

**WHAT DOES IT MEAN TO
BE TAX EXEMPT?**

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Federal Taxes

Exempt from Real Property Taxes?	Exempt from Income Taxes?	Exempt from Federal Excise Taxes?	Exempt from Payroll, Unemployment & Occupational Taxes?
Not Applicable (Property taxes are local taxes not federal)	Yes. Charitable organizations which qualify for tax exempt status under 501(c)(3) do not pay Federal Income Tax, BUT Revenue from activities unrelated to an exempt purpose are subject to an unrelated business income tax (UBIT), IF The gross income from the unrelated business activities is greater than \$1,000.	Sometimes. Nonprofit educational organization is eligible for exemption from federal gasoline tax. Nonprofit hospital and educational organizations are exempt from communication-related excise taxes	No. All institutions have to withhold Federal Income Tax and pay Social Security and Medicare taxes (FICA), BUT Institutions which qualify for 501(c)(3) status are exempt from paying Federal Unemployment Taxes (FUTA).

State Taxes

Exempt from Real Property Taxes?	Exempt from Income Taxes?	Exempt from Sales Taxes?	Exempt from Payroll, Unemployment & Occupational Taxes?
Not Applicable	<p>Yes. All charitable organizations that receive Federal 501(c)(3) tax exempt status are exempt from State taxes to the same extent.</p> <p>In CT, DC, GA, MD and NY must complete filing in order to be exempt from state or district taxes. In NJ and VA, state exempt is automatic once federal exemption is received.</p>	<p>Maybe. Goods that are purchased or sold by the charitable organization may be exempt from sales tax,</p> <p>IF</p> <p>1) the <i>organization</i> or <i>transaction</i> fits one of the state sales tax exception categories, AND</p> <p>2) the <i>organization</i> obtains an exemption determination letter from the state.</p>	<p>Maybe. Nonprofit organizations that have received 501(c)(3) tax exemption are still required to pay unemployment tax unless qualify for exemption, such as a religious exemption, AND</p> <p>The organization employs minimum number of workers for minimum number of weeks during a calendar year. CT, DC, MD, NJ - 1 or more workers.</p> <p>GA, NY & VA -4 or more workers.</p>

Local Taxes

Exempt from Real Property Taxes?	Exempt from Income Taxes?	Exempt from Sales Taxes?	Exempt from Payroll, Unemployment & Occupational Taxes?
<p>Maybe. Depending on local and state law, nonprofit may be exempt from property taxes – usually requires that the building be used in connection with the nonprofit's exempt purpose.</p>	<p>Probably. Nonprofits that qualify under State tax exemption are usually exempt from local taxes to the same extent. Nonprofit must verify.</p>	<p>Probably. Nonprofits that qualify under State sales tax exemptions are usually exempt from local sales and use taxes to the same extent. Nonprofit must verify.</p>	<p>Maybe. For example, in GA nonprofits that employ salaried practitioners, who would normally be subject to an occupational tax, are exempt, eighty percent (80%) or more of the organizations applicable income is derived from charitable activities.</p>

Requirements for Maintaining Federal Tax Exempt Status

How to Stay Exempt

- ❑ The first step for any nonprofit is to become tax exempt under Section 501(c)(3) of the Internal Revenue Code.
- ❑ However, once an organization receives tax exempt status from the IRS, its status is not permanently guaranteed.
- ❑ Nonprofits must comply with on-going IRS requirements in order to maintain tax exempt status.

How to Stay Exempt

- Have a public purpose and must not violate private benefit & private inurement rules
- Do not engage in excessive lobbying or any political activities
- Do not engage in excessive amount of unrelated trade or business activity
- Meet IRS filing requirements
- Do not violate public policy.

Serving a Public Purpose

- A nonprofit must have a mission that is charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children, as described in Form 1023.
- If nonprofit makes significant changes to its mission, it must disclose it to the IRS on its Form 990 or 990-EZ.
- A significant change would include changing from one activity to another, such as moving from a mentoring program to an ESL program, or adding a substantial new activity, such as providing day care services for clients attending job training.
- You should also report any significant activities that are discontinued.

Private Inurement

- A nonprofit must comply with the private inurement rule. Under the private inurement rule, a nonprofit may not use its assets for the benefit of insiders.
 - For example, the organization cannot pay more than fair market value for services provided by an insider. This includes paying senior staff more than reasonable compensation.
- Insiders include people such as the founder, officers, directors and senior management, such as the CEO or COO. It also includes an insider's spouse, as well as his or her parents, siblings, children, grandparents, grandchildren and their spouses.

Private Benefit

- ❑ A nonprofit must not use its assets for the private benefit of others. This is very similar to the private inurement rule, except it is not limited to insiders.
 - For example, if nonprofit rents out space in a building, it cannot charge below market rent to Board member's friend. It would be using the organization's assets to serve a private individual's interests and not the organization's exempt purposes.
- ❑ The organization may always provide assistance to individuals who meet its service criteria.

Lobbying

- A nonprofit may engage in attempting to influence legislation (lobbying), as long as it is an “insubstantial” part of its activities.
- There are two tests for determining whether the activity is substantial – Under the first test, the IRS will look at all the facts and circumstances to determine if the lobbying is insubstantial.
- As an alternative, nonprofits (except churches and private foundations) can make a 501(h) election, under which the organization may spend the following on lobbying and stay exempt:
 - 20% of the first \$500,000 of exempt purpose expenditures
 - + 15% of the next \$500,000
 - + 10% of the next \$500,000
 - + 5% of the remaining, up to a total of \$1 million.

Political Activity

- The Internal Revenue Code contains an absolute prohibition on a Sec. 501(c)(3) nonprofit engaging in political activity on behalf of or against an individual running for elected office.
- If the nonprofit violates this prohibition, it will be subject to excise taxes and loss of its exempt status.
- The IRS has specific guidance about what is political activity. Generally, it is any activity that shows a bias in favor of one candidate or against another. In most instances, contributions of time, money or other things of value, endorsements and lawmaker ratings are not permitted.

Unrelated Trade or Business

- ❑ A nonprofit may not use its exempt status to unfairly compete with for-profit businesses.
- ❑ Therefore, the exempt organization is subject to tax on income earned from a trade or business unrelated to its exempt purpose.
- ❑ A nonprofit cannot devote more than an insubstantial amount of its activities to regularly carrying an unrelated trade or business. If it does it risks losing its exempt status.
- ❑ Income generated from debt-financed property may also be subject to tax.

Unrelated Trade or Business

- ❑ The first question is whether an activity is a trade or business?
- ❑ Next, is there is a substantial relationship between the activity and the organization's mission?
- ❑ Next, is the activity *regularly* carried on? Does it show a frequency and continuity, and is pursued in a manner similar to comparable commercial activities of for-profit businesses.

Unrelated Trade or Business

- There are statutory exemptions from the tax:
 - Passive income (royalties, rents, etc.)
 - A business, if substantially all of the work is carried out by volunteers.
 - A business carried on for the convenience of members, clients or employees.
 - Thrift shops, if substantially all the items are donated.
 - Bingo games that are legal where played and where bingo is not regularly carried on by for-profit businesses.
 - Distribution of low cost articles in exchange for a charitable donation.
 - As a general rule, for purposes of UBIT, anything above 85% is probably “substantial.”

Must Meet Annual Reporting Requirements

- ❑ Every tax exempt organization must file annual report with IRS.
- ❑ There is a limited exception for church and church related organizations.
- ❑ Whether the nonprofit should file Form 990, 990-EZ or 990-N depends on the amount of the organization's gross revenue.
- ❑ A nonprofit may file a Form 990-EZ if its gross receipts are less than \$200,000 and has total assets of less than \$500,000.
- ❑ A nonprofit with gross receipts that are normally less than or equal to \$50,000 may file the Form 990-N.

Annual Reporting Requirements

- ❑ Form 990-N is due the 15th day of the 5th month following tax year (i.e. for calendar year filers, the return is due May 15th).
- ❑ The form is filed electronically through the IRS website.
- ❑ The organization must answer eight questions:
 - Name,
 - Address,
 - Trade name,
 - EIN,
 - Tax year,
 - Name and address of principal officer,
 - Website, and
 - Affirm that income is below threshold for filing.

Annual Reporting Requirements

- An organization will automatically lose its tax-exempt status if it fails to file some form of the Form 990 (either the Form 990, 990-EZ or 990-N) at least once every three years.
- May have to file the Form 990 with state governments as well. In DC – Not required. In NJ, NY – required. In CT, GA, and VA - required unless filing a Form 990-N. In MD, must file Form COF-85 if not filing a Form 990.