

In Uncertain Times, Nonprofits Must Keep Up With Legal Compliance

04.11.25 | Linda J. Rosenthal, JD



This year "...will not go down in the record books as a quiet or uneventful one." See [Another Reminder to Pay Withholding Taxes](#), *FPLG Blog*.

"For the philanthropy community, the new political reality poses enormous possible challenges, particularly for 501(c)(3)s which have, in the past, safely relied on government funding and grants of key programs, especially in the realm of social services...." We know that "[m]any groups are already facing decisions and hard choices about how to generate new revenue and how to cope with too many bills to pay."

"While exploring options," we emphasized, "one decision should be avoided: delaying, or not paying, federal withholding taxes for employees."

By the way, this advice in [Another Reminder to Pay Withholding Taxes](#) is *not* from last week or last month. It's a blog post from November 17, 2017: in the first year of the prior Trump administration.

Tax-Exempt Status: Key Misconceptions

The opportunities for trouble by failing to meet employer-related tax obligations increase sharply during turbulent years. Each news cycle brings more stories of 501(c)(3)s of all sizes abruptly facing the cutoff of financial support from previously reliable funding sources.

They happen, too, during calmer years albeit less often. Sometimes, the trouble arises because of simple misconceptions about the breadth of the 501(c)(3) exemption from tax. We explained the basic rules in [A Reminder to Nonprofit Employers](#) (March 26, 2015) and [Payroll Taxes: The One Payment a Nonprofit Should NEVER Skip](#) (May 29, 2015).

“Nonprofit charities get lots of perks: tax savings, deductible contributions, and preferred postal rates,” to name just some. “This preferential status lulls many boards and staff into a false sense of believing the rules that apply to regular corporations and regular workplaces don’t apply to them....”

The “... most common mistake that charitable nonprofits make is to (incorrectly) assume that the coveted 501(c)(3) tax exemption applies to all taxes. It doesn’t. It applies only to federal income taxes.” Organizations are “still liable for the same duties and obligations that all employers face,” including tax-withholding mandates.

A “nonprofit employer must report the income of any employee and also withhold the necessary amounts under federal and state tax schedules. There are withholding duties as well in connection with social security. Medicare taxes (FICA), and federal unemployment tax (FUTA), unless there is a specific exemption from these obligations pursuant to the tax-exemption determination letter. There are also employer duties at the state level.

The law concerning nonpayment of withholding taxes is clear and unambiguous. These funds”are deemed to be held in trust for the United States.” Diversion for operational or business expenses is prohibited.

Indeed, the “... safest approach” for charitable nonprofits is “to assume that all laws and regulations that apply to businesses and employers generally apply to charities (and other nonprofits) as well.”

Cascading Problems

A “charity may ‘delay’ tax payments, intending to make it up as soon as possible. But a ‘cascade’ of irreversible consequences gets rolling fairly quickly after making this financial mistake.” First, it ‘create[s] distrust among multiple groups of stakeholders in one fell swoop.’”

Second, “[e]ven if the organization can repay the back taxes and penalties, the additional problems created by the payroll tax delinquency” often are irreversible, and “can cause the organization to fail so completely it must close its doors.”

We related one example in our May 29, 2015 post. “It happened to the Alliance of AIDS Services-Carolina. The 25-year-old organization had a long-standing contract with Wade County, North Carolina. But in 2012 and 2013, the nonprofit began to have some financial difficulties. *** In order to ‘manage’ these problems, the organization did something ‘excruciatingly common.’ It missed payment on payroll taxes to juggle and pay other outstanding bills. But the Internal Revenue Service quickly acted, imposing a tax lien, first in April 2014, and then a few months later, in July 2014. By September, the County cut off the federal ‘Ryan White’ funding so crucial to the viability of the Alliance.”

The organization “managed to clear up its IRS problems, but by then, the County ended its contract with the Alliance, and took the program services back under government control and operation.”

Personal Liability for Withholding Taxes

There is another major hazard in connection with failure to pay over withholding taxes collected. The government may pursue individual board members and executives for this money.

The law holds individuals personally responsible for nonpayment of these taxes, and the penalties are severe. See 26 U.S. Code section 6672, “Failure to collect and pay over tax, or attempt to evade or defeat tax.”

“Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.”

Under this law, the definition of a “person” includes “any officer or employee of a corporation who has a duty to collect, account for, or pay withholding taxes.”

While there is a limited exception for certain unpaid volunteer board members of tax-exempt organizations, there’s an exception to that exception; that is, “... if it results in no person being liable for the penalty imposed.... ”

There is a long line of cases in which “...the IRS has successfully held board members and executives of charitable organizations liable for misuse of withholding taxes that should have been remitted to the government.” The tax agency is aggressive in these matters, and – generally – the federal courts uphold these actions.

“Board members, executives, and employees who fall within the Code’s definition of a responsible person should actively ensure that their nonprofit has remitted all withholding taxes to the government on time.”

Conclusion

This reminder about rigorously complying with employment-tax laws is just one example of the larger theme developed by nonprofit-law expert, Gene Takagi, Esq., for an Inauguration Day article in *The Nonprofit Quarterly*.

In *Nonprofit Legal Compliance in an Unfriendly Political Environment* (January 20, 2025), he wrote: “Broad segments of the nonprofit sector are concerned about the new presidential administration and the threats it poses to nonprofit organizations.”

“No matter whether the approach is to go on defense or offense,” he advises, “shoring up the organization’s compliance is critical. A charity or nonprofit’s plans can be shut down for a failure to properly register....”

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