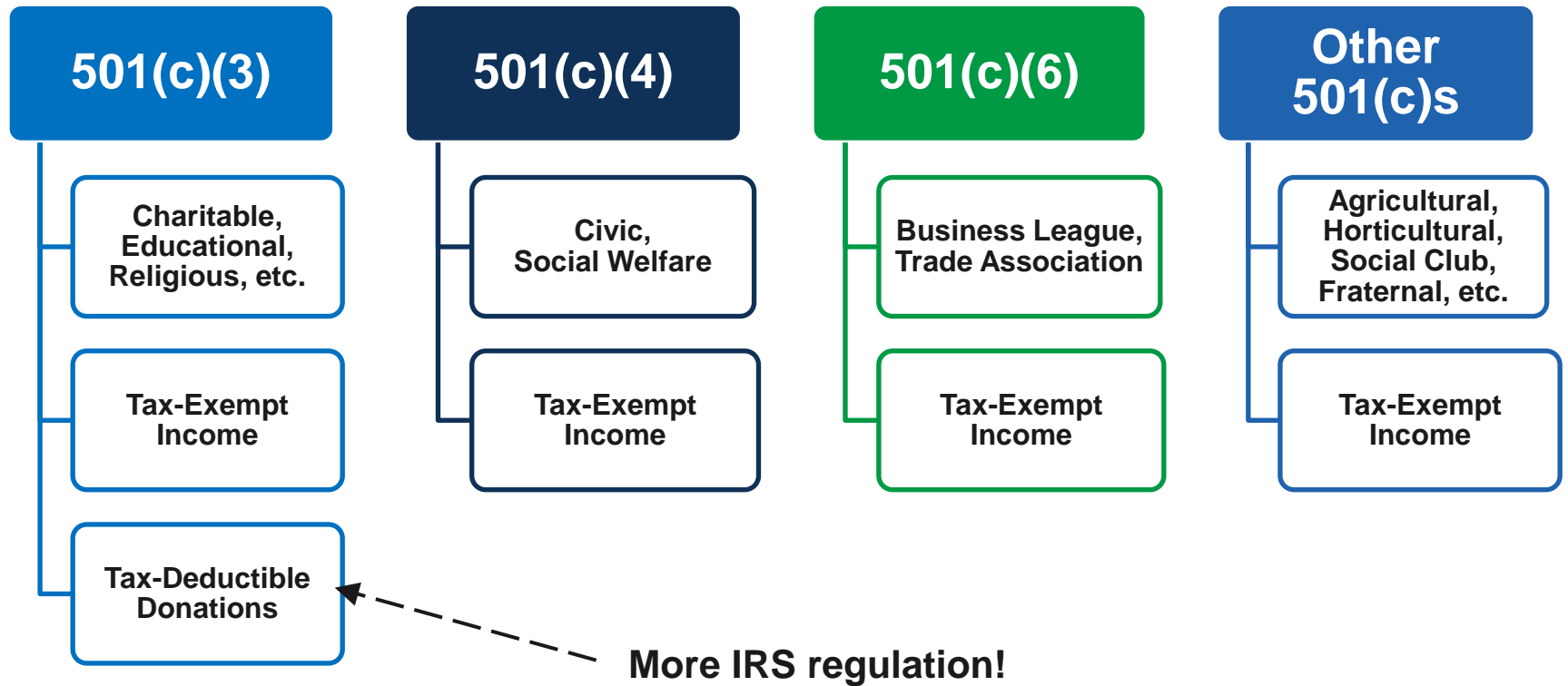
# Overview of Tax-Exempt Status

# Overview of Tax-Exempt Status

- Source of exemption
  - Section 501(a) and 501(c) provide exemption for organizations we'll discuss today
  - 29 different types under Section 501(c)!
  - State status in Colorado piggybacks on federal status



# Types of Tax-Exempt Organizations



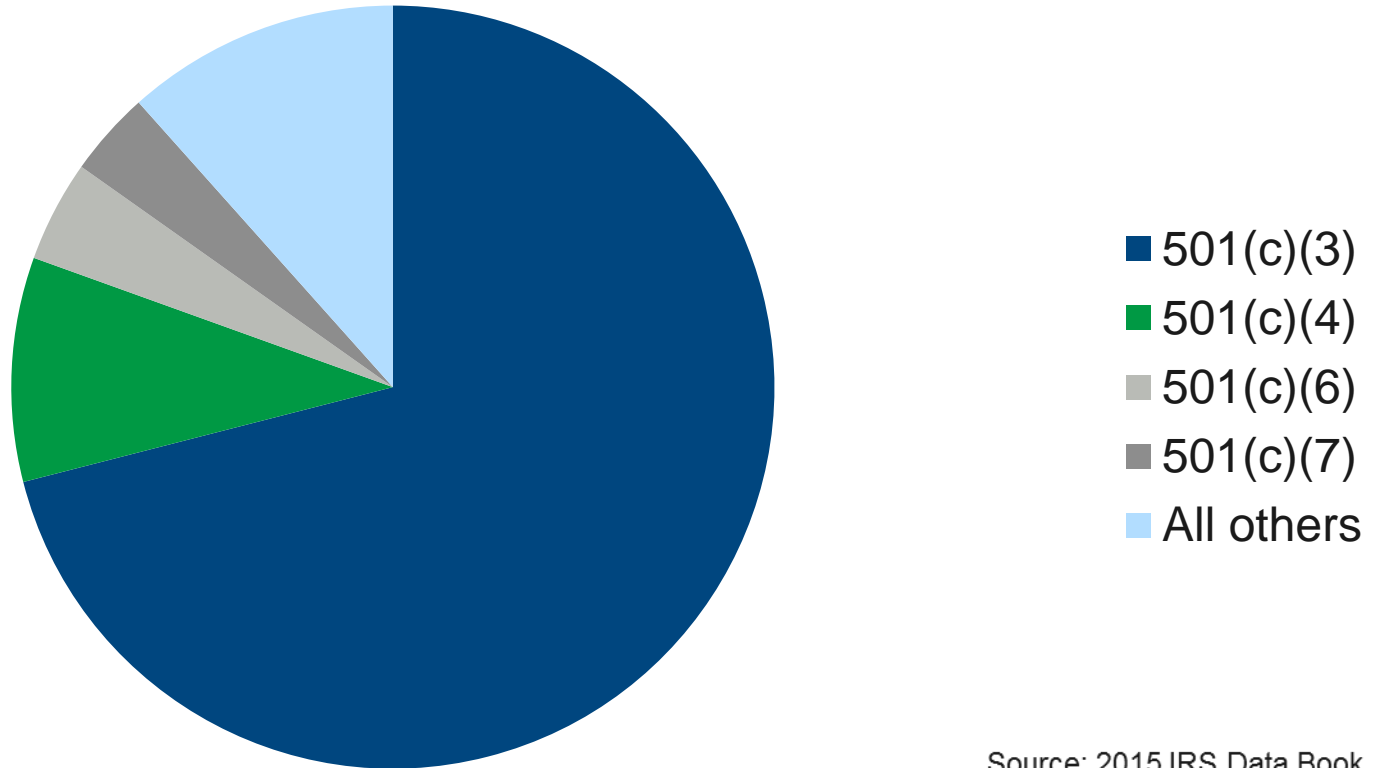
# Overview of Tax-Exempt Status

- Other benefits of exemption
  - Exemption from state and federal income tax
  - Other benefits depend on type of organization
    - Sales tax
    - Property tax
    - Postal privileges
    - Greater eligibility for grants
    - Tax-deductible contributions



# Overview of Tax-Exempt Status

## 501(c) Organizations

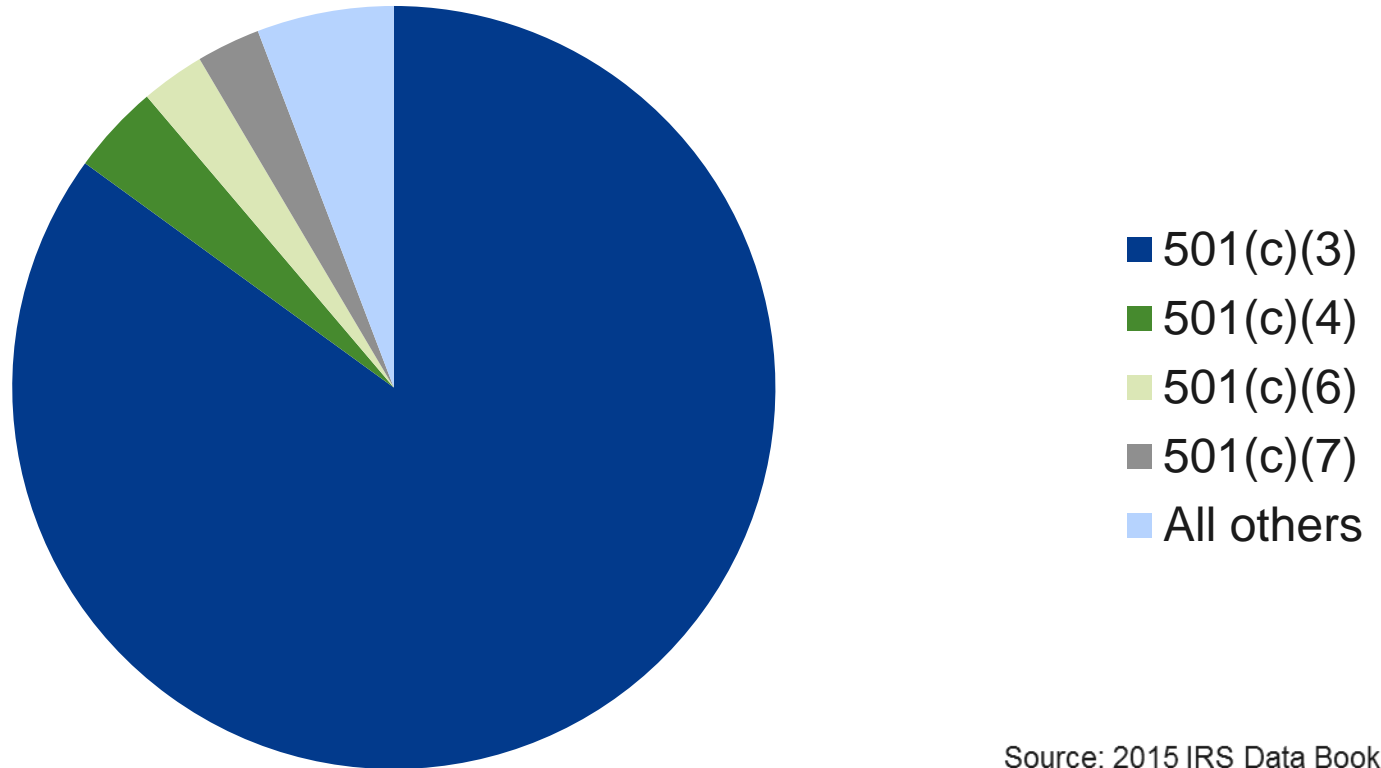


Source: 2015 IRS Data Book



# Overview of Tax-Exempt Status

## New 501(c) Applications



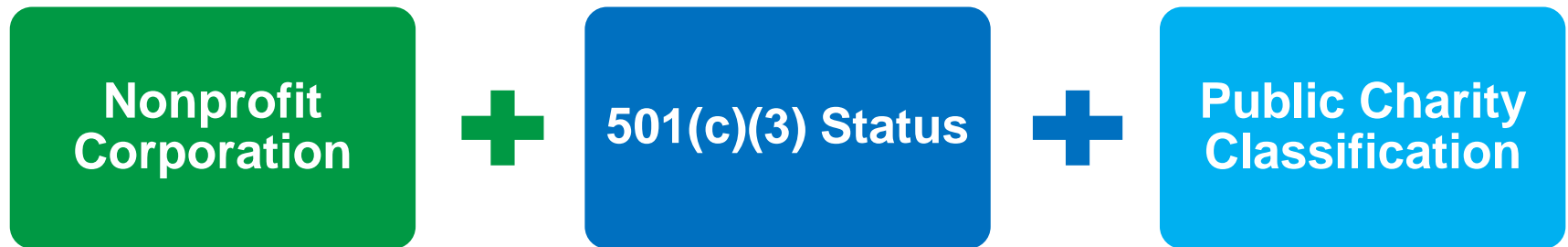
Source: 2015 IRS Data Book





# Today's Primary Focus

**A nonprofit entity that is ...**



# Requirements for 501(c)(3) Charity

# Requirements for a 501(c)(3) Charity

- Three main requirements
  1. Must be organized and operated exclusively for 501(c)(3) purposes
  2. No private inurement of income or assets to private individuals
  3. No substantial lobbying and no political campaign activity



# Requirements for a 501(c)(3) Charity

## 1. Organized and operated exclusively for 501(c)(3) purposes

- Statute enumerates eight purposes under 501(c)(3)
- Charitable trust law provides overlay
  - Benefits flowing to charitable class (sufficiently broad and indefinite)
  - Limitations where public policy violated (e.g., violations of law, racial discrimination)



# Requirements for a 501(c)(3) Charity

## 1. Organized and operated exclusively for 501(c)(3) purposes

- Charitable
- Educational
- Religious
- Scientific
- Literary
- Prevention of cruelty to children or animals
- Fostering national/international sports competition
- Testing for public safety



# Requirements for a 501(c)(3) Charity

## 1. Organized and operated exclusively for 501(c)(3) purposes

- Organizational test requires certain provisions to be included in formation documents
  - Purpose of exempt organization should be set out and document should not expressly allow prohibited activities
  - Assets must be devoted exclusively to exempt purposes, so document should provide where assets go upon dissolution



# Requirements for a 501(c)(3) Charity

## 1. Organized and operated exclusively for 501(c)(3) purposes

- Operational test requires that the organization be operated “exclusively” for 501(c)(3) purposes, though regulations interpret “exclusively” as “primarily”
  - Unrelated business income taxation
  - Private benefit
  - Commerciality



# Requirements for a 501(c)(3) Charity

## 1. Organized and operated exclusively for 501(c)(3) purposes

- Any non-exempt activities must be insubstantial, and may result in unrelated business taxable income
  - Important exceptions include passive income, volunteer, donated goods, convenience
  - Monitor with caution activities at 15 percent level, and consider using subsidiary for activities nearing 30 percent





# Requirements for a 501(c)(3) Charity

## 1. Organized and operated exclusively for 501(c)(3) purposes

- Activity that is too commercial violates the operational test (the “commerciality doctrine”)
  - Charity can try to distinguish by not competing with for profit; having reduced fees/sliding scale for low-income users; serving a customer base consisting of charitable class; and relying on donations to some extent
  - Doctrine coming up in social enterprise area



# Requirements for a 501(c)(3) Charity

## 2. No private inurement

- Translation: impermissible use or payment of assets or income to an “insider”
  - Focus is on control or substantial influence over and relation to organization
  - Think founders, directors, officers, key employees, family members of the previous individuals, and certain related organizations



# Requirements for a 501(c)(3) Charity

## 2. No private inurement

- No “de minimis” private inurement
- Comes up in situations like compensation approval, sales, rentals, loans and other related-party deals
- Manage by focusing on reasonableness, documentation

*Note: many other exempts also subject to this restriction*



# Requirements for a 501(c)(3) Charity

## 2. No private inurement

- Traditionally, violation meant revocation of status
- Excess benefit transaction rules are alternative
- Penalty taxes on individuals
- Focus on reasonableness, documentation, rebuttable presumption

*Note: 501(c)(4)s also subject to excess benefit transaction rules*



# Requirements for a 501(c)(3) Charity

## 2. No private inurement

- Separate concept from private benefit
- Separate requirement from private foundation self-dealing rules



# Requirements for a 501(c)(3) Charity

## 3. No substantial lobbying; no political campaign activity

- Private foundations cannot lobby at all
- Other charities must keep to insubstantial amount
  - Facts-and-circumstances test
  - Expenditure test, aka 501(h) election



# Requirements for a 501(c)(3) Charity

## 3. No substantial lobbying; no political campaign activity

- Facts-and-circumstances test determined on case-by-case basis
  - Less clarity
  - No safe harbor measurement



# Requirements for a 501(c)(3) Charity

## 3. No substantial lobbying; no political campaign activity

- Expenditure test measures allowable lobbying as a percentage of overall expenditures
  - Organization must elect this test
  - Different allowable amounts for direct and grassroots lobbying





# Requirements for a 501(c)(3) Charity

## 3. No substantial lobbying; no political campaign activity

- Grants to lobbying grantees OK if no earmarking
- Some express exceptions to lobbying definition:
  - Self-defense
  - Technical advice
  - Non-partisan analysis, study or research
  - Examinations of broad social, economic or similar problems
  - Some membership communications



# Requirements for a 501(c)(3) Charity

## 3. No substantial lobbying; no political campaign activity

- Concern here is partisan activity
- But non-partisan activity can be OK
  - Forums or debates
  - Public policy statements
  - Voter registration
  - Educational materials about all candidates



# Requirements for a 501(c)(3) Charity

## 3. No substantial lobbying; no political campaign activity

- Compare to other exempt organizations:
  - Non-501(c)(3) organizations can participate in some partisan activity, so long as it is not their primary purpose—this is an area in transition as IRS works to better define this
  - Current challenges around allowable amount, donor identity
  - Again, consider tandem or affiliated structure



# Public Charity vs. Private Foundation

# Framework for Nonprofit Tax Status

Nonprofit Organizations

Tax-Exempt Organizations  
§ 501(c)

Charitable Organizations  
§ 501(c)(3)

## Public Charities

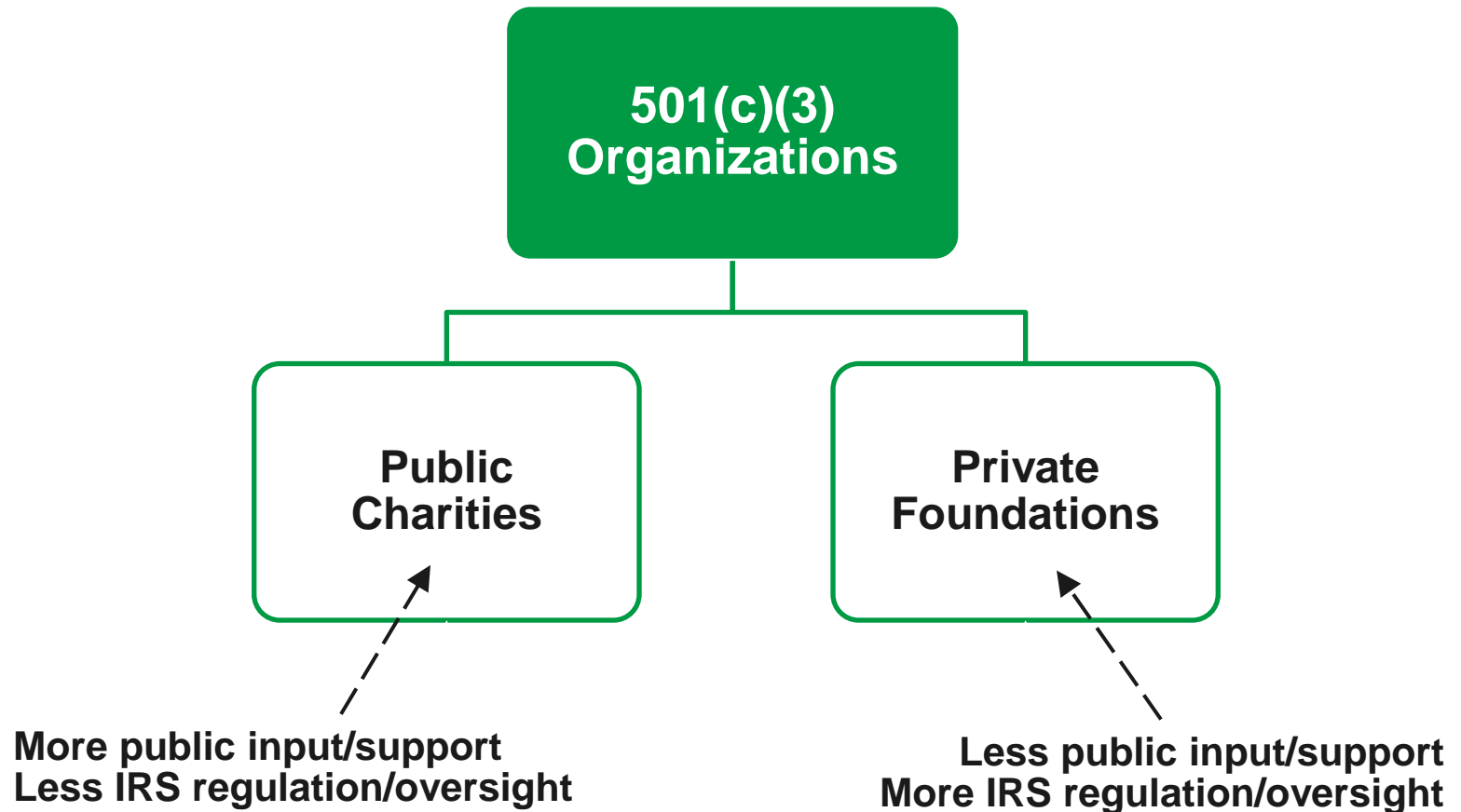
- Traditional Charities  
§ 509(a)(1)/170(b)(1)(A)
- “Gross Receipts” Charities  
§ 509(a)(2)
- Supporting Organizations § 509(a)(3)

## Private Foundations

- Non-operating Foundations
- Operating Foundations
- Pass-thru Foundations
- Pooled Income Funds
- Split Interest Trusts



# Types of 501(c)(3) Organizations



# Public Charity vs. Private Foundation

- Types of public charities
  - Institutional charities
    - Hospitals, schools, churches, governmental organizations
  - Publicly supported charities
    - Test for primary support from gifts, grants and contributions
    - Test for primary support from exempt function income
  - Supporting organizations
    - Type I, II or III



# Public Charity vs. Private Foundation

- Types of private foundations
  - Non-operating foundations (grantmakers)
  - Operating Foundations
    - Carry out their own programs, similar to public charity
    - Must meet certain distribution requirements and other tests
  - Others
    - Pooled income fund, pass-thru foundation, non-exempt charitable trusts/split income trust





# Public Charity vs. Private Foundation

- Public charity status comes with benefits:
  - Reduced IRS regulation
  - Preferential treatment for deductibility
  - Easier options for changing status



# Public Charity vs. Private Foundation

- Private foundations have additional restrictions and requirements:
  - Net investment income excise tax
  - Self-dealing restrictions
  - Mandatory payout requirements
  - Restrictions on business holdings
  - Restrictions on jeopardizing investments
  - Restrictions on taxable expenditures



# Applying for 501(c)(3) Status

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- Exceptions from filing:
  - Churches, interchurch organizations, conventions or associations of churches and integrated auxiliaries
  - Organizations with annual gross receipts of \$5,000 or less
  - Organizations that are part of group exemption

*Note: Organizations may wish to apply nonetheless*



# Applying for 501(c)(3) Status

- Streamlined Form 1023-EZ:
  - Projected gross receipts of \$50,000 or less for next three years
  - Actual gross receipts of \$50,000 or less for past three years
  - Total assets at or under \$250,000
  - Limited to certain types of organizations / activities
  - Form require attestations re activities, documents



# Applying for 501(c)(3) Status

- **Miscellaneous**

- Filing fee required
- If filed within 27 months of formation, exempt status retroactive to formation date
- If filed later than 27 months, exempt status retroactive to postmark date unless organization can establish reasonable cause



# Applying for 501(c)(3) Status

- Compare to non-501(c)(3) organizations
  - Form 1024 shorter, less detailed
  - Non-501(c)(3)s can be self-declared and do not need to apply for recognition of status
  - Recent law changes does require 501(c)(4)s to notify IRS about their intent to operate as a 501(c)(4) within 60 days of formation



# Conclusion