

## **Don't risk your exempt status**

If you think that, once your nonprofit receives its official tax-exempt status from the IRS, you don't have to revisit it again, think again. The activities you conduct, the ways you generate revenue and how you use that revenue can make or break your exempt status.

In fact, the IRS recently cracked down on not-for-profit credit counseling businesses for operating in a for-profit mode. Even though the practices of these companies are far from those of the average association or charity, it's worth reviewing the IRS's exempt-status rules to make sure your organization is operating within them.

## **One exemption doesn't fit all**

Most charitable organizations fall under the category outlined in Internal Revenue Code (IRC) Section 501(c)(3). These are groups that are organized and operated exclusively for religious, educational, charitable, scientific, literary, public safety, amateur sports, or child or animal welfare purposes; that use none of their earnings to enrich private shareholders or individuals; and that engage in limited lobbying and no political campaigning.

There are other nonprofit classifications as well, outlined in IRC Sec. 501(c)(4) through 501(c)(27). These organizations are considered tax-exempt but not charitable, such as trade associations, social clubs and business organizations like chambers of commerce. Depending on which section of the code they're subject to, the rules and guidelines for these nonprofits vary.

## **Risky business**

Because there are 25 categories of tax exemption, it's impractical to cover all scenarios for all organizations in this article. For instance, 501(c)(7) organizations, which include social and recreational clubs, may risk their exempt status if their facilities are regularly open to nonmembers.

But there are certain hot button issues of which all types of not-for-profits should be aware. These types of activities might raise an IRS red flag:

**Lobbying.** Having a Sec. 501(c)(3) status limits the amount of lobbying a charitable organization can undertake. This doesn't mean lobbying is totally prohibited, but, according to the IRS, "The organization will not, as a substantial part of its activities, attempt to influence legislation."

For nonprofits that are exempt under other categories of Sec. 501(c), there are fewer restrictions on lobbying activities. Lobbying activities these groups undertake must relate to the accomplishment of the group's purpose. For instance, an association of teachers can lobby for education reform without risking its tax exemption. But if it lobbied on behalf of wetlands conservation, that might be another story.

***Campaign activities.*** The IRS considers lobbying to be different from campaign activities, which are completely off limits to Sec. 501(c)(3) organizations. According to the IRS, to maintain tax-exempt status under Sec. 501(c)(3), nonprofits can't participate or intervene in any political campaign for or against a candidate for public office.

If you're not a 501(c)(3) organization, campaign restrictions vary depending on which classification applies to your not-for-profit.

***Excess profit and private inurement.*** The cardinal rule about profits is that a nonprofit can't be operated to benefit private interests, which was the case in some of the credit counseling businesses. If your fundraising is successful and you have an abundance of extra income, you must put it back into the organization through additional services or creating a reserve or an endowment, not by rewarding an individual or that person's related entities.

***Unrelated revenue.*** How are you generating income? If it's through a trade or business you conduct regularly and it's outside the scope of your mission, you may be subject to unrelated business income tax (UBIT). Examples include a university that rents performance halls and provides related services to nonuniversity users or an organization selling advertising in its newsletter or program.

Almost all nonprofits are subject to this provision of the tax code, and, if you ignore it, you could find yourself risking your exempt status. But keep in mind that losing your exempt status from unrelated business income is rare.

## **Educate yourself**

Though dense, IRS Publication 557, *Tax-Exempt Status for Your Organization*, outlines the rules for all nonprofits that qualify for exempt status under all sections of 501(c). It's available on the IRS's Web site at <http://www.irs.gov>. Your tax advisor can help you interpret and apply the information based on your specific situation.