

# Tax Exemption under IRC 501(c)

05.14.13 | Linda J. Rosenthal, JD



## *The Difference Between 501(c)(3), 501(c)(4) & 501(c)(7)*

Selecting the proper tax structure for your organization will have a significant impact on the activities you can undertake, how the organization is operated and what transactions are considered tax exempt for the organization and tax deductible for your donors.

Section 501(c) of the Internal Revenue Code lays out specific organizational definitions and the requirements for an organization to be eligible for tax exempt status. Some of the most common exemptions are:

### *Exemption under 501(c)(3) – Charitable Organizations*

In order for an organization to qualify as a tax exempt organization under section 501(c)(3) of the Internal Revenue Code, the organization must comply with quite a few legal requirements.

**Purposes** – First, the organization must be operated exclusively for one of the tax exempt purposes listed in the code section. Specifically these purposes include “charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. The term *charitable* is used in its generally accepted legal sense.” Additionally, the organization may not be involved in politics or the influencing of legislation as a substantial part of its activities.

**Benefits** – In addition to having a stated purpose that complies with the 501(c)(3) requirements, the organization must not be created or operated to benefit private interests or specific individuals. Specifically, the organization must not unduly benefit the founder, shareholders, board members or other interested individuals. Any interested party transacting business with the organization must do so in a way that does not disadvantage the organization.

### *Exemption under 501(c)(4) – Social Welfare Organizations*

Organizations that qualify for this tax exempt status under 501(c)(4) are typically civic leagues or other corporations or associations dedicated to the promotion of social welfare.

Purpose – Unlike charitable organizations under 501(c)(3), social welfare organizations can lobby for legislation and participate in all aspects of the political process, because social welfare organizations are not subject to the disclosure rules that apply to other tax exempt organizations. Since the US Supreme Court ruled in Citizens United, this type of organization has become a preferred vehicle for financing political campaigns in the form of Super Political Action Committees or “Super PACs.”

#### Exemption *under 501(c)(7) – Social Clubs*

Organizations that qualify for tax exemption under this section are typically social clubs that are created for the pleasure or recreational activities provided to its members. Social clubs must comply with a number of limitations to qualify for tax exemption:

- The club must foster personal interaction between members
- Membership must be limited
- The club must be supported by membership fees, dues etc.
- The club’s earnings must not specifically benefit an individual
- The club may not discriminate based on a person’s race, color or religion (although there are some exemptions that allow the denial of membership based on religion)
- The club may not provide goods or services to the general public

While the three exemption types listed in this blog are some of the most common categories for tax exemption under in Section 501(c), there are actually 28 different tax exempt categories to consider.

Selecting the best fit for an organization can be complicated and often involves a number of different considerations including the goals of the organization, the organization’s revenue sources, the activities it wishes to participate in and the segment of the population the organization chooses to serve. Working with an attorney who has extensive experience in nonprofit law will help you select the exemption that best fits your organization, will save you the time and energy of sorting through each of the 28 exemptions yourself, and will start your organization on the path to success.