



Maintaining Your Tax-Exempt Status

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- ▶ What causes an organization to lose their tax-exempt status?
- ▶ Process to reinstate an organization's tax-exempt status
- ▶ Resources and Tools



Losing Tax- Exempt Status

Common Causes

- ▶ Failure to File Annual Returns
- ▶ Engaging in Prohibited Activities
- ▶ Private Benefit or Inurement
- ▶ Operating Outside Tax-Exempt Purpose
- ▶ Failure to Meet Organizational Requirements
- ▶ Revocation by the IRS

Failure to File Annual Returns



- ▶ Most tax-exempt organizations are required to file an annual information return
 - Form 990, 990-EZ, or 990-N
 - Who is not required to file:
 - Churches and certain church-related organizations
 - Governmental units and affiliates
 - See full list [here](#)
 - Failure to file for three consecutive years will result in automatic revocation of tax-exempt status
 - Effective on the original filing due date of the third annual return
 - IRS published Automatic Revocation of Exemption List
 - Find information about an organization's status and filings [here](#)
 - Updated monthly

Engaging in Prohibited Activities

- ▶ Must operate exclusively for exempt purposes
- ▶ Engaging in prohibited activities can jeopardize tax-exempt status
- ▶ Examples of prohibited activities:
 - Substantial lobbying
 - Political campaign intervention
 - Excessive unrelated business income

Engaging in Prohibited Activities, cont.



► Lobbying

- All activities intended to influence foreign, national, state, or local legislation
 - Includes direct lobbying (attempting to influence the legislators) and grassroots lobbying (attempting to influence legislation by influencing the general public)
 - Legislation: Includes acts by Congress, any state legislature, and local council, or similar governing body about acts, bills, resolutions, or similar items, or action by the public in referenda, ballot initiatives, constitutional amendments, or similar procedures
 - Doesn't include actions by executive, judicial, or administrative bodies
- 501(c)(3) organizations: May engage in some, but too much lobbying activity risks loss of tax-exempt status
- 501(c)(4) Social Welfare organizations: May further its exempt purpose through lobbying as its primary activity without jeopardizing its exempt status
- 501(c)(6) Business League organizations: May engage in lobbying that is germane to accomplishing its exempt purpose without jeopardizing its exemption
 - May need to give members notice of dues used for lobbying activities or be subject to a proxy tax on the amount of the expenditures

Engaging in Prohibited Activities, cont.



► Political Campaign Activities

- All activities that support or oppose candidates for elective federal, state, or local public office
 - Doesn't matter whether the candidate is elected
 - A candidate is one who offers themselves or is proposed by others for public office
 - Doesn't include any activity to encourage participation in the electoral process (voter registration or voter education) provided that the activity doesn't directly or indirectly support or oppose any candidate
- 501 (c) (3) organizations: Absolutely prohibited
- 501 (c) (4) Social Welfare organizations: May engage in some, so long as that is not its primary activity
- 501 (c) (6) Business League organizations: Will not be disqualified merely because it engages in some political activity
 - May need to give members notice of dues used for political campaign activities or be subject to a proxy tax on the amount of the expenditures
- 527 Political organizations: Created primarily to influence the selection, nomination, election, appointment or defeat of candidates to federal, state or local public office

Engaging in Prohibited Activities, cont.

- ▶ Excessive Unrelated Business Income
 - Three factors to qualify as UBI:
 - Trade or Business,
 - Regularly Carried On, and
 - NOT Substantially Related to Exempt Purpose
 - There is no qualitative threshold and a lot of uncertainty around the question of “how much UBI is too much?”
 - Long-held IRS position: Unrelated activities are allowed to be substantial, so long as they are not the organization’s primary purpose
 - IRS regulations state that an organization will not be regarded as tax-exempt under 501 (c) (3) if more than an insubstantial part of its activities is not in furtherance of an exempt purpose

Private Benefit or Inurement

- ▶ Tax-exempt organizations are generally prohibited from providing excessive benefits to private individuals or organizations
- ▶ If the organization's activities primarily benefit private individuals or entities rather than the public, it may lose its tax-exempt status
- ▶ Examples:
 - A nonprofit sets up a scholarship fund that supports only staff members' children
 - A hospital offers joint venture incentives to physicians to entice them to join the medical staff in order to bring more patients to the facility
 - An organization pays the CEO a reasonable and comparable salary and benefits, but also pays a lavish living allowance that brings total compensation to an amount not in line with comparable positions
 - A nonprofit art gallery exhibits artwork created by its members for a fee but grants board members the same service without cost

Operating outside Tax-Exempt Purpose



- ▶ If an organization deviates significantly from its stated tax-exempt purpose or engages in activities that are inconsistent with its tax-exempt status, it may lose its exemption
- ▶ Exemption Applications (Form 1023 & Form 1024) require detailed narrative descriptions of all the activities of the organization – past, present, and planned
 - Each narrative must include a detailed description of how the activity furthers the organization's exempt purpose
 - Annual information returns ask:
 - Did the organization undertake any significant program services which were not previously reported to the IRS
 - Did the organization cease conducting, or make significant changes in how it conducts, any program services

Failure to Meet Organizational Requirements



- ▶ Tax-exempt organizations must meet certain organizational requirements and failure to meet them can result in loss of tax-exempt status
- ▶ Requirements:
 - Having a proper governing document (articles of incorporation or bylaws)
 - Purpose clause stating the organization is exclusively organized for charitable, religious, educational, and scientific purposes
 - Dissolution clause stating that upon dissolution the organization's assets shall be distributed for one or more exempt purposes or to the government for a public purpose
 - Maintaining adequate records
 - Adhering to state laws regarding nonprofit organizations

Revocation by the IRS

- ▶ The IRS has the authority to revoke an organization's tax-exempt status if it determines that the organization no longer qualifies for exemption under the applicable tax laws
- ▶ Exempt Organizations Examinations program
 - Audits of tax-exempt organizations
 - Promotes voluntary compliance by analyzing operational and financial activities of tax-exempt organizations
 - May cause organization to be reclassified depending on results of audit findings

Effect of Losing Tax-Exempt Status



- ▶ No longer exempt from federal income tax
 - State exemption could also be affected
- ▶ May be required to file one of the following income tax returns and pay applicable income taxes:
 - Form 1120, U.S. Corporation Income Tax Return – 21% tax rate
 - Form 1041, U.S. Income Tax Return for Estates and Trusts – 10%-37% tax rate
- ▶ Not eligible to receive tax-deductible contributions
- ▶ Removed from the cumulative list of tax-exempt organizations (Pub. 78 database)
- ▶ IRS will send a letter informing the organization of revocation



Reinstating Tax-Exempt Status

Reinstating Tax-Exempt Status



- ▶ Law prohibits the IRS from undoing a proper automatic revocation and does not provide for an appeal process
- ▶ Organizations must apply to have their status reinstated
 - Even if the organization was not originally required to file an application for exemption
 - 501(c)(6) – Self-declare on first filed Form 990
- ▶ Four ways to be reinstated (see next slides)
 - Revenue Procedure 2014-11
- ▶ IRS will issue a new determination letter
 - Donors and other may rely on this as of its stated effective date
- ▶ Organization will be included in the next update of the Pub 78 database
- ▶ IRS BMF will indicate the organization is eligible to receive tax-deductible contributions

Streamlined Retroactive Reinstatement



- ▶ Organizations that were eligible to file Form 990-EZ or 990-N for the three years that caused their revocation may have their tax-exempt status retroactively reinstated to the date of revocation if they have not previously had their tax-exempt status automatically revoked
- ▶ Complete and submit Form 1023, 1023-EZ, 1024, or 1024-A
 - User Fee must be paid at time of submission
 - No later than 15 months after the later of:
 - Date of the organization's Revocation Letter (CP-120A), or
 - Date the organization appeared on the Revocation List on the IRS website
- ▶ IRS will not impose penalty for failure to file annual returns for the three consecutive years that caused the organization to be revoked if the organization is retroactively reinstated under this procedure and files properly completed and executed paper Forms 990-EZ for all such years

Retroactive Reinstatement Process (within 15 months)



- ▶ Organizations that cannot use the Streamlined Retroactive Reinstatement Process may have their tax-exempt status retroactively reinstated to the date of revocation if they:
 - Complete and submit Form 1023, 1024, or 1024-A (same sub-conditions as previous slide)
 - Include with the application a statement establishing that the organization had reasonable cause for its failure to file a required annual return for at least one of the three consecutive years in which it failed to file
 - Include with the application a statement confirming that it has filed required returns for those three years and for any other years after such period
 - File properly complete and executed paper annual returns for the three consecutive years that cause the revocation and any following years
- ▶ IRS will not impose the penalty for failure to file annual returns for the three consecutive years that cause the organization to be revoked if the organization is retroactively reinstated under this procedure

Retroactive Reinstatement (after 15 months)

- ▶ Must satisfy all the requirements described under the retroactive reinstatement (within 15 months) procedure **EXCEPT** that the reasonable cause statement the organization includes with its application must establish reasonable cause for its failure to file a required annual return for **all three** consecutive years in which it failed to file, not just one of the three
- ▶ IRS will not impose the penalty for failure to file annual returns for the three consecutive years that cause the organization to be revoked if the organization is retroactively reinstated under this procedure

Post-Mark Date Reinstatement



- ▶ Organizations may apply for reinstatement effective from the post-mark date of their application if they complete and submit Form 1023, 1023-EZ, 1024, or 1024-A with the appropriate user fee
- ▶ Used if the organization isn't able to use one of the three previously discussed procedures

Reasonable Cause Statement



- ▶ Establishes that an organization exercised ordinary business care and prudence in determining and attempting to comply with its annual reporting requirement
- ▶ Should have a detailed description of all the facts and circumstances about:
 - Why the organization failed to file,
 - How it discovered the failure, and
 - Steps it has taken or will take to avoid or mitigate future failures
- ▶ See Section 8 of Revenue Procedure 2014-11



Resources and Tools

Resources and Tools

- ▶ Tax-Exempt Organization Search: www.irs.gov/charities-non-profits/tax-exempt-organization-search
- ▶ Organizations Not Required to File Form 990: www.irs.gov/charities-non-profits/annual-exempt-organization-return-who-must-file
- ▶ Revocation Resources: www.irs.gov/charities-non-profits/automatic-revocation-of-exemption
- ▶ Reinstatement Process: www.irs.gov/charities-non-profits/charitable-organizations/automatic-revocation-how-to-have-your-tax-exempt-status-reinstated
- ▶ Small to Mid-Size 501 (c) (3) Organization Workshop: www.stayexempt.irs.gov/home/resource-library/virtual-small-mid-size-tax-exempt-organization-workshop



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