How to lose your 501(c)(3) tax-exempt status (*without really trying*)

It's easy for a 501(c)(3) organization to maintain its tax exempt status – and can be just as easy to lose it.

Organizations recognized as exempt from federal income tax under this section of the Internal Revenue Code include private foundations as well as churches, educational institutions, hospitals, and many other types of public charities.

A 501(c)(3) organization can maintain its tax-exempt status if it follows the rules affecting these six areas: private benefit/inurement, lobbying, political campaign activity, unrelated business income (UBI), annual reporting obligation, and operation in accordance with stated exempt purpose(s).

1. Private Benefit/Inurement

Private benefit:

A 501(c)(3) organization's activities should be directed toward some exempt purpose. Its activities should not serve the private interests, or private benefit, of any individual or organization more than insubstantially.

Inurement:

A 501(c)(3) organization is prohibited from allowing its income or assets to benefit insiders – typically board members, officers, directors and important employees of an organization. If an organization benefits insiders, the insiders and the organization could be subject to penalty excise taxes and the organization could lose its tax-exempt status.

2. Lobbying

Lobbying is when an organization contacts, or urges the public to contact, members or employees of a legislative body (or any executive branch official who may participate in the formulation of legislation) for the purpose of proposing, supporting, or opposing legislation, or when the organization advocates the adoption or rejection of legislation.

While a 501(c)(3) organization is allowed to do some lobbying, too much can hurt its tax-exempt status. Its lobbying activities cannot be more than an insubstantial part of its overall activities.

3. Political activity

All 501(c)(3) organizations are prohibited from participating in any political campaign on behalf of (or in opposition to) any candidate running for public office. The prohibition applies to all campaigns at the federal, state and local levels.

For more guidance on what constitutes prohibited political campaign intervention, check out Charities, Churches and Educational Organizations - Political Campaign Intervention.

4. Unrelated Business Income (UBI)

Earning too much income generated from unrelated activities can jeopardize an organization's 501(c)(3) tax-exempt status. This income comes from a regularly carried-on trade or business that is not substantially related to the organization's exempt purpose. However, there are some modifications, exclusions and exceptions.

For more information about what constitutes unrelated business income of an exempt organization and how it is taxed, see Publication 598, *Tax on Unrelated Business Income of Exempt Organizations.*

5. Annual reporting obligation

While 501(c)(3) public charities are exempt from federal income tax, the Internal Revenue Code requires most of these organizations to report certain information annually.

This reporting requirement, fulfilled by completion of one of the Form 990 series of returns, verifies that the organization continues to qualify for exemption and informs the public about the organization's programs and operations.

The Pension Protection Act of 2006 added a new law that provides for automatic revocation of an organization's tax-exempt status if it fails to file a required annual information return for three consecutive years.

In June 2011, the IRS enforced this provision for the first time by publishing a list of approximately 275,000 organizations that lost their tax-exempt status for failing to meet their annual filing obligations for three consecutive taxable years.

Organizations can learn more about their filing requirements, including new requirements applicable to supporting organizations, at IRS Nonprofits and Charities.

6. Operation in accord with stated exempt purpose(s)

An organization must pursue the exempt activities it promised in its IRS application for exemption. If an organization has deviated from its original purposes, it must inform the IRS to prevent future problems.

For more information on this or other IRS topics, go to IRS.gov.

Helpful topics:

- Tax Information for Charities & Other Non-Profits
- Subscribe to IRS's free exempt organization newsletter, the *EO Update*
- Review phone forum presentations on tax-exempt issues