

# Requirements for Maintaining your Tax-Exempt Status

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After receiving your tax-exempt status from the IRS and the state of California, many nonprofits breathe a sigh of relief and assume that their tax exempt status is secured indefinitely. In fact, preserving on organizations' tax exempt status requires the organization to undertake certain actions and refrain from engaging in other actions.

Specifically, to maintain tax exempt status an organization must:

- **Keep Accurate Financial Records:** Charities are required to maintain accurate financial records to maintain the integrity of the nonprofits assets and liabilities. The creation of an internal system for financial records is an absolute necessity, and many nonprofits choose to employ an accountant or experienced book keeper to keep everything organized and accurate.
- **File Annual Corporate Tax Returns and Pay Applicable Taxes:** Failure to file the annual corporate tax return and pay any applicable taxes may result in the forfeiture of the tax exempt status for the organization.
- **Sales and Use Tax** – Sales and use taxes may be waived on certain purchases made by the tax exempt organization but these exemptions should be examined on a case by case basis.
- **Property Tax** – Some non-profit organizations may be exempt from paying property taxes on real property owned by the organization. The organization must be organized under Internal Revenue Code Sections 501(c)(3) or 23701(d) to qualify for the exemption.
- **State Payroll Tax** – Tax exempt organizations in California are typically required to pay the same taxes as commercial employers including: State Disability Insurance (SDI), Unemployment Insurance (UI), Employee Training Tax (ETT) and Personal Income Tax (PIT). Nonprofit organizations may choose to pay these taxes as a typical commercial

employer, or provide a direct reimbursement to the state for any benefits paid on their behalf.

- **State Income Tax Return** – Nonprofit organizations in California must file state income tax returns although taxes on certain types of income will be waived for the nonprofit if they have completed an Exemption Application – Form 3500. The organization may apply for state exemption before receiving exemption from the IRS.
- **Federal Return** – Every tax exempt organization must file an Annual Exempt Organization Return, typically a 990 series form. The correct form is determined by looking at the financial activity of the organization. Failure to file your form 990 for three consecutive years will result in automatic revocation of your organization’s exempt status.

*Avoid Jeopardizing Your Tax Exempt Status by Engaging in Prohibited Activities:*

Tax-exempt organizations are prohibited from engaging in a number of activities including:

- Inuring private individuals or shareholders with organization earnings,
- Using the organization to provide a substantial benefit to private interests,
- Influencing legislation or participating in the political campaign of a candidate for public office,
- Engaging in illegal activities.

Many tax-exempt organizations find that working with an experienced non-profit attorney can help them avoid the headaches of jeopardizing their non-profit status. Being proactive and keeping an eye on the issues before they arise is the best way to avoid losing your tax exemption. In this situation, an ounce of prevention is truly worth a pound of cure.