

5 Ways to Lose Your Tax Exemption

08.18.14 | Linda J. Rosenthal, JD



Congratulations! You just received the long-awaited determination letter from the Internal Revenue Service.

You are now a tax-exempt, charitable organization under section 501(c)(3) of the Internal Revenue Code. You can accept donations, get grants, and do great things for the world.

But, if you're not careful —

There are five foolproof ways to lose this coveted status. You don't need all of them. Just one — any one — of the five will do the trick:

- **Political Activity:** The key word here is zero. That's how much political activity a 501(c)(3) organization can do. Nothing. No endorsements. No campaigning. Nada. It's a simple, straightforward rule: Don't do it.
- **Private Benefit:** A 501(c)(3) organization must be organized *and* operated exclusively for charitable ("exempt") purposes. It can't be set up or run for the founders', officers', or directors' private interests, or for the private benefit of their families, or to enrich their for-profit businesses. So, even if the your group has some legitimate exempt purposes, if there's a single, substantial, private purpose or benefit, the tax exemption can be in jeopardy. How much is too much? Good question. It depends on the facts and circumstances. There's a specific rule, though, that "no part of the net earnings" can benefit "private shareholders or individuals." That means you, your family, and your businesses. You get the picture.
- **Too Much Unrelated Business Income:** If a 501(c)(3) has income from a trade or business that is regularly carried on and that is not substantially related to its exempt purposes, it may have to pay tax on that revenue. But if the amount of this unrelated business income

gets too big and is out of proportion with the exempt purposes, then, again, the organization's tax exemption can be at risk. How much is too much? It's complicated. Really. It's not a matter of a simple percentage or formula. Have a qualified professional help you evaluate it.

- Too Much Lobbying Activity: Unlike the absolute rule against political activity, a 501(c)(3) is allowed to do some lobbying; that is, "carrying on propaganda, or otherwise attempting to, to influence legislation . . ." Just not too much. It can't be a "substantial part of the activities. . ." Again, what's too much? It depends on all of the facts and circumstances. The IRS looks at a variety of factors, including the amount of time and money spent. But here – at least – there's a "safe harbor" election that a public charity can make; if a specified amount of expenditures is not exceeded, then the tax exemption is safe.
- Failing to File Form 990s: For a long time, the government has asked 501(c)(3)s to file information returns. But starting in 2008, though, it became clear that they really mean it. If an organization doesn't file a Form 990 for 3 consecutive years, the group's tax exemption is automatically revoked. So an organization can do everything else right: have exclusively charitable purposes, avoid private benefit, and obey all of the rules, but the tax exemption can disappear. So no excuses: File those returns!