



Exempt Organizations

Tax Exempt & Government Entities



Preface

Exempt Organizations (EO) is dedicated to fulfilling the two overarching goals of the IRS 2014-2017 Strategic Plan:

- To deliver high quality and timely service to America's taxpayers by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness, and
- To reduce taxpayer burden and encourage voluntary compliance.

To further these objectives, IRS has developed a wide range of products to help exempt organizations and those who represent them understand their tax responsibilities.

We encourage you to learn about the wealth of educational resources available on the Charities and Non-Profits pages of IRS.gov (www.irs.gov/charities) and our special training website (www.StayExempt.irs.gov).

Subscribe to our free e-newsletter, the *EO Update*, to get email updates and alerts from the IRS about developments in exempt organizations tax law, upcoming IRS webinars, as well as live tax forums and workshops in your area.

Visit the [IRS Video Portal](#) and the [IRS YouTube Channel](#) to find recordings of presentation on many topics of interest to the exempt organizations community.

We appreciate your participation in the Workshop for Small and Medium-Sized 501(c)(3) organizations. This workshop and the instructional materials have been developed as part of a customized program for representatives of small and medium-sized exempt organizations as well as students and faculty of nonprofit management and related academic programs. We hope that this text helps you become more familiar with tax laws governing exempt organizations and understand how compliance with these laws will strengthen the organization(s) you represent. We welcome your comments and recommendations for improvement.

The material in this book is for educational use only and may not be cited as precedent.

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1 | Introduction

Objectives

Upon completion of this workshop, you will be able to:

- Articulate the main difference between “nonprofit” organizations and “tax-exempt” organizations.
- List several of the types of organizations qualifying for 501(c)(3) “public charity” status.
- Explain the activities that 501(c)(3) organizations should avoid or limit to protect their exempt status.

Please note: This material is for educational use only, in association with the Exempt Organizations (EO) Workshop for Small and Medium-Sized 501(c)(3) Organizations. It is not intended to establish IRS positions and may not be relied upon or cited as precedent.

For More Information

This text primarily focuses on requirements for 501(c)(3) organizations. Some basic information is presented about organizations exempt under other Code sections as well. For a more detailed discussion, including exceptions to the general information provided in this text, please refer to the publications and sections of law cited in the material. Each chapter of this text contains a complete list of references.

Legal Authority

The Internal Revenue Code (IRC) is Title 26 of the U.S. Code. Congress first codified the tax laws in 1939. It was comprehensively updated in 1954 and 1986. The tax laws have been amended many times by Congress and interpreted by the courts, and the resulting body of law guides all U.S. tax administration.

Treasury and the IRS issue regulations that set forth their interpretation of the law. The regulations are signed and issued by the Secretary of the Treasury (or his delegate) under Title 26. The regulations carry more weight than any rulings or releases on tax matters otherwise issued by the IRS or Treasury.

Internal Revenue Code Citations

All section references are to the IRC unless otherwise stated. For example, Section 501(c)(3) refers to IRC Section 501(c)(3). The IRC is also sometimes referred to as “the Code.”

Forms and Publications

Download forms and publications at www.irs.gov/Forms-&-Pubs.

Order forms and publications online at www.irs.gov/Forms-&-Pubs/Order-Products.

If you cannot locate a product, call **800-829-3676**.



2 | Tax-Exempt Status

Types of Exempt Organizations

The IRC specifies certain types of organizations that are exempt from federal income tax. The most common types are charitable, religious and educational organizations, civic associations, labor organizations, business leagues, social clubs, fraternal organizations and veterans' organizations.

Although this text focuses on organizations exempt under Section 501(c)(3), commonly referred to as charities or charitable organizations, it also includes some general information about other types of tax-exempt organizations.

Applying for Tax-Exempt Status

Not all nonprofit organizations are tax exempt under federal law. To be recognized as tax exempt by the IRS, a charitable organization described in Section 501(c)(3) must generally file a Form 1023 or a 1023-EZ, if eligible. Certain limited exceptions apply. For example, churches are not required to apply for exemption but many choose to do so.

Form 1024 is used by most other types of organizations that wish to apply for recognition of exemption under Section 501(a). Even if an organization is not required to file Form 1024 to be tax exempt, it may wish to file Form 1024 to receive a determination letter from the IRS and obtain certain incidental benefits. If the IRS approves the application, it will issue a "determination letter" indicating the Code Section under which the organization is exempt from federal income tax.

Who Can Be Tax Exempt?

Section 501(c) describes many different kinds of organizations that qualify for exempt status. The Organization Reference Chart at the end of this chapter (Exhibit A) lists the various subsections under which an organization could qualify for tax-exempt status, and under each subsection:

- A brief description of the type of organization that may qualify
- The general nature of its activities

Common Types of Exempt Organizations

Some of the more common types of exempt organizations are described in the following Code Sections:

- 501(c)(3) Religious, Educational, Charitable
- 501(c)(4) Civic Leagues, Social Welfare Organizations
- 501(c)(5) Labor, Agricultural, or Horticultural
- 501(c)(6) Business Leagues, Chambers of Commerce
- 501(c)(7) Social and Recreational Clubs
- 501(c)(8) Fraternal Beneficiary Societies and Associations
- 501(c)(10) Domestic Fraternal Societies and Associations
- 501(c)(19) Veterans' Organizations



Benefits of Exempt Status

The main benefit of exempt status is that the organization does not pay federal income tax on income related to its exempt purpose. Other benefits include:

1. Possible exemption from certain employment, state income, sales and property taxes, and
2. Reduced postal rates offered to certain organizations by the U.S. Postal Service.

If an organization is not recognized as tax exempt, it must file one of the following annual income tax returns:

- Form 1120, *U.S. Corporation Income Tax Return*
- Form 1041, *U.S. Income Tax Return for Estates and Trusts*
- Form 1065, *U.S. Partnership Return of Income*

Deductible Contributions to Organizations Exempt Under 501(c)(3)

Contributions to 501(c)(3) organizations are deductible on the donor's federal income tax return if the donor chooses to itemize deductions. Contributions to most other types of tax-exempt organizations do not qualify for a deduction.

501(c)(3) Organizations: Requirements

501(c)(3) organizations comprise the largest category of exempt organizations. There are two requirements for exemption under Section 501(c)(3). The organization must be:

1. **Organized**, and
2. **Operated** exclusively for one or more exempt purposes.

Requirement 1: Organized

A 501(c)(3) organization must be organized as a nonprofit corporation, trust or unincorporated association. In addition, its organizing documents (articles of incorporation, trust documents, articles of association, etc.) must:

- Limit its purpose(s) to those described in Section 501(c)(3).
- Restrict its authority to engage in activities that do not further those purposes.
- Dedicate its assets only to exempt purposes.

Requirement 2: Operated

Because a 501(c)(3) organization must engage exclusively in activities that accomplish its exempt purpose(s), other activities are prohibited or restricted.

A 501(c)(3) organization cannot:

- Participate in political campaigns on behalf of, or in opposition to, any candidate for public office.
- Perform lobbying activities as a substantial part of its overall activities.
- Allow its earnings to inure to the benefit of any private shareholder or individual.
- Operate for the benefit of private interests such as those of its founder, the founder's family, its shareholders or persons controlled by such interests.
- Operate for the primary purpose of conducting a trade or business that is not related to its exempt purpose.
- Perform activities that are illegal or that violate fundamental public policy.



Exempt Purpose

A 501(c)(3) organization's organizational document must state that it is organized for one of the following exempt purposes:

- Charitable,
- Educational,
- Religious,
- Scientific,
- Literary,
- Fostering national or international amateur sports competition,
- Preventing cruelty to children or animals, or
- Testing for public safety.

Typical 501(c)(3) Organizations

The most common types of 501(c)(3) organizations are charitable, educational or religious.

Charitable Organizations

Charitable organizations conduct activities that further the following purposes:

- Relief of the poor, the distressed or the underprivileged
- Advancement of religion
- Advancement of education or science
- Construction or maintenance of public buildings, monuments or works
- Lessening the burdens of government
- Reducing neighborhood tensions
- Helping eliminate prejudice and discrimination
- Defending human and civil rights
- Combating community deterioration and juvenile delinquency

Educational Organizations

Educational organizations include:

- Primary or secondary schools, colleges or professional or trade schools that have a regularly scheduled curriculum, faculty and enrolled body of students
- Organizations that conduct public discussion groups, forums, panels, lectures or other similar programs
- Organizations that present a course of instruction by means of correspondence or through the use of electronic devices, means or services
- Museums, zoos, planetariums, symphony orchestras or similar organizations
- Nonprofit day-care centers
- Youth sports organizations



Religious Organizations

While all churches are religious organizations, not all religious organizations are churches.

- **Churches:** The term church includes synagogues, temples, mosques and similar types of organizations. Churches are not required to file an application for exemption. Nevertheless, many churches do file voluntarily to obtain an IRS determination letter. The letter assures contributors that the church is recognized as exempt by the IRS. To be recognized as a church, an organization must meet certain criteria. These criteria are outlined in **Publication 1828**, *Tax Guide for Churches and Religious Organizations*. Exempt churches are not required to file an annual Form 990 (see **Chapter 8** for details).
- **Other Religious Organizations:** Other religious organizations (such as, mission organizations, speakers' organizations, nondenominational ministries, ecumenical organizations and faith-based social services agencies) that do not meet the criteria of a church must apply for tax-exempt status on Form 1023.

Public Charity or Private Foundation

Every organization that qualifies as tax exempt under Section 501(c)(3) is classified as either a public charity or a private foundation. Under Section 508, every organization is automatically classified as a private foundation, except churches, certain educational organizations and certain trusts, unless it meets the criteria of a public charity listed in Section 509(a).

The primary distinction between a public charity and a private foundation lies in the source of financial support. A public charity typically has a broad base of public support whereas a private foundation generally is supported by just a few individuals, such as members of a family.

Whether a 501(c)(3) organization is classified as a public charity or private foundation is important because different tax rules apply to each. For example, the deductibility of contributions to a private foundation is more limited than the deductibility of contributions to a public charity. In addition, private foundations are subject to stricter federal regulation and may be subject to excise taxes not imposed on public charities.

Public Charities

Organizations meeting the definition of public charity under Section 509(a) include:

- Churches
- Schools
- Organizations that provide medical or hospital care (including the provision of medical education and, in certain cases, medical research)
- Organizations that receive a substantial part of their support in the form of contributions from publicly supported organizations, governmental units and/or from the general public
- Organizations that normally receive not more than one-third of their support from gross investment income (such as interest, dividends, rents, royalties) and income from taxable unrelated business income (less any tax due) and more than one-third of their support from gifts, grants, contributions or membership fees and gross receipts from activities related to their exempt functions
- Organizations that support one or more of the organizations described above and has a relationship with those organizations (supporting organizations) that ensures that the supported organization is effectively supervising or paying particular attention to the operations of the supporting organization
- Organizations that are organized and operated exclusively for testing for public safety

To be classified as a public charity solely on the basis of public support, an organization must meet one of the tests set out in the regulations. An organization's level of public support is calculated on the basis of a five-year moving average, which includes the current tax year and the four years preceding the current year.

Such organizations must continuously seek significant and diversified public support and should carefully monitor their public support calculations to avoid losing their public charity status.



Initial Determination of Public Support Status

A new 501(c)(3) organization will be classified as a public charity for its first five years if the organization shows it can reasonably expect to be publicly supported, regardless of the public support actually received during that five-year period.

The IRS will monitor an organization's public charity status after the first five years based on the public support information reported annually by the organization. Beginning with the organization's sixth year – and for all following years – if an organization shows it meets a public support test, it will remain a public charity for that year and the next tax year.

Example: Determination of Public Support

If a calendar year organization meets the public support test for the 2014 tax year, the organization is considered to be a public charity for the 2014 and 2015 tax years. If the organization does not meet the support test for the 2015 tax year, it will still be considered to be a public charity for that year because of the carryover from 2014.

However, if the organization cannot meet the public support test for the 2016 tax year, it will be reclassified as a private foundation starting at the beginning of the 2016 tax year, and should file Form 990-PF, *Return of Private Foundation*, for the 2016 tax year and for future years.

Other Common Types of Exempt Organizations

501(c)(3) charitable organizations are only one type of tax-exempt organizations. Below are brief descriptions of other common types of exempt organizations.

501(c)(4) - Civic Leagues, Social Welfare Organizations

Section 501(c)(4) provides for the exemption from federal tax of civic leagues, social welfare organizations and local associations of employees. 501(c)(4) organizations operate to further the common good and the general welfare of the people of the community, such as by bringing about civic betterment and social improvements. Section 501(c)(4) organizations also include groups formed to educate and inform the public about particular issues.

Examples of 501(c)(4) organizations include volunteer fire companies, civic leagues and community associations.

Although 501(c)(4) organizations often conduct activities similar to those of 501(c)(3) organizations, they are not constrained by many of the restrictions and prohibitions placed on 501(c)(3)s. For example, Section 501(c)(4)s may engage in an unlimited amount of lobbying, provided the lobbying is related to the organization's exempt purpose. In addition, while such organizations may engage in political campaign activities, an organization must ensure that its political campaign activities do not constitute the organization's primary activity. On the other hand, contributions to 501(c)(4) organizations are not deductible for the donor.

501(c)(5) - Labor, Agricultural, or Horticultural Organizations

Organizations exempt under Section 501(c)(5) exist to better the conditions of workers, improve products or develop a greater degree of efficiency in particular occupations.

A labor organization is an association of workers combined to protect or promote members' interests by bargaining collectively with their employer to secure better working conditions, wages and similar benefits. The term includes labor unions, councils and committees.

Agricultural and horticultural organizations are involved in raising livestock, forestry, cultivating land, raising and harvesting crops or aquatic resources, cultivating useful or ornamental plants, and similar pursuits.

501(c)(6) - Business Leagues, Chambers of Commerce, etc.

Organizations exempt under Section 501(c)(6) include business leagues, chambers of commerce and boards of trade. Business leagues are associations of persons with common business interests whose purpose is to promote those interests. It is not to engage in a regular business for profit. Their activities are devoted to the improvement of business conditions in one or more lines of business rather than the performance of particular services for individual persons.



501(c)(7) - Social and Recreation Clubs

A social club exempt under Section 501(c)(7) is organized for pleasure, recreation and other similar nonprofit purposes. Substantially all of its activities are devoted to those purposes. This section encompasses clubs supported by membership fees, dues and assessments, as well as fees charged to members for the use of facilities.

Typical organizations under this section include:

- College alumni associations that do not qualify as educational organizations
- College fraternities or sororities operating chapter houses for students
- Country clubs
- Amateur hunting, fishing, tennis, swimming and other sport clubs
- Dinner clubs that provide a meeting place and dining room for members
- Hobby clubs
- Garden clubs
- Variety clubs

A club that engages primarily in a business activity open to the general public will not qualify for exemption from tax under Section 501(c)(7). In addition, exemption will be denied to any club with a written policy of discrimination against any person on the basis of race, color or religion.

501(c)(8) - Fraternal Beneficiary Societies and Associations

A fraternal beneficiary society, order or association under 501(c)(8) must:

- Have a fraternal purpose;
- Be operated under a “lodge system” consisting of local branches chartered by a parent organization for the exclusive benefit of the members; and
- Provide for the payment of life, sick, accident or other insurance benefits to the members of the society, order or association or their dependents.

The organization may qualify for exemption as long as the majority (in other words, not all) of the members are eligible for benefits.

501(c)(10) - Domestic Fraternal Societies and Associations

Section 501(c)(10) domestic fraternal societies and associations are similar to 501(c)(8) fraternal beneficiary societies except that they may not provide insurance benefits to members. Domestic fraternal societies must also devote their net earnings exclusively to religious, charitable, scientific, literary, educational or fraternal purposes. College fraternities are not eligible for exemption under Section 501(c)(10), but may be eligible under Section 501(c)(7).

501(c)(19) - Veterans' Organization

A Section 501(c)(19) veterans' organization is a post or organization located in the United States of past or present members of the U.S. military, or an auxiliary unit of such a post or organization. An organization does not qualify for exemption under Section 501(c)(19) unless at least 75 percent of its members are past or present members of the U.S. military. Substantially all the other members must be cadets or spouses, widows, widowers, ancestors or lineal descendants of past or present members of the armed forces or cadets.

Veterans' organizations must be operated exclusively to promote the social welfare of the community, to assist disabled and needy war veterans and their dependents, or to provide entertainment or care to hospitalized veterans.

They may also carry on programs to perpetuate the memory of veterans; conduct programs for religious, charitable, scientific, literary or educational purposes; sponsor patriotic activities; provide insurance benefits to members or their dependents; or provide social and recreational activities to members.



Contributions to These Other Common Types of Exempt Organizations

Contributions to organizations exempt under Sections 501(c)(4), (5), (6), (7), (8), (10) and (19) generally aren't tax-deductible. A contribution to a veterans' organization is deductible only if at least 90 percent of the organization's members served in the U.S. armed forces during a period of war and substantially all the other members are either veterans, cadets or spouses, widows or widowers of war veterans, veterans or cadets. A contribution to a domestic fraternal society, order, or association operating under the lodge system is deductible only if it's used exclusively for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals.

For More Information

- **Publication 526**, *Charitable Contributions*
- **Publication 557**, *Tax-Exempt Status for Your Organization*
- **Publication 1828**, *Tax Guide for Churches and Religious Organizations*
- **Publication 3386**, *Tax Guide – Veterans' Organizations*
- **Publication 3833**, *Disaster Relief – Providing Assistance Through Charitable Organizations*
- **Publication 4220**, *Applying for 501(c)(3) Tax-Exempt Status*
- **Publication 4221-NC**, *Compliance Guide for Tax-Exempt Organizations (other than 501(c)(3) Public Charities and Private Foundations)*
- **Publication 4221-PC**, *Compliance Guide for 501(c)(3) Public Charities*
- **Publication 4221-PF**, *Compliance Guide for 501(c)(3) Private Foundations*
- **Form 1023**, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*
- **Form 1024**, *Application for Recognition of Exemption Under Section 501(a)* (for organizations described in Sections 501(c)(2), (4), (5), (6), (7), (8), (9), (10), (12), (13), (15), (17), (19) and (25))



Exhibit A

Organization Reference Chart

| Section of 1986 Code | Description of organization | General nature of activities |
|----------------------|--|--|
| 501(c)(1) | Corporations organized under Act of Congress (including federal credit unions) | Instrumentalities of the United States |
| 501(c)(2) | Title holding corporation for exempt organization | Holding title to property of an exempt organization |
| 501(c)(3) | Religious, educational, charitable, scientific, literary, testing for public safety, fostering national or international amateur sports competition, or the prevention of cruelty to children or animals | Activities of a nature implied by the description of the class of organization |
| 501(c)(4) | Civic leagues, social welfare organizations and local associations of employees | Promotion of social welfare; charitable, educational or recreational |
| 501(c)(5) | Labor, agricultural, and horticultural organizations | Educational or instructive, the purpose being to improve conditions of work and to improve products and efficiency |
| 501(c)(6) | Business leagues, chambers of commerce, real estate boards, etc. | Improvement of business conditions of one or more lines of business |
| 501(c)(7) | Social and recreation clubs | Pleasure, recreation, social activities |
| 501(c)(8) | Fraternal beneficiary societies and associations | Lodge providing for payment of life, sickness, accident or other benefits to members and dependents |
| 501(c)(9) | Voluntary employees' beneficiary associations | Providing for payment of life, sickness, accident or other benefits to members |
| 501(c)(10) | Domestic fraternal societies and associations | Lodge devoting its net earnings to charitable, fraternal and other specified purposes. No life, sickness or accident benefits to members |
| 501(c)(11) | Teachers' retirement fund associations | Teachers' association for payment of retirement benefits |
| 501(c)(12) | Benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies or similar | Activities of a mutually beneficial nature similar to those implied by the description of the organization |
| 501(c)(13) | Cemetery companies | Burials and incidental activities |
| 501(c)(14) | State chartered credit unions, mutual reserve funds | Providing loans to members |
| 501(c)(15) | Mutual insurance companies or associations | Providing insurance to members substantially at cost |
| 501(c)(16) | Cooperative organizations to finance crop operations | Financing crop operations in conjunction with activities of a marketing or purchasing association |
| 501(c)(17) | Supplemental unemployment benefit trusts | Providing for payment of supplemental unemployment compensation benefits |



Exhibit A (continued)

Organization Reference Chart

| Section of 1986 Code | Description of organization | General nature of activities |
|----------------------|--|--|
| 501(c)(18) | Employee funded pension trust (created before June 25, 1959) | Payments of benefits under a pension plan funded by employees |
| 501(c)(19) | Post of organization of past or present members of the Armed Forces | Activities implied by nature of organization |
| 501(c)(20) | Group legal services plan organizations | Activities implied by nature of the organization |
| 501(c)(21) | Black lung benefit trusts | Funded by coal mine operators to satisfy their liability for disease or death due to black lung diseases |
| 501(c)(22) | Withdrawal liability payment fund | Providing funds to meet the liability of employers withdrawing from a multi-employer pension fund |
| 501(c)(23) | Veterans' organization (created before 1880) | Providing insurance and other benefits to veterans |
| 501(c)(25) | Title holding companies or trusts with multiple parents | Holding title and paying over income from property to 35 or fewer parents or beneficiaries |
| 501(c)(26) | State-sponsored organization providing health coverage for high-risk individuals | Providing health care coverage to high-risk individuals |
| 501(c)(27) | State-sponsored workers' compensation reinsurance organization | Reimburses members for losses under workers' compensation acts |
| 501(c)(28) | The National Railroad Retirement Investment Trust | The organization established under section 15(j) of the Railroad Retirement Act of 1974 |
| 501(c)(29) | Co-op health insurance issuers | Providing health insurance to individuals and small groups as part of the Co-op program |
| 501(d) | Religious and apostolic associations | Regular business activities, communal religious community |
| 501(e) | Cooperative hospital service organizations | Performing cooperative services for hospitals |
| 501(f) | Cooperative service organizations of operating educational organizations | Performing collective investment services for education organizations |
| 501(k) | Child care organizations | Providing care for children |
| 501(n) | Charitable risk pools | Pools certain insurance risks of 501(c)(3) organizations |
| 521(a) | Farmers' cooperative associations | Cooperative marketing and purchasing for agricultural producers |
| 527 | Political organizations | A party, committee, fund, association, etc., that directly or indirectly accepts contributions or makes expenditures for political campaigns |
| 529 | Qualified tuition programs | Established and maintained to allow either prepaying, or contributing to an account established for paying, a student's qualified higher education expenses at an eligible educational institution |



3 | Jeopardizing 501(c)(3) Status

Jeopardizing Tax-Exempt Status

A 501(c)(3) organization must engage in activities that further its exempt purposes or it jeopardizes its tax-exempt status and its eligibility to receive tax-deductible contributions.

Section 501(c)(3) organizations may not be used for the private benefit of any individual, nor may their earnings inure to the benefit of insiders. Moreover, a 501(c)(3) organization may only engage in legislative activities to a limited extent, and is forbidden to engage in political activities. An organization will also lose its exempt status under Section 501(c)(3) if it operates for the primary purpose of carrying on an unrelated trade or business, which will be discussed in detail in [Chapter 4](#).

Finally, an organization must meet its reporting obligations by filing [Form 990](#), *Return of Organization Exempt From Income Tax*, [Form 990-EZ](#), *Short Form Return of Organization Exempt From Income Tax*, or [Form 990-N](#), (*e-Postcard*), annually. Most 501(c)(3) organizations, with the notable exception of churches, have a Form 990 filing requirement. Failure to file a required return could result in loss of exempt status. See [Chapter 8](#) for detailed information on this requirement.

Private Benefit

An organization must serve a public interest to qualify for exemption under Section 501(c)(3). If the organization serves public and private interests, the private benefit must be incidental to the public benefit.

Inurement

Section 501(c)(3) of the Code states that no part of an organization's net earnings may inure to the benefit of a private shareholder or individual. This means the organization may not permit the use or distribution of its assets other than as reasonable compensation for goods or services actually furnished or in arm's-length transactions.

Inurement generally refers to benefits conferred on insiders such as officers, directors and key employees. Examples of prohibited inurement include the payment of dividends or unreasonable compensation and the transfer of property for less than fair market value.

The prohibition against inurement to insiders is absolute; therefore, any amount of inurement is grounds for loss of tax-exempt status. In addition, the insider involved may be subject to excise tax. Note that prohibited inurement does not include reasonable payments for services rendered, payments that further tax-exempt purposes, or payments made for the fair market value of real or personal property.

Inurement: Excess Benefit Transactions

The IRS may impose an excise tax on a person who benefits from an excess benefit transaction as well as any organization manager who knowingly participates in the transaction. (A disqualified person is any person who is or was in a position to exercise substantial influence over the affairs of the organization.)

An excess benefit transaction is any transaction between a Section 501(c)(3) or (c)(4) organization and a disqualified person in which the economic benefit is greater than the value of the consideration provided for the benefit (such as a non-fair market value transaction or unreasonable compensation for services).



Preventing Private Benefit and Inurement: Internal Controls

Adopting and implementing internal controls may help exempt organizations prevent private benefit and inurement, and thus help protect an organization's tax-exempt status. An internal control system may include:

- Segregating financial duties
- Requiring second signatures on large checks
- Tracking inventory
- Conducting internal audits (for example, formal review of an organization's activities to ensure that proper policies are in place to implement internal controls)
- Record keeping (see [Chapter 7](#))

Preventing Private Benefit and Inurement: Conflict of Interest Policy

Adopting a conflict of interest policy may also help prevent inurement. A conflict of interest policy may include:

- Procedures for disclosure by persons having a financial interest
- Procedures for determining whether the financial interest of a person may result in a conflict of interest
- Procedures for addressing the conflict of interest after determining that it exists
- Procedures for adequate record keeping of actions taken
- Procedures ensuring that the policy is distributed to all trustees, principal officers and other persons in authority

An example of a conflict of interest policy can be found at the end of this chapter in [Exhibit C](#).

Lobbying and Political Activities

A Section 501(c)(3) organization may conduct a limited amount of lobbying activity but is prohibited from intervening in any political campaign activities.

Lobbying Activity

A 501(c)(3) organization may conduct lobbying activities provided they are insubstantial in relation to their exempt purpose activities. Lobbying is defined as an attempt to influence legislation.

Legislation includes action by Congress, state legislatures, local councils or similar governing bodies, with respect to acts, bills, resolutions or similar items (such as legislative confirmation of appointive office). It also includes action by the public in referenda, ballot initiatives, constitutional amendments or similar procedures. It does not include actions by executive, judicial or administrative bodies.

An organization is considered to be attempting to influence legislation if it contacts, or urges the public to contact, members or employees of a legislative body for the purpose of proposing, supporting or opposing legislation, or if the organization advocates the adoption or rejection of legislation.

Organizations may, however, take a particular position on public policy issues without the activity being considered lobbying in certain circumstances. For example, organizations may conduct educational meetings, prepare and distribute educational materials or otherwise consider public policy issues in an educational manner without jeopardizing their tax-exempt status.

If lobbying activities are substantial, a 501(c)(3) organization may fail the operational test and risk losing its tax-exempt status. Substantiality is measured by one of the following two tests:

- Substantial part test
- Expenditure test



Measuring Lobbying Activity: Substantial Part Test

The substantial part test determines substantiality on the basis of all the facts and circumstances in each case. The IRS considers many factors, including the time devoted (by both compensated and volunteer workers) and the expenditures devoted to the activity, when determining whether the lobbying activity is substantial.

Under the substantial part test, an organization that conducts excessive lobbying activity in any taxable year may lose its tax-exempt status, resulting in all its income being subject to tax. In addition, an organization is subject to an excise tax equal to 5 percent of its lobbying expenditures for the year in which it ceases to qualify for exemption.

Further, a tax equal to 5 percent of the lobbying expenditures for the year may be imposed against organization managers who facilitated or agreed to the expenditures with the knowledge that the expenditures would likely result in the loss of tax-exempt status.

Measuring Lobbying Activity: Expenditure Test

As an alternative to the subjective substantial part test, most public charities may elect to use the expenditure test under Section 501(h), which is an objective, mathematical test.

Code Sections 501(h) and 4911 establish a sliding scale of permissible “lobbying nontaxable amounts.” Expenditures in excess of the nontaxable amount are called excess lobbying expenditures and are subject to a 25 percent excise tax. In addition, an organization will lose its exemption if it “normally” spends more than 150 percent of its lobbying nontaxable amount over a four-year period.

Churches and church-related organizations, including integrated auxiliaries and conventions or associations of churches and affiliates of these organizations, may not use the expenditure test.

Organizations electing to use the expenditure test must file **Form 5768**, *Election/Revocation of Election by an Eligible Section 501(c)(3) Organization to Make Expenditures to Influence Legislation*, at any time during the tax year for which it is to be effective. The election remains in effect for succeeding years unless it is revoked by the organization. Revocation of the election is effective on the year following the year in which the revocation is filed.

Political Campaign Activity

Section 501(c)(3) organizations are prohibited from directly or indirectly participating or intervening in any political campaign on behalf of, or in opposition to, any candidate for elective public office. Contributions to political campaign funds or public statements of position (verbal or written) made on behalf of the organization in favor of, or in opposition to, any candidate for public office violate the prohibition against political campaign activity. Violation of this prohibition may result in denial or revocation of tax-exempt status and the imposition of an excise tax on the amount of the political expenditure.

For example, voter education or registration activities with evidence of bias that: (a) would favor one candidate over another, (b) oppose a candidate in some manner or (c) have the effect of favoring a candidate or group of candidates, would constitute prohibited participation or intervention.

Depending on the facts and circumstances, certain activities or expenditures may not be prohibited. For example, certain voter education activities, including the presentation of public forums and the publication of voter education guides, conducted in a non-partisan manner, do not constitute prohibited political campaign activity.

In addition, other activities intended to encourage people to participate in the electoral process, such as voter registration and get-out-the-vote drives, would not constitute prohibited political campaign activity if conducted in a non-partisan manner.

Individual Activity by Organization Leaders

The political campaign activity prohibition is not intended to restrict free expression on political matters by leaders of organizations speaking for themselves in their private capacity as individuals. Nor are they prohibited from speaking about important issues of public policy. However, if their organizations are to maintain their exemption under Section 501(c)(3), leaders cannot make partisan comments in official organization publications or at official functions.

To avoid potential attribution of their comments outside of organization functions and publications, organization leaders who speak or write in their individual capacity are encouraged to indicate their comments are personal and not intended to represent the views of the organization.



Inviting a Candidate to Speak

Depending on the facts and circumstances, an organization may invite political candidates to speak at its events without jeopardizing its tax-exempt status. Political candidates may be invited in their capacity as candidates, or individually (not as a candidate).

Speaking as a Candidate

When a candidate speaks at an organization event as a political candidate, the organization must take steps to ensure that:

- It provides an equal opportunity to political candidates seeking the same office,
- It does not indicate any support of or opposition to the candidate (this should be stated explicitly when the candidate is introduced and in communications concerning the candidate's attendance), and
- No political fundraising occurs.

Equal Opportunity to Participate

In determining whether candidates are given an equal opportunity to participate, an organization should consider the nature of the event to which each candidate is invited and the manner of presentation.

For example, an organization that invites one candidate to speak at its well-attended annual banquet, but invites the opposing candidate to speak at a sparsely attended general meeting, will have violated the political campaign prohibition, even if the manner of presentation for both speakers is otherwise neutral.

Public Forum

Sometimes an organization invites several candidates to speak at a public forum. A public forum involving several candidates for public office may qualify as an exempt educational activity. However, if the forum is operated to show a bias for or against any candidate, it would be considered intervention or participation in a political campaign and would be a violation of the prohibition.

When an organization invites several candidates to speak at a forum, it should consider the following factors:

- Whether questions for the candidate are prepared and presented by an independent, nonpartisan panel
- Whether the topics discussed by the candidates cover a broad range of issues that the candidates would address if elected to the office sought and are of interest to the public
- Whether each candidate is given an equal opportunity to present his or her views on the issues discussed
- Whether the candidates are asked to agree or disagree with positions, agendas, platforms or statements of the organization
- Whether a moderator comments on the questions or otherwise implies approval or disapproval of the candidates

Speaking as a Non-Candidate

An organization may invite political candidates to speak in a non-candidate capacity. For instance, a political candidate may be a public figure because he or she:

- Currently holds, or formerly held, public office
- Is considered an expert in a non-political field
- Is a celebrity or has led a distinguished military, legal or public service career



When a candidate is invited to speak at an event in a non-candidate capacity, it is not necessary for the organization to provide equal access to all political candidates.

However, the organization must ensure that:

- The individual is chosen to speak solely for reasons other than candidacy for public office
- The individual speaks only in a non-candidate capacity
- Neither the individual nor any representative of the organization makes any mention of the individual's candidacy or the election
- The event is held in a nonpartisan atmosphere
- No campaign activity occurs in connection with the candidate's attendance

In addition, the organization should clearly indicate the capacity in which the candidate is appearing and should not mention the individual's political candidacy or the upcoming election in the communications announcing the candidate's attendance at the event.

Voter Guides

Some organizations distribute voter guides as part of their voter education activities. Voter guides are usually distributed during an election campaign and provide information on how candidates stand on various issues.

A careful review of the following facts and circumstances may help determine whether an organization's publication or distribution of voter guides constitutes prohibited political campaign activity:

- Whether the candidates' positions are compared to the organization's position
- Whether the guide includes a broad range of issues that the candidates would address if elected to the office sought
- Whether the description of issues is neutral
- Whether all candidates for an office are included
- Whether the descriptions of candidates' positions are either:
 - The candidates' own words in response to questions
 - A neutral, unbiased and complete compilation of all candidates' positions

Business Activity

The question of whether an activity constitutes participation or intervention in a political campaign may also arise in the context of a business activity of the organization, such as the sale or rental of mailing lists, the leasing of office space or the acceptance of paid political advertising. In this context, some of the factors to be considered in determining whether the organization has engaged in prohibited political campaign activity include:

- Whether the goods, services or facilities are available to the candidates on an equal basis
- Whether the goods, services or facilities are available only to candidates and not to the general public
- Whether the fees charged to candidates are at the organization's customary and usual rates
- Whether the activity is conducted only for the organization or solely for the candidate



Consequences of Political Campaign Activity

In addition to jeopardizing its tax-exempt status under Section 501(c)(3) and eligibility to receive tax-deductible contributions, an organization that engages in political campaign activity may become subject to an excise tax on its political expenditures. A political expenditure is any amount paid or debt incurred while participating or intervening in any political campaign. This excise tax may be imposed in addition to, or in lieu of, revocation of exempt status. The organization must correct the violation to avoid additional taxes.

Excise Tax

An initial tax is imposed on an organization at the rate of 10 percent of the political expenditures. Also, a tax at the rate of 2.5 percent of the expenditures is imposed against the organization managers who, without reasonable cause, agreed to the expenditures knowing they were political. The tax on management may not exceed \$5,000 for any one expenditure.

In any case in which an initial tax is imposed against an organization, and the expenditure is not corrected within the period allowed by law, an additional tax equal to 100 percent of the expenditures is imposed. In that case, an additional tax is also imposed against the organization managers who refused to agree to make the correction. The additional tax on management is equal to 50 percent of the expenditures and may not exceed \$10,000 for any one expenditure.

Correction of Expenditure

Correction of a political expenditure requires the recovery of the expenditure, to the extent possible, and establishment of safeguards to prevent future political expenditures.

Failure to Comply with Reporting Obligations

While 501(c)(3)s are exempt from federal income tax and unemployment tax, most of them will have information reporting obligations. These are met by filing Forms 990, 990-EZ or 990-N. For particulars on which organizations must file, which form to use and how to complete it, see [Chapter 8](#).

Failure to file Form 990, Form 990-EZ or Form 990-N can jeopardize an organization's tax-exempt status. If an organization does not file for three consecutive years, its tax-exempt status will be revoked as of the filing due date for the third return. If tax-exempt status is revoked on this basis, the organization may reapply by filing Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, and paying the appropriate user fee to have its tax-exempt status reinstated. Certain organizations may be eligible to reapply by filing Form 1023-EZ. Complete the Form 1023-EZ Eligibility Worksheet in the Instructions for Form 1023-EZ to determine if the organization is eligible to file this form. If the organization can show reasonable cause for not filing, the reinstatement of tax-exempt status may be retroactive.

For More Information

- [Publication 557](#), *Tax-Exempt Status for Your Organization*
- [Publication 1828](#), *Tax Guide for Churches and Religious Organizations*
- [Publication 4221-PC](#), *Compliance Guide for 501(c)(3) Public Charities*
- [Form 1120-POL](#), *U.S. Income Tax Return for Certain Political Organizations*



Jeopardizing 501(c)(3) Status - Case Studies

Exhibit B

Case Study 1

Jane Doe founded XYZ Charity, a 501(c)(3) organization, to aid the victims of severe injuries resulting from motor vehicle accidents, stroke, drowning and other related causes. XYZ provides funds and therapeutic equipment, runs fundraising affairs and social functions to aid victims and exchanges and disseminates information concerning recent breakthroughs in care and treatment of injuries in all stages of recovery.

Jane's family has supported her efforts by financially supporting the organization and serving as members of the Board of Directors. The Doe family maintains complete control of XYZ Charity.

Wanda Doe, Jane's daughter, was the victim of a motor vehicle accident. Through the Charity, she receives services and assistance. Roughly 30 percent of the organization's income is expended for Wanda's benefit.

Q: Does this scenario show private benefit or inurement? Why?

A:

Q: If there is private benefit or inurement, what could the organization have done to prevent it?

A:

Case Study 2

Charity B was formed by parents of children attending a private school. Charity B's sole purpose is to provide bus transportation to and from the school for the members' children. The Board of Directors and all positions within the charity are filled by the parents. The parents pay an initial fee and an additional charge for each child. The organization's income equals the operation's expenses.

Q: Does this scenario show private benefit or inurement? Why?

A:



Jeopardizing (c)(3) Status - Case Studies

Case Study 3

Charity C was formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to further enhance its recreational features. The lake is large and borders several municipalities. The public uses it extensively for recreation. Along its shores are public beaches, launching ramps and other public facilities. Charity C is financed by contributions from lake front property owners, members of the adjacent community and municipalities bordering the lake. The improved water quality and recreational opportunities surrounding the lake have increased the property values of the lake front residences.

Q: Does this scenario show private benefit or inurement? Why?

A:

Q: If there is private benefit or inurement, what could the organization have done to prevent it?

A:

Case Study 4 (Work both scenarios; arrive at separate conclusions for each.)

Scenario A – Individual Activity by an Organization’s Leader

B is the president of University K, a 501(c)(3) organization. University K publishes a monthly alumni newsletter. In each issue, President B has a column titled “My Views.” The month before the election, President B states in the “My Views” column, “It is my personal opinion that Candidate U should be re-elected.” For that one issue, President B pays from his personal funds the portion of the cost of the newsletter attributable to the “My Views” column.

Q: What factors should be considered in determining whether the prohibition against political intervention has been violated?

A:

Q: After considering these factors, do you think President B’s actions constitute political campaign intervention attributable to University K? Why or why not?

A:



Jeopardizing (c)(3) Status - Case Studies

Scenario B – Candidate Appearances

E is the president of N, a historical society with a 501(c)(3) exemption. In the month prior to an election, President E invites the four Congressional candidates for the district in which Society N is located to address the members, one each at a regular meeting held in successive weeks. Each candidate is given an equal opportunity to address and field questions on a wide variety of topics from the members. One of the candidates declines the invitation. Society N's publicity announces the dates for each of the candidate's speeches, states that the order of the speakers was determined at random and indicates that one invited candidate has declined. President E's introduction of each candidate includes no comments on their qualifications or any indication of a preference for any candidate.

Q: What factors should be considered in determining whether the prohibition against political intervention has been violated?

A:

Q: After considering these factors, has Society N engaged in political activity by inviting the speakers? Why or why not?

A:



Sample Conflict of Interest Policy

Exhibit C

Note: This policy is also available on Appendix A in the instructions for Form 1023.

Article I

Purpose

The purpose of the conflict of interest policy is to protect this tax-exempt organization's (Organization) interest when it is contemplating entering into a transaction or arrangement that might benefit the private interest of an officer or director of the Organization or might result in a possible excess benefit transaction. This policy is intended to supplement but not replace any applicable state and federal laws governing conflict of interest applicable to nonprofit and charitable organizations.

Article II

Definitions

1. Interested Person

Any director, principal officer or member of a committee with governing board delegated powers, who has a direct or indirect financial interest, as defined below, is an interested person.

2. Financial Interest

A person has a financial interest if the person has, directly or indirectly, through business, investment or family:

- a. An ownership or investment interest in any entity with which the Organization has a transaction or arrangement,
- b. A compensation arrangement with the Organization or with any entity or individual with which the Organization has a transaction or arrangement, or
- c. A potential ownership or investment interest in, or compensation arrangement with, any entity or individual with which the Organization is negotiating a transaction or arrangement. Compensation includes direct and indirect remuneration as well as gifts or favors that are not insubstantial.

A financial interest is not necessarily a conflict of interest. Under Article III, Section 2, a person who has a financial interest may have a conflict of interest only if the appropriate governing board or committee decides that a conflict of interest exists.

Article III

Procedures

1. Duty to Disclose

In connection with any actual or possible conflict of interest, an interested person must disclose the existence of the financial interest and be given the opportunity to disclose all material facts to the directors and members of committees with governing board delegated powers considering the proposed transaction or arrangement.

2. Determining Whether a Conflict of Interest Exists

After disclosure of the financial interest and all material facts, and after any discussion with the interested person, he/she will leave the governing board or committee meeting while the determination of a conflict of interest is discussed and voted upon. The remaining board or committee members will decide if a conflict of interest exists.

3. Procedures for Addressing the Conflict of Interest

- a. An interested person may make a presentation at the governing board or committee meeting, but after the presentation, he/she will leave the meeting during the discussion of, and the vote on, the transaction or arrangement involving the possible conflict of interest.



Sample Conflict of Interest Policy (continued from page 20)

- b. The chairperson of the governing board or committee shall, if appropriate, appoint a disinterested person or committee to investigate alternatives to the proposed transaction or arrangement.
- c. After exercising due diligence, the governing board or committee will determine whether the Organization can obtain with reasonable efforts a more advantageous transaction or arrangement from a person or entity that would not give rise to a conflict of interest.

If a more advantageous transaction or arrangement is not reasonably possible under circumstances not producing a conflict of interest, the governing board or committee will determine by a majority vote of the disinterested directors whether the transaction or arrangement is in the Organization's best interest, for its own benefit and whether it is fair and reasonable. In conformity with the above determination it will make its decision as to whether to enter into the transaction or arrangement.

4. Violations of the Conflicts of Interest Policy

- a. If the governing board or committee has reasonable cause to believe a member has failed to disclose actual or possible conflicts of interest, it will inform the member of the basis for such belief and afford the member an opportunity to explain the alleged failure to disclose.
- b. If, after hearing the member's response and after making further investigation as warranted by the circumstances, the governing board or committee determines the member has failed to disclose an actual or possible conflict of interest, it will take appropriate disciplinary and corrective action.

Article IV

Records of Proceedings

The minutes of the governing board and all committees with board delegated powers will contain:

- a. The names of the persons who disclosed or otherwise were found to have a financial interest in connection with an actual or possible conflict of interest, the nature of the financial interest, any action taken to determine whether a conflict of interest was present and the governing board's or committee's decision as to whether a conflict of interest in fact existed.
- b. The names of the persons who were present for discussions and votes relating to the transaction or arrangement, the content of the discussion, including any alternatives to the proposed transaction or arrangement and a record of any votes taken in connection with the proceedings.

Article V

Compensation

- a. A voting member of the governing board who receives compensation, directly or indirectly, from the Organization for services is precluded from voting on matters pertaining to that member's compensation.
- b. A voting member of any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Organization for services is precluded from voting on matters pertaining to that member's compensation.
- c. No voting member of the governing board or any committee whose jurisdiction includes compensation matters and who receives compensation, directly or indirectly, from the Organization, either individually or collectively, is prohibited from providing information to any committee regarding compensation.
- d. Physicians who receive compensation from the Organization, whether directly or indirectly or as employees or independent contractors, are precluded from membership on any committee whose jurisdiction includes compensation matters. No physician, either individually or collectively, is prohibited from providing information to any committee regarding physician compensation.



Sample Conflict of Interest Policy (continued from page 21)

Article VI

Annual Statements

Each director, principal officer and member of a committee with governing board delegated powers will annually sign a statement which affirms such person:

- a. Has received a copy of the conflicts of interest policy,
- b. Has read and understands the policy,
- c. Has agreed to comply with the policy, and
- d. Understands the Organization is charitable and in order to maintain its federal tax exemption it must engage primarily in activities which accomplish one or more of its tax-exempt purposes.

Article VII

Periodic Reviews

To ensure that the Organization operates in a manner consistent with charitable purposes and does not engage in activities that could jeopardize its tax-exempt status, periodic reviews will be conducted. The periodic reviews will, at a minimum, include:

- a. Whether compensation arrangements and benefits are reasonable, based on competent survey information, and the result of arm's-length bargaining.
- b. Whether partnerships, joint ventures and arrangements with management organizations conform to the Organization's written policies, are properly recorded, reflect reasonable investment or payments for goods and services, further charitable purposes and do not result in inurement, impermissible private benefit or in an excess benefit transaction.

Article VIII

Use of Outside Experts

When conducting the periodic reviews as provided for in Article VII, the Organization may, but need not, use outside advisors. If outside experts are used, their use will not relieve the governing board of its responsibility for ensuring periodic reviews are conducted.



4 | Unrelated Business Income (UBI)

Unrelated Business Income Tax

A Section 501(c)(3) tax-exempt organization may engage in income-producing activities unrelated to its tax-exempt purposes as long as the unrelated activities are not a substantial part of the organization's overall activities. However, the net income from the activities will be subject to the Unrelated Business Income Tax (UBIT) if these three conditions are met:

1. The activity constitutes a trade or business.
2. The trade or business is regularly carried on.
3. The trade or business is not substantially related to the exercise or performance of the organization's exempt purpose.

Trade or Business

The term "trade or business" includes any activity carried on for the production of income from selling goods or performing services.

An activity does not lose its identity as a trade or business merely because it is carried on within a larger group of similar activities.

Example: The regular sale of pharmaceutical supplies to the general public by a hospital pharmacy that also furnishes supplies to the hospital and its patients is a trade or business.

Regularly Carried On

Business activities are considered regularly carried on if they show frequency and continuity and are pursued in a manner similar to commercial activities of non-exempt organizations.

Example: A hospital auxiliary's operation of a sandwich stand for two weeks at a state fair would not be the regular conduct of a trade or business. Operating the sandwich stand daily at the hospital, however, would be the regular conduct of a trade or business.

Not Substantially Related

A business activity is not substantially related to an organization's exempt purpose if it does not contribute importantly to accomplishing that purpose (other than through the production of income or funds). The fact that the organization used the income to further its charitable purposes does not make the activity substantially related to its exempt purposes. Whether an activity contributes importantly depends on the facts of each case.

In determining whether activities contribute importantly to accomplishing an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function they serve. If an activity is conducted on a larger scale than is reasonably necessary to perform an exempt purpose, it does not contribute importantly to accomplishing the organization's exempt purposes. An activity does not lose its identity as a trade or business merely because it is carried on within a larger group of similar activities that may be related to the organization's exempt purposes.

Example 1: An exempt hospital maintains a pharmacy on one of its floors that sells prescription and nonprescription drugs. The primary source of the pharmacy's income is the sales made to patients of the hospital. The pharmacy is also open to the general public, providing an exterior entrance and drive-through window that are used by the public. A small percentage of the pharmacy's income is from frequent and continuous sales of prescription and nonprescription drugs to individuals who walk in off the streets to make purchases.

The sale of the supplies to the patients furthers the hospital's exempt purposes and serves as a convenience to the patients. However, the sales to the general public do not further the exempt purposes of the hospital and would be treated as an unrelated trade or business. The income from the sales to the public, which are frequent and continuous, would be subject to UBIT.



Not Substantially Related (continued)

Example 2: An exempt hospital owns a medical office building that is located next door. It leases space in the building to doctors on its medical staff who find it convenient to have their private practices there. The doctors' private practices are independent of their activities as members of the hospital's medical staff and the hospital's authority over the doctors' treatment of hospital patients does not extend to the services that the doctors provide to individuals who visit their offices (the visitors to the offices are treated as private patients of the doctors).

The hospital operates a pharmacy in the medical office building as a convenience to individuals who visit the doctors there. Income from the sale of prescription and nonprescription pharmaceutical supplies to the private patients is the primary source of income for the pharmacy.

The sale of pharmaceutical supplies to the private patients of the doctors under these circumstances constitutes an unrelated business or trade. The activity is not carried on by the hospital primarily for the convenience of patients that are using the hospital's facilities, which would further its exempt purposes. Instead, these individuals are buying supplies from the pharmacy as an incident to their visit as private patients of the doctors. So, the income from the sale of the pharmaceutical supplies sales is subject to UBIT.

Example 3: Doctors on staff at an exempt hospital who have private practices are allowed to use a limited number of the hospital's exam rooms to see patients from their private practices. This is done only when it is mutually convenient for the doctor and his patient to meet at the hospital.

As a courtesy, the hospital pharmacy occasionally fills prescriptions written by the doctors during visits by the private patients. The hospital does not promote these sales, the sales are infrequent and the income from these sales is an insignificant portion of the total pharmacy sales.

The sales to the private patients would constitute a trade or business since they are not substantially related to furthering the hospital's exempt purposes and are not made primarily for the convenience of the hospital's patients. However, because of the way in which the casual sales of prescription drugs to the private patients are made (infrequently and noncontinuously), the income from the sales would not be subject to UBIT.

Examples of Unrelated Trade or Business Activities

Examples of some of the more common forms of unrelated trade or business activities include:

- Advertising,
- Gaming,
- Sale of merchandise and publications,
- Rental income,
- Parking lots, and
- Debt management plan services.

Advertising

Many tax-exempt organizations sell advertising in their publications or other forms of public communication. The sale of advertising generates unrelated trade or business income. This may include the sale of advertising space in bulletins, magazines and journals or on the organization's website.

Gaming

Most forms of gaming, if regularly carried on, may be considered the conduct of an unrelated trade or business. This can include raffles, lotteries, pull-tabs, scratch-offs, pari-mutuel betting, Calcutta wagering, pickle jars, punchboards, tip boards, tip jars, instant bingo and certain video games.

(Bingo, defined and discussed later, does not generate UBI for 501(c)(3) organizations.)



Sale of Merchandise and Publications

The sale of merchandise and publications, as well as the actual publication of materials, is considered an unrelated trade or business if the items involved do not have a substantial relationship to the exempt purposes of the organization.

Rental Income

Generally, income derived from the rental of real property and incidental personal property is excluded from unrelated business income. However, there are certain situations when rental income may be unrelated business taxable income:

- If an organization rents out property on which there is a debt outstanding (for example, a mortgage note), the rental income may constitute unrelated debt-financed income subject to UBIT.
- If personal services are rendered in connection with the rental, the income may be unrelated business taxable income.

Parking Lots

Scenario 1: An organization owns a parking lot that is used by organization members and visitors when they attend organization activities. Any income from parking fees would not be subject to UBIT.

Scenario 2: An organization operates a parking lot that is used by the general public. Parking fees would be taxable because providing parking to the general public is not substantially related to the organization's exempt purpose and parking fees are not treated as rent from real property.

Scenario 3: An organization enters into a lease with a third party who operates the organization's parking lot and pays rent to the organization. If the organization did not have a mortgage on the parking lot, the payments would not be subject to tax. They would constitute rent from real property.

Debt Management Plan Services

Providing debt management plan services is considered unrelated trade or business when conducted by any organization other than a credit counseling organization that meets the requirements of Section 501(q). Debt management plan services are services related to the repayment, consolidation or restructuring of a consumer's debt. They include marketing and processing debt management plans and negotiating with creditors to lower interest rates or to waive or reduce fees.

Are There Exceptions to Unrelated Trade or Business Activities?

The term unrelated trade or business is subject to several exceptions under which certain business activities that may otherwise constitute unrelated business are removed from the scope of UBIT.

Exceptions to UBI. The main exceptions are:

- Activities conducted substantially by volunteers
- Activities conducted for the convenience of members, students, patients, officers or employees
- Sales of donated merchandise
- Distribution of low-cost articles incidental to the solicitation of charitable contributions
- Convention and trade show activity
- Qualified sponsorship income
- Bingo income

Other exceptions also apply, but they are less common and will not be covered in this text.



Activities Conducted by Volunteers

Unrelated trade or business does not apply when substantially all of the work is performed by a worker who is not compensated (a volunteer).

Example: A gift shop operated by an exempt orphanage where all of the clerks are volunteers would not be considered an unrelated trade or business even though the operation does not contribute importantly to any exempt purpose or function of the orphanage.

Convenience

Unrelated trade or business does not include a trade or business carried on by either a 501(c)(3) organization or a state college or university primarily for the convenience of its members, students, patients, officers or employees.

Example: A laundry operated by a college for the purpose of laundering dormitory linens and students' clothing is not an unrelated trade or business.

Sale of Donated Merchandise

Unrelated trade or business does not include selling merchandise if substantially all of the merchandise has been received as gifts or contributions.

Example: A thrift store operated by an exempt organization that sells clothes and other goods donated by members of the general public would not be considered an unrelated trade or business.

Distribution of Low-Cost Articles

Unrelated trade or business does not include activities conducted by 501(c)(3) organizations and veterans' organizations that involve distribution of low-cost items as part of charitable fundraising. Under the 2015 rate, an item is considered low-cost if it is not valued at more than \$10.50. This threshold is adjusted annually for inflation.

Example: Contributions received by an exempt organization that distributes mailing labels with its solicitations for contributions would meet this exception if the mailing labels cost less than the threshold amount.

Convention or Trade Show

Unrelated trade or business does not include activities conducted by a Section 501(c)(3), (4), (5) or (6) organization at a convention, annual meeting or trade show if the activity is intended to promote the products or services of an industry or educate attendees of new industry developments and the organization regularly conducts such trade shows as one of its exempt purposes.

Example: Renting display space to exhibitors at an annual meeting of a 501(c)(3) organization would meet this exception.

Sponsorship Payments

Sponsorship payments are not considered income from an unrelated trade or business if there is no arrangement or expectation that the payor will receive any return benefit. Acceptable minor benefits include use or acknowledgement of the donor's name or logo, or goods or services of insubstantial value.

Use or acknowledgment does not include advertising. It may include exclusive sponsorship arrangements, logos and slogans, a list of the donor's locations, contact numbers or Internet address, and value-neutral descriptions, displays or depictions of products or services.

Example: An exempt organization organizes an amateur sports team. A major pizza chain supplies the team uniforms and pays the team's operational expenses. The uniforms bear the name and logo of the pizza chain. The use of the name and logo of the pizza chain constitutes acknowledgment of the sponsorship. The funding and supplied uniforms are not considered income from an unrelated trade or business.



Bingo

Income from bingo games is not subject to unrelated business income tax if the bingo game is:

- The traditional type of bingo
- Legal under state and local law
- Not ordinarily carried out on a commercial basis

Traditional: Satellite and Internet bingo do not qualify because these games are conducted in many different places simultaneously and the participants are not all present when the wagers are placed, the winners determined and the prizes distributed. Instant bingo, mini bingo and similar scratch-off cards are pull-tab games, not bingo.

Legal Under State and Local Law: The exception only applies if the game does not violate any state or local law. It is immaterial whether state or local officials enforce the law.

Not Ordinarily Carried out on a Commercial Basis: If for-profit businesses regularly conduct bingo games in any part of the jurisdiction (usually the entire state), the bingo exception does not apply. If, however, state law permits localities to determine whether for-profit businesses may conduct bingo, or if state law limits or confines the conduct of bingo games by for-profit entities to specific local jurisdictions, then the local jurisdiction is appropriate for determining whether bingo games are ordinarily carried out in a commercial manner.

Expenses

Expenses allocable to any activity that meets one of these exceptions may not be deducted when calculating the organization's UBIT.

Exclusions and Deductions from UBI

The Code provides certain other exclusions and deductions from the calculation of the unrelated business income tax, including:

Exclusions

- Interest and dividends
- Royalties
- Rents
- Gains and losses from the sale of property

Deductions

- Trade or business expenses deduction
- Interest expense deduction
- Deduction for losses
- Net operating loss deduction
- Charitable contribution deduction
- \$1,000 specific deduction



Exclusions – Passive Income

Most passive income is excluded from UBIT.

Interest and Dividends

Interest, dividends and certain other income from an exempt organization's routine investments are excluded when calculating the organization's UBIT.

Example: Interest from the exempt organization's bank account is excludable.

Royalty Income

Royalties and all deductions connected with royalty income are excluded. Royalties are payments for the use of a right, such as a trademark, trade name or copyright. However, when substantial services are required as part of the agreement to use a right, the payment is not a royalty but a payment for services.

Example: A payment from a manufacturer to an exempt labor organization for the use of the organization's logo in the manufacturer's advertising is considered royalty income.

Rents from Real Property

Rents from real property are excluded, as are rents from personal property leased with real property, provided they are incidental to the total rent. This exclusion does not apply to rents from personal property that is leased without real property, rents from real property based on net profit, rents from real property when personal services are provided or rents from real property that is debt-financed.

Example: Rent received for the use of an exempt organization's hall for a wedding, where no services such as bartending or catering are provided and the building's mortgage has been paid in full, is an example of excluded rental income.

Certain Gains and Losses from Sale of Property

Gains and losses from the sale of property, other than inventory and property held primarily for sale in the course of a trade or business, are excluded in calculating UBIT.

Example: A gain on the sale of stock held as an investment by an exempt organization is excluded.

Deductions

In computing its unrelated business income, an organization may subtract permissible deductions directly connected with the carrying on of the unrelated trade or business.

Before an expense can be deducted:

- The deduction must be allowed by Chapter 1 of the Code, which contains the general income tax provisions applicable to taxable organizations.
- The deduction must be directly connected with the carrying on of the unrelated trade or business.

UBI is calculated by aggregating the income and deductions attributable to all unrelated trades or businesses of the organization. A loss from one unrelated business can be used to offset income from another unrelated business.



Dual Use of Assets or Personnel

If assets or personnel of an organization are employed both in an unrelated trade or business and in exempt activities, then deductible items are allocated between the two uses on a reasonable basis. The portion attributable to the unrelated business use is deductible in computing UBI.

Example: An organization owns a parking lot used by organization members and visitors during the day, but rented out to patrons of a movie theater in the evening. Any income from parking fees collected during the day would not be subject to UBIT. But parking fees collected from the evening movie goers would be taxable, because providing parking to the general public is not substantially related to the organization's exempt purpose.

Expense Allocation Methods:

Example 1

A tax-exempt school contracts with an individual to conduct a summer tennis camp, an activity unrelated to the school's exempt purpose. The school provides the tennis courts, housing and dining facilities. The contractor hires the instructors, recruits campers and provides supervision. The income the school receives from this activity is from a dual use of the facilities and personnel. The school, in computing its UBI, may deduct the part of the expenses attributable to the facilities and personnel. The school determined that the summer revenues were 40 percent student and 60 percent non-student. School expenses (for example, real estate taxes, building insurance, personnel) totaled \$20,000.

Since only half the school facilities were used for an unrelated trade or business activity (tennis courts, housing, dining facilities and personnel), 50 percent of these expenses can be allocated to this activity ($\$20,000 \times .5 = \$10,000$). However, since the student use is not subject to tax, expenses attributable to them are not deductible. Therefore, only 60 percent of the \$10,000 expense allocated to the activity is deductible on Form 990-T, *Exempt Organization Business Income Tax Return* ($\$10,000 \times .6 = \$6,000$).

Example 2

XYZ Charity has an employee who spends 70 percent of his time on gaming activities and 30 percent on activities related to the charity's exempt purpose. The organization may allocate 70 percent of the employee's wages to UBI on Form 990-T.

Note: The organization should maintain adequate records and contemporaneous documentation to support how the employee's time was spent.

Other Deductions

Net Operating Loss

A net operating loss deduction is allowed in computing UBI. This deduction is allowed in one tax year based on a loss generated in certain previous or subsequent tax years.

Example: During the first year of operation, an exempt organization had a net operating loss of \$10,000 from an unrelated trade or business activity. During its second year, net income from its unrelated trade or business activity was \$12,000. The organization may claim a net operating loss deduction of \$10,000 in the second year, based on the prior year loss, and reduce the unrelated trade or business income for the second year from \$12,000 to \$2,000.

Charitable Contributions

An exempt organization is allowed a deduction for charitable contributions. This deduction is limited to 10 percent of its UBI computed without regard to the deduction for contributions. To be deductible, the contribution must be paid to another qualified organization.

Example: An exempt university that operates an unrelated trade or business producing taxable income of \$100,000 may deduct up to \$10,000 of a charitable contribution to another university for educational work.



Specific Deduction

A specific deduction of \$1,000 is allowed in computing unrelated business taxable income. Only one specific deduction is allowed for each tax year, regardless of the number of unrelated businesses carried on by the organization.

Example: An organization with taxable income from an unrelated trade or business of \$15,000 pays tax on \$14,000.

Substantial Unrelated Business Activities May Jeopardize Exemption

A Section 501(c)(3) organization may have unrelated trade or business income without any adverse impact on its exempt status. If, however, the business activity is substantial, the organization jeopardizes its exempt status.

Form 990-T

Who Must File

An exempt organization must file Form 990-T for any taxable year in which it has gross income from unrelated trade or business of \$1,000 or more. The requirement to file Form 990-T is in addition to the requirement to file Forms 990, 990-EZ, 990-N or 990-PF.

When to File

Form 990-T is due the 15th day of the fifth month following the end of the organization's accounting period (tax year). For example, May 15 for a December 31 year-end.

Extension of Time to File

Corporations may request an automatic six-month extension of time to file Form 990-T by using [Form 8868](#), *Application for Extension of Time To File an Exempt Organization Return*.

Interest and Penalties

An exempt organization may be subject to interest and penalty charges if it files a late return or fails to pay tax when due. The organization is not required to include the interest and penalty charges on Form 990-T because the IRS will calculate the amount and bill the organization for it.

Form 990-W

An organization filing Form 990-T must make installment payments of estimated tax if the total expected tax for the year is \$500 or more. Both corporations and trusts use [Form 990-W](#), *Estimated Tax on UBTI for Tax-Exempt Organizations*.

For More Information

- [Publication 598](#), *Tax on Unrelated Business Income of Exempt Organizations*
- [Form 990-T](#), *Exempt Organization Business Income Tax Return*
- [Form 990-W](#), *Estimated Tax on Unrelated Business Taxable Income for Tax-Exempt Organizations*
- [Form 1120](#), *U.S. Corporation Income Tax Return*
- [Form 8868](#), *Application for Extension of Time To File an Exempt Organization Return*



5 | Gaming Activities

Gaming as a Fundraising Activity

Many exempt organizations commonly and successfully use gaming activities to raise funds for their programs.

Organizations that conduct or sponsor gaming activities – for one night or all year, or at their primary location or at a remote location – are subject to federal tax law requirements. Therefore, they must know the rules governing income, employment and excise taxes.

Gaming includes activities such as bingo, beano, raffles, lotteries, instant bingo, pull-tabs, scratch-offs, pari-mutuel betting, Calcutta wagering, pickle jars, punchboards, tip boards, tip jars and certain video games.

Gaming and UBIT

Unless an exception applies, unrelated business income tax (UBIT) is paid on receipts derived from gaming. Income from bingo for Section 501(c)(3) organizations is excluded from the UBIT by the Code (see [Chapter 4](#)), as is income from lawful gaming conducted in North Dakota.

Lawful gaming ordinarily requires a license from the state in which the gaming is conducted.

Gaming Activities and 501(c)(3) Organizations

Gaming is a business activity that does not further Section 501(c)(3) purposes. Thus, a Section 501(c)(3) organization may conduct gaming only if it is not a substantial part of the organization's activities and provides funds for the organization's exempt purposes.

Wagering Taxes

There are two taxes relating to wagering. One is an excise tax under Code Section 4401 on certain wagering transactions. The other is an occupational tax under Code Section 4411 on persons who make a business of accepting wagers. A person liable for the excise tax on wagering is automatically liable for the occupational tax on wagering and must register the wagering activity with the IRS.

Definition of Wager

For purposes of the tax, 'wager' means any wager with respect to a sports event or a contest, any wager placed in a wagering pool conducted for profit with respect to a sports event or a contest and any wager placed in lottery conducted for profit.

Conducted for Profit: A wagering pool or lottery is conducted for profit not only if it earns a direct profit, but also if it is expected to generate increased sales or attendance, or if the operator takes a percentage of the contributions or charges a fee to join the pool.

Wagering Excise Tax

The taxes on wagering apply to wagers placed in a lottery conducted for profit for the purpose of raising funds. Pull-tabs, raffles and tip jars meet the definition of taxable wagers placed in a lottery.

The wagering tax applies to the sum risked by the person placing the bet, not the amount the person stands to win.



Wagers Exempt From Wagering Tax

There is no wagering tax on wagers placed on the following:

(a) Games When All Are Present

A wager placed in a game in which the wagers are placed, the winners are determined and the prizes are distributed in the presence of all persons placing wagers in such game is not subject to the wagering tax.

Games of this type involve group play and include bingo, keno, card games, dice games and games involving wheels of chance, such as roulette wheels.

(b) Drawings Conducted By Exempt Organizations

A wager placed in a drawing conducted by a tax-exempt organization is not subject to the tax on wagers, as long as no part of the net proceeds from drawing inures to the benefit of any private shareholder or individual.

Drawing: A drawing is any physical drawing of a ticket or use of a wheel or similar device by which the winner is conclusively determined by a number, letter, legend or symbol without reference to an outside event that is beyond the control of the operator.

Inures to the Benefit of Private Shareholders or Individuals: The proceeds of a drawing inure to the benefit of private shareholders or individuals when, for example, the expenses of the drawing, including the salary of the operator, are unreasonable. When the drawing is conducted by a membership organization, such as a social club, fraternal society or veterans' organization, the proceeds of drawings limited to members are not deemed to inure to the private benefit of the members if the proceeds are used for the operation of the club or society. However, proceeds – all or part of which come from nonmembers – inure to members if used to reduce membership dues or to pay costs that would normally be paid from member dues or assessments. And proceeds of drawings that are open to the public inure to the benefit of members if the proceeds help to defray the organization's expenses.

(c) Coin-Operated Device

The wagering tax is not assessed on amounts spent to operate coin-operated devices. Coin-operated devices include slot machines, pinball machines and machines that display poker hands.

How is the Wagering Tax Determined?

The wagering excise tax applies to the gross amount of wagers received. This means that the tax is based on the total amount received before any payout of prizes or other expenses.

The tax rate is determined by whether the wager is authorized under the laws of the state in which it is accepted. If the wager is authorized, the rate of tax is .25 percent of the amount of the wager. If the wager is not authorized, the tax is 2 percent of the amount of the wager.

Form 730, Monthly Tax Return for Wagers

The organization reports and pays the wagering excise tax by filing **Form 730, Monthly Tax Return for Wagers**. It is due each month by the last day of the month after the month the wager was placed. If an organization accepts taxable wagers, it should file a return for each month regardless of whether it has taxable wagers to report. If it has none to report, it should write zero in the last box of the dollar amount. If it stops accepting wagers, it should check the final return box above Line 1. An organization may be subject to a penalty for failure to file the form and for failure to pay the tax.

Record Keeping for Wagering Tax

Every person liable for wagering tax must keep a daily record showing the gross amount of all wagers on which a tax is due. Among other things, the daily records must show:

- The gross amount of wagers accepted
- The gross amount of each class or type of wager accepted on each separate event, contest or other wagering medium



Occupational Tax

The Code imposes an occupational or stamp tax in connection with certain wagers. This tax is an annual fee imposed on both the organization and employees who receive wagers.

The amount of the occupational tax depends on whether the wager is authorized under the laws of the state in which the wager is accepted. If the wager is authorized, the amount of the tax is \$50 per year per person. If the wager is not authorized, the amount of the tax is \$500 per year per person.

Form 11-C, Occupational Tax and Registration Return for Wagering

An organization reports and pays the occupational tax on wagering with **Form 11-C, Occupational Tax and Registration Return for Wagering**. Form 11-C must be filed before an organization begins accepting wagers. After that, the organization must file a renewal return by July 1 for each year in which the organization accepts wagers. A Form 11-C should also be filed when certain changes in ownership occur, while a supplemental registration return should be filed when certain other changes occur. An organization may be penalized for failure to file the form and pay the tax.

Examples of Excise and Occupational Tax Applicability

Example: An exempt organization conducts a raffle open to the general public. The organization deposits all the proceeds into its scholarship fund for local college students from which it awards an annual scholarship in furtherance of exempt purposes. Because the organization does not use any of the raffle's proceeds for administrative expenses or to benefit a private individual, the raffle does not meet the definition of a taxable wager. Therefore, no wagering taxes apply.

Example: An exempt organization sells pull-tabs at its building. The organization uses some proceeds to pay its real estate taxes. The organization has four employees selling pull-tabs. This organization would be liable for the wagering excise tax because it used a portion of the proceeds from its pull-tab sales to pay for its operational expenses. Because the excise tax applies, the organization and its four pull-tab sellers would be required to file the annual occupational tax.

Form W-2G, Certain Gambling Winnings

An exempt organization that conducts gaming must report to the IRS certain gambling winnings and any federal income tax that it is required to withhold on those winnings.

Which Winnings Must an Organization Report?

In general, the organization must report gambling winnings of \$600 or more and that are at least 300 times the amount of the wager. The organization has the option of deducting the cost of the wager from the winnings in determining whether the \$600 threshold is met.

Example: An organization conducts pull-tab games. Mr. G buys a \$2 pull-tab and wins \$10,000. Because the amount won is greater than \$600 and is 5,000 times the amount of the wager, the organization must report Mr. G's winnings.

Example: Mr. S buys a \$2 pull-tab and wins \$600. You may reduce the amount of the winnings by the cost of the wager, in which case the winnings are \$598. You do not have to report the winnings because the \$600 threshold is not met.

Keno Games

An organization conducting keno games must report keno game winnings that are \$1,500 or more after deducting the cost of the wager.

Example: Ms. E wagers \$5 on keno at an exempt organization and wins \$1,500. Because the winnings are less than \$1,500 after deducting the cost of the wager, the organization does not have to report the winnings.

Bingo Games and Slot Machines

Exempt organizations must report winnings at a bingo game or slot machine that are \$1,200 or more before deducting the cost of the wager.



When to File Form W-2G

An exempt organization reports gambling winnings by filing a **Form W-2G**, *Certain Gambling Winnings*, for every person to whom it pays the winnings.

Multiple Winners

When the person receiving gambling winnings is one of a group of two or more winners, he or she must complete **Form 5754**, *Statement by Person(s) Receiving Gambling Winnings*, and give it to the organization. Form 5754 provides information about each winner and each winner's share of the winnings. An organization then prepares a Form W-2G for each of the persons listed as winners on the Form 5754.

If an organization files on paper, it must file copy A of Form W-2G by February 28 following the calendar year in which it pays the winnings. Use Form 1096 to transmit paper Forms W-2G. If it files electronically, it must file Form W-2G by March 31 following the calendar year in which it pays the winnings. If it is required to file 250 or more Forms W-2G in a year, it must file them electronically.

In addition, an organization must give copies B and C of Form W-2G to the winner by January 31 following the calendar year in which it pays the winnings.

Income Tax Withholding from Gaming Winnings - Regular Withholding

An organization that conducts gaming must withhold income tax from certain gambling winnings. The proceeds of gambling winnings greater than \$5,000 are subject to withholding at a rate of 25 percent if won in:

- A wager placed in a sweepstake, wagering pool or lottery
- Any other wagering transaction, if the amount of the proceeds is at least 300 times as large as the amount wagered

The total proceeds from the wager are subject to withholding, not just the amounts in excess of \$5,000.

If the winnings are in the form of a noncash payment, such as a car, the fair market value of the item won is considered the amount of the winnings. An organization must withhold income tax if the fair market value of the item won exceeds \$5,000 after deducting the price of the wager. The amount to withhold depends on whether the organization or the winner pays the withholding tax:

- If the winner pays the withholding tax to the organization, it must withhold 25 percent of the fair market value of the item won minus the amount of the wager.
- If the organization pays the withholding tax, it must withhold 33.33 percent of the fair market value of the item won minus the amount of the wager.

Exception to Regular Withholding

Organizations do not withhold income tax on winnings from slot machines, keno or bingo, unless they are required to backup withhold.

Gaming winners must provide the organization with a statement on Form W-2G containing:

- Name, address and taxpayer identification number
- A declaration that no other person is entitled to any portion of the payment

Backup Withholding from Gaming Winnings

If an organization is required to report winnings on Form W-2G, the winner must provide his or her name, address and taxpayer identification number. If the winner does not provide this information, and if the winnings were not subject to 25 percent regular withholding, the organization must withhold income tax at the backup withholding rate of 28 percent.



Reporting the Withholding on Form 945

The organization is responsible for paying regular or backup withholding, whether or not it collects the withholding from the prize recipient. The best time to collect withholding or backup withholding is before the prize is paid.

An organization reports regular and backup withholding from gaming winnings on **Form 945**, *Annual Return of Withheld Federal Income Tax*. Form 945 is an annual return and is due by January 31 of the year after the year in which the taxes were withheld.

Additional Examples of Reporting and Withholding

Example: ABC Charity sells raffle tickets for \$25 each. The grand prize is \$6,000. Form W-2G is required because withholding is required for raffle proceeds that exceed \$5,000. Withholding on raffle prizes is not affected by the ratio of the prize to the wager. Because the prize, less the price of the ticket, is \$5,975 ($\$6,000 - \$25 = \$5,975$), the withholding would be \$1,494 ($\$5,975 \times 25$ percent).

Example: Nonprofit Charity conducts a fundraising event and sells \$2 raffle tickets. The prize is a \$2,000 large screen TV. Because the prize, less the value of the ticket, is \$600 or more and greater than 300 times the amount of the wager, the organization must complete Form W-2G, but does not have to withhold because the prize is less than \$5,000.

Example: CDN, an exempt organization, has a winner of \$5,100 from one of the pull-tabs, which cost \$10. Because the winnings, less the wager, exceed \$5,000, Form W-2G is completed and federal income tax is withheld. Income tax withheld is reported on Form 945. The winner would receive \$3,827 ($\$5,100$ gross winnings less $\$1,273$ withholding tax) (computed $(\$5,100 - \$10) \times 25$ percent).

Example: CDN, an exempt organization, conducts a weekly bingo game. A payout of \$1,300 is made for a single game. The winner furnishes identifying information, along with her SSN, to the organization. The organization must complete Form W-2G because the winnings exceed \$1,200. The regular gambling withholding of 25 percent does not apply to bingo.

Example: XYZ Charity sells \$10 raffle tickets. The grand prize is a \$7,000 snowmobile. As explained in the first example, the winnings are subject to regular gambling withholding and Form W-2G is required.

Failure to File Correct Information Returns by the Due Date

If an organization does not file a correct information return (Form 945, *Annual Return of Withheld Federal Income Tax*) by the due date – and cannot show reasonable cause – it may be penalized. The penalty applies in cases of failure to file timely, failure to include all information required to be shown on a return or inclusion of incorrect information on the return. The penalty is \$50 per document unless a correction is made within certain timeframes.

Failure to Furnish Correct Payee Statements

If an organization fails to provide correct payee statements (Form W-2G, *Statement for Recipients of Certain Gambling Winnings*) and cannot show reasonable cause, it may be subject to a penalty. The penalty applies for failure to provide the statement by Jan. 31, include all information required to be shown on the statement or include correct information on the statement. The penalty is \$100 per statement (not to exceed \$1,500,000 per year), regardless of when the correct statement is furnished.

For More Information

- **Publication 3079**, *Tax-Exempt Organizations and Gaming*
- **Form 730**, *Monthly Tax Return for Wagers and Instructions*
- **Form 11-C**, *Occupational Tax and Registration Return for Wagering*
- **Form W-2G**, *Statement for Recipients of Certain Gambling Winnings*
- **Form 945**, *Annual Return of Withheld Federal Income Tax*



6 | Employment Issues

Employment Taxes

Exempt organizations withhold and pay federal employment taxes under the same rules as other employers.

501(c)(3) organizations that pay wages to employees must withhold, deposit and pay employment tax, including federal income tax withholding and Social Security and Medicare (FICA) taxes. If total compensation paid to an employee of an exempt organization is less than \$100 in a calendar year, however, that compensation is not subject to FICA tax.

501(c)(3) organizations do not pay federal unemployment (FUTA) taxes on the wages of their employees, but other exempt organizations do. Any person who fails to withhold and pay employment tax may be subject to penalties.

Worker Status: Employee or Independent Contractor

An employer generally does not have to withhold or pay taxes on payments to independent contractors. But if an organization incorrectly classifies an employee as an independent contractor, it may be held liable for the tax. Understanding classification is essential to fulfilling legal responsibilities for withholding and information reporting on workers.

Definition of Employee

For federal tax purposes, a person is an employee if his employer has the right to tell him what to do and how to do it. This right to control is important, even if it is not exercised.

Independent Contractor Defined

An independent contractor is self-employed, carrying on an independent trade or business. An organization has some right to direct or instruct an independent contractor, but less than with an employee. An independent contractor has a genuine possibility of profit or loss. An employee who receives a salary does not normally incur business losses.

Worker Classification: Three Categories of Evidence

Worker classification is determined by the relationship between the entity and the worker. The IRS has developed three categories of evidence to determine if a worker is an employee or an independent contractor. Often some facts will favor employee status and some will favor independent contractor status. To make a correct determination, an entity must consider both the evidence for autonomy and the evidence for right to control.

The three specific categories of evidence are:

- Behavioral control
- Financial control
- Relationship of the parties

Behavioral Control

The factors showing the right to direct or control how the worker performs the task are:

- **Instructions** – An employee is generally subject to the organization's instructions about when, where and how to do the work; what tools or equipment to use; what order or sequence to follow; etc.
- **Training** – An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.



Financial Control

The factors showing the right to direct or control the financial aspects of the worker's activities include:

- **Significant Investment** – An independent contractor often has a significant investment in the facilities used in performing services for someone else. Does the worker own the standard tools and equipment of the trade or profession? Is there a significant investment in equipment? Does the worker maintain a separate office?
- **Unreimbursed Expenses** – Independent contractors are more likely to have unreimbursed expenses than employees. Does the worker hire and pay helpers?
- **Services Available to the Relevant Market** – An independent contractor is free to seek out business opportunities. Does the worker advertise and maintain a visible business location?
- **Method of Payment** – An employee is guaranteed a regular wage amount for an hourly, weekly or other period of time. An independent contractor is usually paid a flat fee for a job.
- **Opportunity for Profit or Loss** – An independent contractor can make a profit or loss.

Relationship of the Parties

These factors show how the parties perceive their relationship:

- **Intent of the Parties/Written Contracts** – A written contract specifying employee or independent contractor status is important evidence. However, the entire substance of the relationship must be considered.
- **Employee Benefits** – Providing a worker with typical employee benefits (for example, health insurance or a pension plan) is evidence of employee status.
- **Discharge/Termination** – Can the firm terminate or discharge the worker or can the worker leave before the task is completed without becoming liable for nonperformance under the contract or agreement? These facts suggest employee status.
- **Regular Business Activity** – Are the services an important aspect of the regular business of the entity? If so, an employer-employee relationship may be indicated.

IRS Help on Classification Issues

The IRS has free publications to assist in resolving questions of worker classification and other questions in the area of employment:

- **Publication 15**, *(Circular E), Employer's Tax Guide*
- **Publication 15-A**, *Employer's Supplemental Tax Guide*
- **Publication 1779**, *Independent Contractor or Employee*

For help in determining whether a worker is an employee for purposes of federal employment taxes and income tax withholding, an organization should file **Form SS-8**, *Determination of Worker Status for Purposes of Federal Employment Tax and Income Tax Withholding*. The instructions explain where to file the form. Also, an organization might consider consulting an accountant, attorney or the IRS directly for assistance with employee classification.

State or Other Federal Classification Requirements

Different federal and state agencies make determinations of employee classification based on the facts of each case and the applicable law. IRS determinations may differ from those of state government agencies. If an exempt organization plans to classify some workers as independent contractors, it may want to obtain a separate ruling from each agency.



Employees and Non-Employees – Defined by Statute

The following positions are classified as employees or independent contractors by law:

Corporate Officers

A corporate officer is an employee unless he/she performs no services, or only minor services, and neither receives nor is entitled to receive any remuneration, directly or indirectly. Corporate officers include presidents, vice presidents, treasurers, etc. This is so even if:

- The officer is the sole shareholder and, as such, controls his or her own duties and remuneration.
- The officer is supplied by a leasing company.

Corporate Director

A corporate director is an independent contractor.

Payment of Compensation

After an organization has decided on the proper classification of its workers, it must consider many other requirements for paying compensation. The following paragraphs outline important issues and requirements for dealing with the IRS and the Social Security Administration (SSA).

Registering for a Federal ID Number

If an organization is required to report employment taxes or provide tax statements to employees, it needs an employer identification number (EIN). The EIN is a nine-digit number **issued by the IRS**, with digits arranged as follows: xx-xxxxxxx. The EIN identifies the employers' tax accounts (as well as certain entities without employees), and must be visible on all items sent to the IRS or SSA.

The **Internet EIN application** is the preferred method for customers to apply for and obtain an EIN. Once the application is completed, the information is validated during the online session, and an EIN is issued immediately. The online application process is available for all entities whose principal business, office or agency, or legal residence (in the case of an individual) is located in the United States or U.S. Territories.

Applicants may also complete **Form SS-4**, *Application for Employer Identification Number*, and apply by mail or by FAX (International applicants may also apply by phone).

Federal Forms Completed by Employees

The following forms are completed by employees and retained by employers:

- **Form I-9**, *Employment Eligibility Verification*
- **Form W-4**, *Employee's Withholding Allowance Certificate*

Form I-9, *Employment Eligibility Verification*

The Immigration and Nationality Act (8 U.S. Code Section 1356 et seq.) requires employers – regardless of total number of employees – to verify that all persons hired after Nov. 6, 1985, are legally authorized to work in the United States and prohibits employers from knowingly hiring or employing persons not authorized to work.

Form I-9, used to verify employment eligibility, is available from U.S. Citizenship and Immigration Services (USCIS).

The law requires employers to ensure that every employee completes Section 1 of Form I-9 when hired. New employees also must complete Section 2 within three days of hire. This law requires employers to review documents establishing the employee's identity and work eligibility. The documents that satisfy the verification requirements are listed on Form I-9.



Employers should not make hiring decisions based on applicants' national origin or citizenship status when they are authorized to work in the United States. Questions like, "What is your national origin?" and "Are you a U.S. citizen?" may be considered discriminatory and should not be asked in an interview.

Employers may, however, ask whether an applicant is legally authorized to work in this country.

The USCIS provides detailed information on requirements in [Publication M-274](#), *Handbook for Employers*.

Form W-4, Employee's Withholding Allowance Certificate

All new employees should complete Form W-4, and this form should be effective with the first pay date. It guides an employer in determining the proper income tax withholding rate for each employee. If a new employee does not provide a completed Form W-4, single status with zero withholding allowances should be assumed.

A Form W-4 remains in effect until the employee submits a new one. Employees who claim exemption from withholding must complete a new Form W-4 each year by Feb. 15. For the effective date of a replacement Form W-4, see IRS [Publication 15](#), *(Circular E), Employer's Tax Guide*.

Copies of the W-4 must be sent to the IRS if the employee:

- Claims more than 10 withholding allowances
- Claims an exemption from withholding and his or her wages would normally exceed \$200 per week

Copies received during the quarter from employees still employed at the end of that quarter can be sent to the IRS with the quarterly Form 941 filing (see below). Employers must complete boxes 8 and 10 on any Form W-4 sent to the IRS.

Federal Forms Used for Independent Contractors

An organization using independent contractors must complete:

- [Form W-9](#), *Request for Taxpayer Identification Number and Certification*
- [Form 1099-MISC](#), *Miscellaneous Income*

Form W-9, Request for Taxpayer Identification Number and Certification

Use Form W-9, *Request for Taxpayer Identification Number and Certification*, for a TIN and to request certifications and claims for exemption from a U.S. person (including a resident alien), partnership or corporation.

Organizations should keep this form and not send it to the IRS.

Reporting Nonemployee Payments on Form 1099-MISC

Organizations should use Form 1099-MISC, *Miscellaneous Income*, to report payments of \$600 or more to independent contractors. This should include fees, salaries, commissions, wages, prizes and awards for services performed as a nonemployee.

Payments to a for-profit corporation need not be reported on Form 1099-MISC. However, employers must use Form 1099-MISC to report payments of \$600 or more for medical or health care services provided by corporations, including professional corporations.

Forms 1099-MISC must be provided to payees by January 31 and filed with the IRS by February 28 (March 31 if filing electronically) for all payments made in the prior calendar year. Paper Forms 1099-MISC are transmitted to the IRS using [Form 1096](#), *Annual Summary and Transmittal of U.S. Information Returns*.



Penalties for Failure to Furnish Form 1099-MISC

Penalties may apply if organizations:

- Fail to file on time without reasonable cause
- Fail to include all information required
- Provide incorrect information

A \$250 penalty per document is charged unless corrections are made within approved time frames.

Additional penalties apply if organizations:

- Fail to provide the statement to the payee by January 31
- Fail to include all information required
- Include incorrect information

A \$250 per statement penalty is charged (with a maximum of \$3,000,000 per year) regardless of how soon after the due date a correct statement is furnished.

Withholding Federal Taxes

How much federal income tax to withhold is based on the employee's W-4. See [Publication 15](#), (*Circular E*), *Employer's Tax Guide*, to determine the correct amount.

Social Security and Medicare taxes are levied on both the employer and the employee. The employer must withhold the employee's part of the taxes and pay a matching amount.

The Social Security tax rate for 2015 is 6.2 percent each for the employee and employer, for a total of 12.4 percent. For wages paid in 2015, tax is withheld and paid until the employee's wages exceed \$118,500.

The Medicare tax rate is 1.45 percent for each employee with a 1.45 percent employer match for a total of 2.9 percent. Unlike the Social Security tax, there is no maximum amount set for wages subject to Medicare withholding.

In the future, refer to Publication 15, (*Circular E*), *Employer's Tax Guide*, for updates.

Backup Withholding

Employers must withhold 28 percent of nonemployee compensation payments if the payee fails to furnish his or her correct TIN. A state government tax agency may also require backup withholding. In some cases, the IRS requests backup withholding for other reasons. Backup withholding does not apply to wages paid to employees.

Depositing Federal Taxes

Employers deposit federal employment taxes using the Electronic Federal Tax Payment System (EFTPS) or by mailing or delivering a check, money order or cash to an authorized financial institution. Some employers are required to use EFTPS.



Filing Federal Employment Tax Returns

The following are some employment returns or forms that are required of most organizations:

- **Form 940**, *Employer's Annual Federal Unemployment (FUTA) Tax Return*
- **Form 941**, *Employer's Quarterly Federal Tax Return*
- **Form 944**, *Employer's Annual Federal Tax Return*
- **Form 945**, *Annual Return of Withheld Federal Income Tax*
- **Form W-2**, *Wage and Tax Statement*
- **Form W-3**, *Transmittal of Wage and Tax Statements*
- **Form 5500**, *Annual Return/Report of Employee Benefit Plan*

Organizations should refer to the instructions for each of these returns or forms as well as Publication 15 to determine the schedule for making deposits.

Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*

FUTA, along with state unemployment systems, provides for payments of unemployment compensation to workers who have lost their jobs. FUTA does not apply to the wages of employees of 501(c)(3) organizations, but wages paid by other tax-exempt organizations are subject to FUTA. Only the employer pays FUTA tax; it is not deducted from employees' wages.

Form 940 is due on Jan. 31 for wages paid in the prior calendar year. However, if an employer deposited all FUTA tax when due, it may file on or before Feb. 10.

Form 941, *Employer's Quarterly Federal Tax Return*

Each quarter, employers who pay wages subject to income tax withholding or Social Security and Medicare taxes must file Form 941, *Employer's Quarterly Federal Tax Return* (in some cases an employer is required to file Form 944 or an exception applies). Form 941 must be filed by the last day of the month that follows the end of the quarter.

Form 944, *Employer's Annual Federal Tax Return*

Employers who qualify file Form 944, *Employer's Annual Federal Tax Return*, instead of Form 941. Those filing Form 944 have until Jan. 31 after the end of the calendar year. An organization gets an additional 10 days if the taxes are paid in full by the due date.

Exceptions to Forms 941 and 944 Filing Requirements

The following exceptions apply to Forms 941 and 944 filing requirements:

- Seasonal businesses, such as a summer recreational camp, do not have to file for the quarters when they have no tax liability because they have paid no wages. An organization that will not have to file a return for one or more quarters during the year should check the seasonal employer box on line 17 of Form 941.
- Agricultural employers use Form 943, *Employer's Annual Tax Return for Agricultural Employees*.
- Income tax withholding on non-payroll items and backup withholding must be reported on Form 945, *Annual Return of Withheld Income Tax*.



Form 945, Annual Return of Withheld Federal Income Tax

Employers should use Form 945, *Annual Return of Withheld Federal Income Tax*, to report withholding from nonpayroll payments, such as pensions, annuities, IRA distributions and backup withholding. Organizations should check with their state's tax department for details on state withholding and reporting requirements.

Form 945 is due by Jan. 31 following the calendar year in which the reportable payments were made.

Penalties: Form 940, Form 941, Form 944 and Form 945

There are penalties for:

- Late deposits
- Insufficient deposits
- Failure to deposit using EFTPS (when required)
- Late filing, unless you can show reasonable cause. If you file late, attach an explanation to the return

There are also penalties for willful failure to pay tax, file returns, and filing false or fraudulent returns.

Form W-2, Wage and Tax Statement

Employers should use Form W-2 to report wages paid to each employee. From these reports, the Social Security Administration (SSA) computes employees' benefits at the time of retirement or disability or their families' survivor benefits. Earnings are also used to determine eligibility for Medicare.

The IRS uses the reports to enforce income tax laws and to ensure that the FICA taxes that employers pay are properly credited to the Social Security and Medicare programs.

Employers must file Form W-2 for wages paid to each employee from whom:

- Income, Social Security or Medicare tax was withheld.
- Income tax would have been withheld if the employee had claimed no more than one withholding allowance or had not claimed exemption from withholding on Form W-4, *Employee's Withholding Allowance Certificate*.

Employers should do the following:

- File Copy A of Form W-2 with the SSA by February 28 (March 31, if filing electronically).
- Use Form W-3 to transmit Copy A of Form W-2.
- If required to file 250 or more Forms W-2, file them electronically unless the IRS grants a waiver.
- Furnish Copies B, C and 2 of Form W-2 to employees by January 31.

Organizations should file a final return if they terminate or cease to pay wages to an employee.



Penalties for Failure to Furnish Form W-2

If an employer fails to file a correct Form W-2 by the due date, and cannot show reasonable cause, it may be subject to a penalty of \$50 per document unless corrections are made within specified time frames.

The penalty applies if the organization:

- Fails to file on time
- Fails to include all information required
- Includes incorrect information
- Files on paper when required to file electronically
- Reports an incorrect TIN
- Fails to report a TIN

To facilitate timely and accurate returns on unresolved topics or issues, an organization should permit the IRS to speak with their third-party designee (employee or tax preparer) to discuss the form by checking the appropriate box on the Form 940, 941, 944 or 945.

If an employer fails to provide correct W-2 payee statements to employees and cannot show reasonable cause, it may be subject to a penalty. The penalty applies if the employer:

- Fails to provide the statement by January 31
- Fails to include all information required
- Includes incorrect information on the statement

The penalty is \$50 per statement, regardless of when a correct statement is furnished, with a maximum of \$100,000 per year.

Form 5500, *Annual Return/Report of Employee Benefit Plan*

Generally, any administrator or sponsor of an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA) must file information about each plan every year using Form 5500, *Annual Return/Report of Employee Benefit Plan*.

The IRS, Department of Labor (DOL) and Pension Benefit Guaranty Corporation have consolidated certain returns and report forms to reduce the filing burden for plan administrators and employers. By complying with the Form 5500 instructions, employers and administrators will satisfy the annual reporting requirements for the IRS and DOL.

Employers must file all required forms and schedules with the Department of Labor by the last day of the seventh month after the end of the plan year. For a calendar year plan, the due date will be July 31.

Penalties: Form 5500

ERISA and the Code empower the DOL and IRS to impose penalties for giving incomplete information and for not filing statements or returns. Various penalties may be imposed for not meeting the Form 5500 filing requirements, including:

- A penalty of up to \$1,100 a day for each day a plan administrator fails or refuses to file a complete report
- A penalty of \$25 a day (up to \$15,000) for not filing returns for certain plans of deferred compensation, trusts and annuities, and bond purchase plans by the due date
- A penalty of \$1 a day (up to \$5,000) for each participant for whom a registration statement is required but not filed
- A penalty of \$1,000 for not filing an actuarial statement



Income Tax Records to Retain for Employees

Exempt organizations must keep accurate and complete records for income tax, Social Security and Medicare taxes, and FUTA paid for each employee. These records should be kept for four years.

Examples of the types of income tax records that should be kept include:

- Name, address and SSN
- Amount and date of each wage payment and the period of time the payment covers
- Amounts subject to withholding (for each wage payment)
- Amount of withholding tax collected on each payment and the date collected
- If the taxable amount is less than the total payment, the reason for the difference
- Copies of any statements furnished by employees relating to nonresident alien status, residence in Puerto Rico or the Virgin Islands, or residence or physical presence in a foreign country
- Fair market value and date of each payment of noncash compensation
- For accident or health plans, information about the amount of each payment
- Withholding allowance certificates (Form W-4) filed by each employee
- Any agreement between employer and employee on Form W-4 for voluntary withholding of additional amounts of tax
- If necessary to figure tax liability, the dates in each calendar quarter on which any employee worked outside the course of your trade or business, and the amount paid for that work
- Copies of employee statements that report tips received, unless the information shown on such statements appears in another item on this list
- Requests by employees to have their withheld tax calculated on the basis of their individual cumulative wages, and any notice that such a request was revoked

Social Security and Medicare Tax Records to Retain for Employees

Examples of the types of Social Security and Medicare tax records that must be kept:

- Amount of each wage payment subject to Social Security tax
- Amount of each wage payment subject to Medicare tax
- Amount of Social Security and Medicare taxes collected for each payment and the date collected
- Reason for any difference between the total wage payment and the taxable amount

Federal Unemployment (FUTA) Tax Records to Retain for Employees

Examples of the types of FUTA records that must be kept:

- Total amount paid to employees during the calendar year
- Amount of compensation subject to the unemployment tax and the reason for any difference between that amount and the amount of total compensation
- Amount paid into the state unemployment fund
- Any other information required to be shown on Form 940 (or Form 940-EZ)



Other Federal Agencies

Other federal agencies regulate employment issues. For more information contact them at:

- **Social Security Administration** (SSA)
 - Telephone: 800-772-1213
- **U. S. Department of Labor** (DOL)
 - Telephone: 866-4-USA-DOL
- **U.S. Citizenship and Immigration Services**
 - Telephone: 800-375-5283

For More Information

- **Publication 15**, *(Circular E), Employer's Tax Guide*
- **Publication 15-A**, *Employer's Supplemental Tax Guide*
- **Publication 15-B**, *Employer's Tax Guide to Fringe Benefits*
- **Publication 505**, *Tax Withholding and Estimated Tax*
- **Publication 509**, *Tax Calendars*
- **Publication 531**, *Reporting Tip Income*
- **Publication 966**, *Electronic Federal Tax Payment System: A Guide to Getting Started*
- **Publication 1244**, *Employee's Daily Record of Tips and Report to Employer*
- **Publication 1779**, *Independent Contractor or Employee*
- **Publication 3144**, *Tips on Tips: A Guide to Tip Income Reporting for Employers in Businesses Where Tip Income is Customary*
- **Publication 3148**, *Tips on Tips: A Guide to Tip Income Reporting for Employees Who Receive Tip Income*
- **Form SS-4**, *Application for Employer Identification Number*
- **Form SS-8**, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*
- **Form W-2**, *Wage and Tax Statement*
- **Form W-3**, *Transmittal of Wage and Tax Statements*
- **Form W-4**, *Employee's Withholding Allowance Certificate*
- **Form W-9**, *Request for Taxpayer Identification Number and Certification*
- **Form 940**, *Employer's Annual Federal Unemployment (FUTA) Tax Return*
- **Form 941**, *Employer's Quarterly Federal Tax Return*
- **Form 944**, *Employer's Annual Federal Tax Return*
- **Form 945**, *Annual Return of Withheld Federal Income Tax*
- **Form 1096**, *Annual Summary and Transmittal of U.S. Information Returns*
- **Form 1099-MISC**, *Miscellaneous Income*



Exhibit D

Employment Issues - Quiz 

Please circle your answer for each of the scenarios below.

These organizations are fictitious and for learning purposes only. Information in these samples may not be cited as law.

Scenario 1: ABC Foundation placed the following advertisement in the newspaper.

A friendly individual who enjoys working with people is needed to answer a multi-line telephone, greet visitors, make coffee and perform other tasks when time permits. This qualified individual must be able to work from 8:00 a.m. – 5:00 p.m. The position pays \$10 an hour.

Q: Would this person be an employee or independent contractor?

Scenario 2: DEF Country Club is looking for an experienced accountant who specializes in working with tax-exempt organizations. The accountant must be able to prepare a compilation of the financial statements, present these statements to the board of directors, perform the annual gambling audit and prepare the 990 and 990-T returns at the end of the year by the due date.

Q: Would this person be an employee or independent contractor?

Scenario 3: The president of ABC Foundation manages the day-to-day activities of the organization, supervises managers, signs the organization's checks, presides over monthly board meetings and performs other tasks as necessary to ensure the successful operation of the organization.

Q: Would this person be an employee or independent contractor?

Scenario 4: GHI Private School for the Gifted hired a janitor to clean up the school after hours. The janitor must provide all necessary equipment and supplies. He must clean three times a week when the school is not in session. The janitor is provided a key to the school. The school is billed monthly for the services of the janitor. The janitor has several other clients.

Q: Would this person be an employee or independent contractor?

Scenario 5: JKL Youth Bowling League was sued as a result of a youth dropping a bowling ball on a spectator's foot. The spectator filed suit in district court and is suing for \$250,000. JKL Youth Bowling League contracts with a local attorney who specializes in this type of lawsuit. The attorney charges \$250 per hour.

Q: Would the attorney be an employee or independent contractor?

Scenario 6: The MNO Little League organization hired coaches selected by the league's officers. The board sets the times and places for all the games. The coaches are fathers or mothers of the children who play on the team. The organization has established policies and procedures that coaches are required to follow. Generally, the officers do not interfere with the coaching unless there is a problem. The coaches receive \$500 per season.

Q: Would these coaches be employees or independent contractors?

Scenario 7: PQR Theatre places the following advertisement in the newspaper.

Needed: Ushers, ticket takers and ticket sellers. Hourly rate is negotiable based on experience and reliability.

Q: Would these workers be employees or independent contractors?

Scenario 8: A salaried golf professional and his assistants manage the country club's pro shop. In addition, the club requires them to give lessons to the club's members at its established rates.

Q: Would these persons be employees or independent contractors?



Scenario 9: A golf professional sells lessons and equipment on golf club premises. She sets prices, makes appointments and carries on her activities with permission of the club, but without orders or instructions from club members or officials.

Q: Would this person be an employee or independent contractor?

Scenario 10: The STU Foundation hires van drivers to transport physically disabled individuals to their medical appointments. The STU Foundation owns the vans, pays the insurance and all other related expenses for the vans and only uses the vans for this purpose. The van drivers are not allowed to take side trips. Their purpose is solely to transport physically disabled individuals to their medical appointments.

Q: Would these persons be employees or independent contractors?

Scenario 11: The STU Foundation hires van drivers to transport physically disabled individuals to their appointments. The drivers own their own vans and pay for the gas, insurance and maintenance. The drivers charge \$1 per mile and are willing to stop anywhere.

Q: Would the drivers be employees or independent contractors?

Scenario 12: XYZ Anonymous engages in charitable gambling. It hired a gambling manager who supervises employees conducting the pull-tab games, prepares the monthly reports, audits the games, makes the deposits and reports at the monthly meetings.

Q: Would this person be an employee or independent contractor?



7 | Record Keeping

Importance of Record Keeping

An organization must keep books and records to show it complies with tax rules, and it must be able to document the sources of receipts and expenditures reported on **Form 990**, *Return of Organization Exempt From Income Tax*. For additional information on Form 990, please see **Chapter 8**.

An effective record keeping system enables an organization to monitor the progress of programs and aid in the preparation of financial statements and returns.

If an organization does not keep required records, it may be unable to show it qualifies for exemption. Thus, the organization may lose its tax-exempt status. In addition, an organization may be unable to complete its returns accurately and may be subject to penalties.

Monitor Programs

Records can show whether programs are improving, which programs are successful and what changes an organization may need to make. Good records management can contribute to the success of a program and an organization.

Prepare Financial Statements

It's important for organizations to maintain revenue and expense statements and balance sheets to prepare accurate financial statements. These statements can help an organization when working with banks, creditors, contributors and funding organizations.

Prepare Annual Returns and Tax Returns

Records must support income, expenses and credits as reported on the Form 990 series of federal returns and on state tax returns. These can often be the same records used to monitor programs and prepare financial statements. Also, books and records of exempt organizations must be available for inspection by the IRS. If the IRS examines an organization's returns, the organization may be asked to explain items reported. A complete set of records will speed up the examination.

Substantiation of Taxable Revenue and Expenses

Another reason for good record keeping is to substantiate revenues, expenses and deductions for UBIT purposes. An organization must appropriately track the revenues and expenses subject to UBIT so that it can prepare its UBIT return on **Form 990-T**, *Exempt Organization Business Income Tax Return*. For additional information on Form 990-T, see **Chapter 8**.

Comply with Grant-Making Procedures

A charity that makes grants to individuals must keep adequate records to demonstrate that the grants serve charitable purposes. At a minimum, the records should show names and addresses of grantees, purpose of the grant, manner of selecting the grantees and relationship of the grantees to any members, officers, trustees or donors of the organization.

Comply with Racial Nondiscrimination Requirements (Private Schools)

Private schools must keep records showing they have complied with requirements relating to racial nondiscrimination, including annual publication of a racially nondiscriminatory policy through newspaper or broadcast media to the community served by the school. For more information, see **Schedule E**, *Schools*, on the Form 990 and its accompanying instructions.



What Records Should be Kept?

Except in a few cases, the law does not specify record keeping processes. A corporation should keep records of board of directors' meetings.

An organization can choose any record keeping system, suited to its activities, that shows its income and expenses. If an organization has more than one program, it should ensure that records identify the income and expense items attributable to each program.

A record keeping system must include a summary of transactions. This is ordinarily written in the organization's books, such as accounting journals and ledgers. The books must show, among other things, gross receipts, purchases, other expenses, employment taxes and assets. For many small organizations, a checkbook may be the main source for entries in the books, while larger organizations need more sophisticated ledgers and records. All organizations must keep all documentation that supports the entries in the books.

Accounting Periods and Methods

Organizations must keep their financial records based on an annual accounting period called a tax year.

Accounting Periods

A tax year is usually 12 consecutive months. There are two kinds of tax years:

- Calendar tax year: This is a period of 12 consecutive months beginning January 1 and ending December 31.
- Fiscal tax year: This is a period of 12 consecutive months ending on the last day of any month except December.

Accounting Methods

An accounting method is a set of rules used to determine when and how income and expenses are reported. An organization chooses an accounting method when it files its first annual return. There are two basic accounting methods:

- Cash method: Under the cash method, an organization reports income in the tax year received. It usually deducts expenses in the year paid.
- Accrual method: Under an accrual method, an organization generally records income in the tax year earned, even though it may receive payment in a later year. It records expenses in the tax year incurred, whether or not it pays the expenses that year.

For more information about accounting periods and methods, see [Publication 538](#), *Accounting Periods and Methods*, and the instructions to Forms 990 and 990-EZ or Form 990-PF.

Supporting Documents

Transactions such as contributions, purchases, sales and payroll will generate supporting documents (for example, grant applications and awards, sales slips, paid bills, invoices, receipts, deposit slips and canceled checks) that contain information to be recorded in accounting records. It's important to keep these documents because they support the entries in an organization's books and on its tax and information returns. They should be marked and stored in a safe location.

Records Management

Gross Receipts

Gross receipts are the amounts received from all sources, including contributions. An organization should keep supporting documents that show the amounts and sources of its gross receipts. Documents that show gross receipts include cash register tapes, bank deposit slips, receipt books, invoices and credit card charge slips.



Purchases, Including Accounting For Inventory

Purchases are items bought, including any items resold to customers. If an organization produces items, it must account for any items resold to customers. It must also account for the cost of all raw materials or parts purchased for manufacturing into finished products. Supporting documents should show the amount paid and verify the payment was for purchases. Documents for purchases include canceled checks, cash register receipts, credit card sales slips and invoices. These records will help an organization determine the value of its inventory at the end of the year. See [Publication 538, Accounting Periods and Methods](#), for general information on methods for valuing inventory.

Expenses

Expenses are the costs incurred by an organization to carry on its programs. Supporting documents should show the amount paid and the purpose of the expense. Documents for expenses include canceled checks, cash register tapes, contracts, account statements, credit card sales slips, invoices and petty cash slips for small cash payments.

Employment Taxes

Organizations with employees must keep records of compensation and specific employment tax records. See [Publication 15, \(Circular E\), Employer's Tax Guide](#), for details.

Records of Assets and Liabilities

An organization must keep records to verify information about its assets and liabilities. Assets are the property an organization owns and uses in conducting its activities, such as investments, buildings and furniture, and liabilities reflect the financial obligations of the organization. Records should show:

- When and how the asset was acquired
- Documents that support mortgages, notes, loans or other forms of debt
- Purchase price
- Cost of improvements
- Deductions taken for depreciation
- Deductions taken for casualty losses, such as losses resulting from fires or storms
- How the asset was used
- When and how the asset was disposed of
- Selling price
- Expenses of the sale

Typical Documents

Documents that show the above information include purchase and sales invoices, real estate closing statements, canceled checks and financing documents. If an organization does not have canceled checks, it may be able to get payment information from account statements prepared by financial institutions. These include account statements prepared for the financial institution by a third party. Account statements must be legible. The following table lists the contents of acceptable account statements:

| If payment is by: | Then account statement must show: |
|----------------------------------|---|
| Check | Check number, amount, payee's name and date the check amount was posted to the account by the financial institution |
| Electronic funds transfer | Amount transferred, payee's name and date the transfer was posted to the account by the financial institution |
| Credit card | Amount charged, payee's name and transaction date |



How Long to Keep Records for Tax Purposes?

For federal tax purposes, an exempt organization must keep records that support an item of income or deduction on a return until the statute of limitations for that return runs.

The statute of limitations has run when the organization can no longer amend its return and the IRS can no longer assess additional tax. The statute of limitations generally runs three years after the date the return is due or filed, whichever is later. An organization may be required to retain records longer for other legal purposes, such as for state or local tax purposes.

Additional Record Retention Periods

Other record retention periods vary depending on the type of record or return.

Permanent Records

Some records should be kept permanently. These include the application for recognition of tax-exempt status, the determination letter recognizing tax-exempt status, organizing documents (such as articles of incorporation and by-laws, with amendments) and board minutes.

Employment Tax Records

If an organization has employees, it must keep employment tax records for at least four years after the date the tax becomes due or is paid, whichever is later.

Records for Non-Tax Purposes

An organization should keep records until they are no longer needed for non-tax purposes. For example, a grantor, insurance company, creditor or state agency may require that records be kept longer than the IRS requires.

For More Information

- **Publication 583**, *Starting a Business and Keeping Records*
- **Publication 4221-PC**, *Compliance Guide for 501(c)(3) Public Charities*
- **Publication 4221-PF**, *Compliance Guide for 501(c)(3) Private Foundations*



8 | Form 990

Filing one of the Form 990-series returns, or the Form 990-N notice, is mandatory for most exempt organizations. The Form 990-series returns and the notice are unique and useful for four key reasons:

1. Forms **990**, **990-EZ**, **990-N** and **990-PF** are information returns, not tax returns. Tax-exempt organizations, by definition, do not pay income taxes. The primary reason why these organizations file a return is to provide information on their programs and activities. The Form 990-N, which is filed online, provides basic information on the organization. The IRS uses this information to verify that the organization is still in existence, and that the organization is operating in accordance with its stated tax-exempt purpose and not violating the rules and regulations governing tax-exempt status.
2. Tax-exempt organizations are required to make their returns and certain notices available for public inspection. This means organizations must allow the public to inspect the Forms 990, 990-EZ, 990-N and 990-PF for a three-year period. In addition, any **Forms 990-T** filed by 501(c)(3) organizations after August 17, 2006 must be made available for public inspection for a three-year period. Exempt organizations are also required to provide copies of these returns when requested. Documents that exempt organizations are required to make available to the public are discussed in **Chapter 10**.
3. Exempt organization returns are multi-jurisdictional forms, with nearly 40 states requiring exempt organizations to file some or all parts of a Form 990-series return to satisfy the states' filing requirements.
4. In addition to ensuring that an organization is in compliance with state and federal regulations, these information returns promote transparency and accountability, which strengthens the relationship that an exempt organization has with its stakeholders and funders.

What's in this Chapter - Discussing Details of Form 990

This chapter discusses Form 990, *Return of Organization Exempt From Income Tax*; Form 990-EZ, *Short Form Return of Organization Exempt From Income Tax*; Form 990-N (*e-Postcard*); as well as Schedules A, B, D, M and O of the Form 990, which are the most commonly filed schedules. This chapter also explains important sections of the form and provides several resources to aid in successful completion of Form 990. For organizations with limited staff and resources or organizations that are new to the information return process, a summary of the IRS toolkit, publications and resources is included. Detailed information about all schedules on the Form 990 can be found in the **Form 990 Instructions**. A summary of filing requirements for the Form 990 can also be found in **Publication 4839**, *Annual Form 990 Filing Requirements for Tax-Exempt Organizations*.

Form 990-T, *Exempt Organizations Business Income Tax Return*, was discussed in **Chapter 4**. Discussion of Form 990-PF, *Return of Private Foundation*, is beyond the scope of this text.

Who Must File Form 990, Form 990-EZ or Form 990-N

Most organizations exempt from federal income tax under Section 501(a) must file an annual information return (Forms 990, 990-EZ) or Form 990-N. The form you file depends on your organization's gross receipts and total assets for the tax year.

The following organizations are **not** required to file any of the Form 990-series forms for a given tax year:

- Churches and related organizations
- State institutions whose income is excluded from gross income under Code Section 115 and certain other government-affiliated organizations
- Organizations included in a group return for that tax year

Note: If an organization that would be required to file Form 990, Form 990-EZ or Form 990-N has an application for exemption under Section 501(a) pending, it has to file the required form. Also, if an organization that is exempt under Section 501(a) that has not filed for recognition of its exempt status (such as a 501(c)(4) organization) has a Form 990-series filing requirement, it must file the required form.



Form 990

Form 990 is an annual information return that certain tax-exempt organizations file. The return provides information on the organization's mission, activities and governance, and revenue and expenses. There are schedules that an organization may have to submit with the return regarding activities that it engages in (such as political activities or noncash contributions) or that relate to a specific type of organization (for example, colleges and universities or hospitals).

Form 990-EZ

Form 990-EZ is a shorter and simpler version of Form 990 that many smaller organizations can use in place of Form 990. If an organization eligible to submit Form 990-EZ elects to file Form 990, it must file a complete form.

Form 990-N

If an organization isn't required to file Form 990 or Form 990-EZ because it normally has gross receipts of \$50,000 or less for tax year 2010 forward, then it must file Form 990-N, *Electronic Notice (e-Postcard) for Tax-Exempt Organizations not Required to File Form 990 or 990-EZ*. This annual electronic notice requirement applies to tax periods beginning after December 31, 2006. Organizations that are not required to file Form 990-N are discussed above in "Who Must File Form 990, Form 990-EZ or Form 990-N."

Section 509(a)(3) supporting organizations, except for: (1) integrated auxiliaries of churches, (2) exclusively religious activities of religious orders and (3) organizations whose gross receipts are normally \$5,000 or less and that support a Section 501(c)(3) religious organization, cannot file Form 990-N. They must file either Form 990 or Form 990-EZ.

Filing is very simple and requires no specialized computer equipment or software. All you need to do is provide some basic information:

- Your employer identification number (EIN)
- Tax year
- Legal name and mailing address
- Any other names the organization uses
- Name and address of a principal officer
- Website address, if the organization has one
- Confirmation that the organization's annual gross receipts are normally at or below the threshold
- If applicable, a statement that the organization is going out of business

If you're eligible to submit a Form 990-N and choose to file Form 990 instead, you must file a complete return.

What to File

Whether an exempt organization is required to file a Form 990, a Form 990-EZ or Form 990-N depends on whether its gross income and total assets for a tax year exceed a certain amount (the filing threshold).

The tax year is the annual accounting period for which the Form 990 is being filed, whether the calendar year ending December 31 or a fiscal year ending on the last day of any other month.

Determining Gross Receipts and Total Assets

The gross receipts of an organization are the total amounts the organization received from all sources during its tax year. When determining its gross income, the organization does not subtract any costs or expenses.

The total assets of an organization is the amount that the organization reports on its balance sheet as of the end of its tax year. When determining what its total assets are, the organization does not subtract any liabilities.



Thresholds for Filing

For tax years 2010 and beyond, an organization must file Form 990 if it has either: (1) annual gross receipts of \$200,000 or more for the tax year or (2) total assets of \$500,000 or more at the tax year end. If either of these thresholds applies, it can not file Form 990-EZ or Form 990-N. An organization can only file Form 990-EZ instead of Form 990 if it has **both** annual gross receipts of less than \$200,000 and total assets of less than \$500,000.

For tax years beginning in 2010 and beyond, organizations that have annual gross receipts that are normally \$50,000 or less may file Form 990-N instead of Form 990 or Form 990-EZ.

Generally, a gross receipts determination is based on a three-year average. To determine what its annual gross receipts are, an organization should use the rules discussed below.

Gross Receipts Test for Form 990-N,

An organization is considered to have gross receipts of \$50,000 or less for 2010 and forward if the organization is:

- A year old and has received \$75,000 or less in donations or pledges
- Between one and three-years old and averaged \$60,000 or less in gross receipts in each of its first two tax years
- Three-years old or more and averaged \$50,000 or less in gross receipts for the preceding three tax years (including the year for which the return would be filed)

E-filing Requirements

Organizations with \$10 million or more in total assets that file at least 250 returns during the calendar year (including income, excise, employment tax and information returns) are required to file Form 990 **electronically**.

When to File

Organizations that are required to file a Form 990-series return must file Form 990, Form 990-EZ or Form 990-N by the 15th day of the fifth month after their accounting period ends. For example, May 15 would be the due date for an organization with a December 31 year-end.

Extension of Time to File

Use **Form 8868**, *Application for Extension of Time to File an Exempt Organization Return*, to request an automatic three-month extension of time to file Form 990 or Form 990-EZ and submit it on or before the original due date. Organizations can request a second three-month extension by filing another Form 8868 before the initial extension expires, but must show reasonable cause for needing additional time. The IRS will not grant filing extensions that total more than six months for a given tax year. For tax years beginning after December 31, 2015, organizations can request an automatic 6-month extension of time to file the Form 990 (series) return. There is no extension for Form 990-N.

Penalties for Late Filing or Failure to File 990 or 990-EZ Returns

Against the Organization

If an organization's gross receipts are \$1 million or less, and if it is required to file Form 990 or Form 990-EZ and does not file on time, it may be charged a penalty of \$20 a day, up to the lesser of \$10,000 or 5 percent of its gross receipts for the year, unless the organization can show that the late filing was due to reasonable cause. Organizations with annual gross receipts over \$1 million are subject to a penalty of \$100 per day for each day failure continues, with a maximum penalty with respect to any one return of \$50,000. The penalty begins on the due date for filing the Form 990. There is no late filing penalty for Form 990-N.

These penalties may also be charged if the organization files an incomplete or inaccurate return. Organizations that are required to file electronically but file a paper return instead generally are deemed to have failed to file the return.



Note: An organization that is required to file an annual Form 990, Form 990-EZ, Form 990-PF or Form 990-N but fails to do so for three consecutive years automatically loses its tax-exempt status. Even though there may be no late filing penalty for Form 990-N, failure to file the notice for three consecutive years will result in the automatic revocation of the organization's exempt status. In addition, organizations that are not required to file an application to be treated as tax-exempt (such as a Section 501(c)(4) organization), but are required to file one of the annual 990-series forms, will have their exempt status automatically revoked if they fail to file the forms for three consecutive years.

Loss of exempt status may mean that an organization will need to file income tax returns, pay taxes and its contributors will not be able to deduct their donations. In addition, a Section 403(b) retirement plan may have an eligibility failure if the plan sponsor is automatically revoked. And, interest on an organization's outstanding tax-exempt bonds may be affected.

This automatic revocation of exemption becomes effective as of the due date for filing the third annual return or notice. There is no appeals process for the automatic revocation. To have its tax-exempt status reinstated, the organization must reapply (or apply if it initially did not have to file an application to be treated as tax-exempt) for tax-exempt status reinstatement by filing Form 1023 or 1024. A user fee must be submitted with the application. As part of the application, an organization can request that its exemption be retroactively reinstated.

Against Responsible Person(s)

If the organization does not file a complete return or does not furnish correct information, the IRS will send the organization a letter that includes a fixed time to fulfill these requirements. After this period expires, the person failing to comply will be charged a penalty of \$10 a day unless he or she shows that failure to comply was due to reasonable cause. If more than one person is responsible, they are jointly and individually liable for the penalty. The maximum penalty on all persons for failures with respect to any one return will not exceed \$5,000.

There are also penalties, fines and imprisonment for willfully not filing returns and for filing fraudulent returns and statements.

To avoid penalties, an organization must:

- Complete all applicable parts, schedules and line items;
- Unless instructed to skip a line, answer each question on the return;
- Make an entry (including a zero when appropriate) on all lines requiring an amount or other information to be reported;
- Provide required explanations as instructed;
- Sign the return; and
- File by the deadline.

Form 990 Disclosure

The law requires that you make available a copy of your filed Form 990 and all attachments and schedules to anyone who requests it – except certain portions of Schedule B, *Schedule of Contributors*, for certain organizations. The IRS is also required to make your return available on request.

Chapter 10 goes into more detail.



Understanding Form 990

The following sections explain some of the information requested on key parts of Form 990 and are intended to help preparers avoid common errors. Because all 990-EZ items are also requested on Form 990, a separate discussion of Form 990-EZ is not included.

Form 990 Instructions

The Form 990 Instructions provide explanations for each line item of the form and for all of the schedules. In addition, they contain the following items to help organizations successfully complete their information returns:

- Sequencing List – Provides step-by-step guidelines on a logical route through the form
- Glossary – Defines important terms included on the Form 990
- Appendices – Clarify specialized topics and improves technical understanding of specific filing requirements
- Compensation Table – Explains locations on Form 990 for reporting various types of compensation
- Checklist of Required Schedules – Shows at a glance whether the organization has engaged in activities that require it to complete and file certain schedules

Form 990 Overview

Because the answers to some of the items in the earlier parts of the Form 990 depend on information gathered in the later parts, preparers cannot move in a strict order from the first page to the last but will have to skip around. The remainder of this chapter will address the preparer of the return and will provide step-by-step instructions on Form 990 preparation basics.

Note: It is strongly advised that readers have a copy of the Form 990 available to refer to while reviewing this chapter.

Form 990 Walkthrough - Steps to Follow

A 501(c)(3) public charity should first complete Schedule A to ensure that it continues to qualify as a public charity prior to completing the rest of Form 990. If it fails to qualify as a public charity, then it must file Form 990-PF rather than Form 990. (See the specific instructions for Schedule A later in this chapter.)

Sequencing List--Walkthrough in a Nutshell

1. Start with the heading on page 1, complete items A through F and H(a) through M, skipping item G
2. See **Schedule R instructions** and determine the organization's related organizations required to be listed in Schedule R
3. Determine the organization's officers, directors, trustees, key employees and five highest compensated employees required to be listed in Form 990, Part VII, Section A
4. Complete Parts VIII, IX and X
5. Go back to the heading on page 1 and complete item G
6. Complete Parts III, V, VII, XI and XII
7. Read the **Schedule L Instructions** and complete **Schedule L**, *Transactions with Interested Persons*, if required
8. Complete Part VI
9. Complete Parts I and IV
10. Complete **Schedule O** and any other schedules that you were told to complete while answering the questions in Part IV of the core form. Remember, every "Yes" answer in Part IV means you have to fill out the corresponding schedule or part of a schedule.
11. Finally, go back to complete Part II, Signature Block.



Step 1: The Heading (Form 990 p.1)

This section is where you enter the basic information identifying the filing organization: its name, address, EIN, telephone number, website address, etc.

For name of organization, enter the organization's legal name. If the organization does business under a different name, enter that name on the next line. Skip item G until Part VIII of the core form has been completed.

Step 2: Related Organizations (Schedule R)

An organization can be related because it controls, or is controlled by, the filing organization or by the same persons that control the filing organization. It can also be related through a 509(a)(3) supporting/supported organization relationship. A related organization may be an exempt organization, a taxable corporation, partnership or trust, or a disregarded entity. Related organizations are further defined in the glossary and the [Schedule R instructions](#).

Step 3: Officers, Directors, Trustees, Key Employees, Five Highest Compensated Employees

Officers manage the organization's daily operations and are defined by state law and the organization's organizing document and bylaws. They must include the organization's top management official and top financial official.

Directors and trustees are voting members of the organization's governing body. Key employees and highest compensated employees are people who are not officers, directors or trustees, but who meet certain tests regarding high levels of compensation. Key employees also exercise a certain level of control or authority over the organization.

Officers, directors, trustees, key employees and five highest compensated employees are further defined in the glossary and the Part VII instructions.

Step 4: Part VIII, Statement of Revenue (Form 990 p.9)

Part VIII, Statement of Revenue—Columns

- **Column A** – (Total revenue): Filers report their gross receipts for all sources of revenue.
- **Column B** – (Related or exempt function revenue): Filers report all revenue from activities related to the organization's exempt purpose as well as any revenue that is excludable from gross income other than by reason of IRC Sections 512, 513 or 514. For example, interest on state and local bonds excluded from tax by Section 103 is reported in column B.
- **Column C** – (Unrelated business revenue): Filers report any revenue from an unrelated trade or business, whether or not regularly carried on.
- **Column D** – Filers report revenue excludable from unrelated business income by Section 512, 513 or 514.

All filers must complete column A. All filers except Section 527 political organizations must also complete columns B, C and D.

Clarification on select line items in Part VIII

Line 1 – On lines 1a through 1f, report all amounts received as voluntary contributions, gifts or grants. Voluntary contributions include any part of a payment for which the donor does not receive full retail value from the donee. Report gross amounts of contributions collected by fundraisers in the organization's name; do not report a net amount after expenses. You will report all expenses of raising contributions later in Parts VIII and IX. Report the fair market value of a noncash contribution at the time of the donation.

The following are not considered contributions and should not be reported in any section of Line 1:

- Grants or fees from governmental units, foundations or other exempt organizations that represent a payment for a service, the use of a facility or a product that primarily benefits the payer
- That portion of amounts received from any fundraising solicitation that represents payment for goods or services
- Donations of services or the use of materials, equipment or facilities
- Unreimbursed expenses of officers, employees or volunteers



Line 1a. (Federated campaigns) – On line 1a, enter the amount of contributions received through solicitation campaigns conducted by federated fundraising agencies, such as a United Way organization.

Line 1b. (Membership dues) – On line 1b, enter membership dues that function as contributions, or dues paid primarily to support the organization rather than to receive goods or services in return. In determining whether an amount is a payment for goods and services, ignore insubstantial benefits such as free or discounted admission to the organization's facilities or, events or preferred access to goods or services.

Line 1c. (Fundraising events) – On line 1c, enter the amount of contributions received from fundraising events.

Line 1d. (Related organizations) – On line 1d, report amounts contributed by "related organizations," including contributions received from a parent organization, a subordinate or other organization with the same parent. Include only contributions made to enable the organization to provide a service to the general public. Do not include payments for services, facilities or products that primarily benefit the payer.

Line 1e. (Government grants) – On line 1e, report grants from local, state or federal government sources or foreign governments if the primary purpose of the grant is to enable the organization to provide a service for direct benefit of the public. Do not include grants that serve the direct and immediate needs of the governmental unit.

Line 1f. (Other contributions) – On line 1f, report all other contributions not reported already on lines 1a through 1e.

Line 1g. (Noncash contributions) – On line 1g, enter the amount of noncash contributions that were included on lines 1a through 1f. Noncash contributions are anything other than cash, checks, money orders, credit card charges, wire transfers and other transfers and deposits to a cash account of the organization. More information about noncash contributions is in the instructions to [Schedule M](#), which the filer must complete if the amount on line 1g exceeds \$25,000.

Line 2. (Program service revenue) – On lines 2a through 2e, enter the five largest sources of program service revenue. On line 2f, enter the total program service revenue from sources not listed in lines 2a through 2e. Program services are activities that further the organization's exempt purposes.

Note: If you enter an amount anywhere on lines 2a through 2e, you must also enter a business code from Appendix J, Business Activity Codes, or the NAICS website referenced in the instructions

Line 6a. (Gross rents) – On line 6a, enter the amount of rental income received from investment property. Allocate revenue to real property or personal property. Do not report on line 6a rental income that is related to an exempt function; report that income on line 2 instead.

Line 8a. (Gross income from fundraising events) – Income from fundraising events is reported on line 8. Fundraising events are conducted for the sole or primary purpose of raising funds to finance the organization's exempt activities and do not include events or activities that further an organization's exempt purposes. The latter are considered program services and revenue from these events is entered on line 2.

Typical fundraising events include charity balls, bazaars, banquets, door-to-door sales of merchandise, concerts, carnivals, sporting events and auctions.

Example: As part of a fundraising event, an organization sends a book to anyone who contributes at least \$40. The retail value of the book is \$16 and the wholesale cost of the book is \$8. A \$40 contribution would be recorded as:

- \$24 reported as a contribution on line 1c,
- \$16 reported as gross income from fundraising events on line 8a, and
- \$8 reported as a direct expense on line 8b.

Indirect fundraising expenses (such as advertising for a fundraising event) must be reported on the appropriate line in Part IX, column D, and not on line 8b.

Step 4: Part IX – Statement of Functional Expenses (Form 990 p.10)

In completing Part IX, use the organization's normal accounting method. If the normal accounting method does not allocate expenses, use any reasonable method of allocation, but be sure the method you use is documented in your records. Also, do not report expenses reported with other revenue in Part VIII, such as rental expenses, direct fundraising, gaming expenses or the cost of goods sold.



Column A – All filers are required to complete column A, Total expenses; however, only Section 501(c)(3) and (c)(4) organizations are required to allocate expenses to columns B through D.

Column B – Enter all program service expenses. Include lobbying expenses in column B if the lobbying is directly related to exempt purposes. Also include program service expenses for unrelated trade or business activities.

Column C – Report expenses that are attributable to the management and general operations of the organization. Also, record expenses for all lobbying that is not directly related to exempt purposes. Other items that should be reported in this column include expenses associated with:

- Board of director's meetings
- Committee and staff meetings that do not directly involve a program service or fundraising activity
- General legal services
- Accounting and auditing
- Liability insurance
- Human resources
- Management of investments

Column D – Enter expenses incurred in soliciting contributions, gifts and grants. All expenses (except for direct expenses for fundraising events reported in Part VIII, line 8b), including allocable overhead costs, incurred in publicizing and conducting fundraising campaigns and events and soliciting grants from foundations or governmental units, should be reported as fundraising expenses.

Step 4: Part X – Balance Sheet (Form 990 p.11)

The balance sheet of an exempt organization is similar to the balance sheet of a for-profit entity, with one major exception. For-profit entities maintain capital or equity accounts that trace partners' or shareholders' interests in the entity. This is generally irrelevant for 501(c)(3) organizations as inurement of net earnings is prohibited and private benefit must be insubstantial.

All organizations must complete Part X; a substitute balance sheet will not be accepted.

In column A, enter the amounts from the previous year's column B. If the organization was not required to file a Form 990 the previous year, enter the amounts that the organization would have entered in column B had it been required to file the previous year. If the organization is in its first year of existence, enter zeros on lines 16, 26, 33 and 34 in column A. If the organization is making a final return, enter zeros on lines 16, 26, 33 and 34 in column B.

Step 5: Item G

Go back to the heading on page 1 and complete item G, Gross receipts. The instructions tell you which lines of Part VIII to add to compute gross receipts.

Step 6: Part III – Statement of Program Service Accomplishments (Form 990 p.2)

The statement of program service accomplishments allows the organization to tell its story – to explain its mission, describe its programs and services and trumpet its accomplishments. Organizations are encouraged to be expansive in describing program services. A staff person or administrator can create considerable goodwill for being open and candid about an organization's operations and activities.

A program service is a major activity, usually ongoing, that furthers the organization's mission.

Preparers are not limited to the spaces provided in Part III. You can also use Schedule O to continue your description. Schedule O is essentially a blank page where organizations can include information not mentioned elsewhere.



Step 6: Part V – Statements Regarding Other IRS Filings and Tax Compliance (Form 990 p.5)

The questions in Part V serve two purposes: First, they alert an organization they might have other reporting obligations and other forms to file besides Form 990. Second, they ask whether the organization is engaged in certain kinds of activities and, if so, whether it satisfied the tax law obligations that accompany these activities.

The preparer should keep the following questions and corresponding facts in mind when completing this section:

Question: Was the organization a party to a prohibited tax shelter transaction and, if so, did it file Form 8886-T? (Line 5)

Fact: An organization that is a party to a prohibited tax shelter transaction is required to file **Form 8886-T** to disclose that it is a party to such transaction, and to identify any other party to the transaction that it knows of.

Question: If it is a Section 501(c)(3) or other sponsoring organization maintaining a donor advised fund or a supporting organization, did the organization or the fund have excess business holdings? (Line 8)

Fact: Donor advised funds and certain supporting organizations are treated as private foundations for the purposes of the Section 4943 excise tax on excess business holdings and, consequently, must indicate whether they had excess business holdings at any time during the year.

Question: Did the organization make any taxable distributions under Section 4966? (Line 9a)

Fact: Any distribution from a donor advised fund to an individual – whether a grant, reimbursement, payment of compensation for services or other distribution – is subject to an excise tax under Section 4966. Sponsoring organizations and fund managers liable for the tax must file **Form 4720**.

Question: Did the organization make distributions to a donor, donor advisor or related person under Section 4967? (Line 9b)

Fact: If an organization makes a distribution from a donor advised fund on the advice of a donor, donor advisor, family member or 35 percent controlled entity of any of the above persons, and the distribution directly or indirectly benefits one of these persons, Section 4967 imposes a tax on the person upon whose advice the distribution was made, the beneficiary of the distribution and a fund manager for knowingly agreeing to make the distribution. The persons liable for the Section 4967 tax must file Form 4720 to pay the tax.

Step 6: Part VII – Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees and Independent Contractors (Form 990 p.7)

“Current” refers to any time during the tax year for which the return is being filed. For additional information, see definitions of officers, directors, trustees, key employees and highest compensated employees listed in Step 3 of the Sequencing List, above.

Section A requires organizations to list the name and title of:

- Every current officer, director and trustee of the organization, even those that received no compensation during the tax year.
- Current key employees – those persons, other than officers, directors and trustees, who: (a) had reportable compensation exceeding \$150,000 from the filing organization and related organizations for the calendar year ending with or within the organization’s tax year (the \$150,000 test); (b) had or shared organization-wide control or influence similar to that of an officer, director or trustee, or managed or had authority or control over at least 10 percent of the organization’s activities (the responsibility test); and (c) were within that group of the organization’s top 20 highest paid persons for the year who satisfied both the \$150,000 test and the responsibility test described in (a) and (b).
- The five highest compensated current employees, not including persons already identified as an officer, director, trustee or key employee, and not including any employee who received \$100,000 or less of reportable compensation from the organization and any related organizations. To determine the five highest compensated employees, consider only the amount of compensation paid in the calendar year ending with or within the organization’s tax year.
- Any former officer, key employee or highest compensated employee who received more than \$100,000 of reportable compensation in the calendar year ending with or within the organization’s tax year from the organization and any related organizations.



- Any former director or trustee who received, for services provided in that person's former capacity as director or trustee, more than \$10,000 of reportable compensation in the calendar year ending with or within the organization's tax year from the organization and any related organizations.

For purposes of Part VII, "former" refers only to individuals that the organization reported (or should have reported) in any of the above-mentioned categories in one or more of its information returns for the previous five years.

For each person listed in section A, the organization must include his or her reportable compensation. The reportable compensation of officers and other employees is generally the amount reported in box 5 of Form W-2. The reportable compensation of directors and trustees is generally the amount reported in box 7 of Form 1099-MISC.

All organizations are required to report compensation for the calendar year ending with or within their fiscal year and should use amounts reported on Form W-2 or Form 1099-MISC for that calendar year. In addition, organizations must report an estimate of other compensation, including deferred compensation not currently reportable on Form W-2 or Form 1099-MISC and nontaxable benefits such as health benefits, retirement plan benefits and other nontaxable fringe benefits, but excluding certain working condition and fringe benefits.

The instructions to Part VII include a table that explains whether to report and where to report items of compensation and benefits in Part VII, Section A and Schedule J.

Part VII, Section B requires organizations to list the five highest compensated independent contractors that received more than \$100,000 in compensation from the organization for services during the calendar year ending with or within the tax year, whether or not the organizations issue Forms 1099 to those contractors. Section B also requires descriptions of the services provided and listing of the amounts paid to each contractor. "Independent contractors" can be corporations or other entities as well as individuals who are not employees, and include management companies, lawyers, accountants and professional fundraisers that provide services to the organization.

Step 6: Part XI - Reconciliation of Net Assets (Form 990 p.12)

Part XI asks filers to reconcile their beginning-of-year and end-of-year net assets.

Step 6: Part XII - Financial Statements and Reporting (Form 990 p.12)

Part XII is short and straightforward. Its primary purpose is to capture the organization's financial oversight process. Specifically, it asks the organization to disclose the extent to which it used an independent accountant for compilation, review or audit of its financial statements.

An organization with substantial assets or revenue should consider obtaining an audit of its financial statements by an independent auditor. It should also consider establishing an independent audit committee to select the independent auditor and review its performance.

Step 7: Schedule L

Read the instructions to Schedule L, *Transactions with Interested Persons*, and complete some or all parts of the schedule to the extent required. Transactions reportable on Schedule L include:

- Excess benefit transactions involving a 501(c)(3) or 501(c)(4) organization and a disqualified person
- Loans that any type of filing organization makes to, or receives from, an "interested person" (which includes current and former directors, officers, trustees, key employees and highest compensated employees)
- Grants or similar economic assistance provided by an organization to any interested person
- Direct and indirect business transactions between an organization and any interested person (which includes current and former officers, directors, trustees, key employees, their family members and entities they own or control) during the tax year

If any member of the organization's governing body was involved in a financial transaction that should be reported, complete Schedule L before you start on Part VI of the core form. At a minimum, you will need to know the number of governing body members involved in transactions reportable on Schedule L so you can answer line 1b of Part VI regarding independence of governing body members.



Step 8: Part VI – Governance, Management and Disclosure Overview (Form 990 p.6)

The questions in Part VI reflect the IRS's interest in learning about the governance policies and practices of exempt organizations. The IRS believes an organization with an articulated mission, a knowledgeable and dedicated governing body and management team, and sound managerial and financial practices is best equipped to comply with the tax laws, safeguard its assets and succeed in its mission.

Because Form 990 is one of the principal vehicles by which the IRS and the public learn about the organization and its activities, the governing body of the organization should consider reviewing the organization's Form 990 before it is filed.

Part VI is divided into three sections, which capture the organization's management structure, policies and disclosure practices.

Step 8: Part VI – Governance, Management and Disclosure – Section A (Form 990 p.6)

Section A concerns the governing body – the group of persons authorized under state law to exercise ultimate control of the organization. The governing body of a corporation or association is its board of directors; the governing body of a trust is its trustees. Directors are encouraged to actively oversee the management of their organization, stay informed about its activities and financial status and avoid actions or situations that are incompatible with an obligation to act solely in the best interests of the organization.

Line 1 asks for the number of voting members on the governing body of the organization (for example, director, trustee). It then asks how many voting members are independent. "Independent" means the director:

- Was not compensated as an officer or employee of the organization or of a related organization,
- Did not receive total compensation or other payments exceeding \$10,000 from the organization and related organizations as an independent contractor, other than reasonable compensation for services provided in his or her capacity as a director, and
- Was not involved (nor were any of the director's family members involved) in a transaction with the organization or a related organization that is reportable on Schedule L (or would be reportable on Schedule L if filed by the related organization).

No matter the size, a governing board generally shouldn't be dominated by individuals with family or business relationships. Independent board members are important because their presence increases the likelihood that decisions will be made in the best interests of the organization and the community it serves, rather than the best interests of the individuals on the board.

Other questions in Section A inquire about business and family relationships between and among the organization's officers, directors, trustees and key employees, whether and what control is exercised over the organization by governing members and whether the organization contemporaneously documented its board and committee meetings and actions.

An important part of governance is transparency, which includes public disclosure of internal fraud or criminal activity. Line 5 asks if, during the reporting year, the organization became aware of a significant diversion of its assets, such as by fraud or embezzlement, whether the diversion occurred during the year or earlier. A diversion is considered material if the gross value of all diversions (not taking into account restitution, insurance or similar recoveries) discovered during the organization's tax year exceeds the lesser of:

- Five percent of the organization's gross receipts for its tax year,
- Five percent of the organization's total assets as of the end of its tax year, or
- \$250,000.

Step 8: Part VI – Governance, Management and Disclosure – Section B (Form 990 p.6)

The questions in Section B ask whether the organization has adopted certain governance policies or procedures, such as a conflict of interest policy, a whistleblower policy, a document retention and destruction policy, a joint venture policy and a process for determining executive compensation. While the adoption of these policies isn't mandated, the IRS nevertheless encourages exempt organizations to consider the merits of implementing these or similar policies and procedures to promote compliance with federal tax-exempt law and to minimize the risk of non-compliance.



Step 8: Part VI – Governance, Management and Disclosure – Section C (Form 990 p.6)

Section C involves organizational disclosure. More specifically, it asks organizations to explain what information they make available to the public and how they make it available.

An exempt organization is required to make a copy of its exemption application (Form 1023 or 1024) and its three most recent Form 990-series returns available for public inspection during normal business hours at its principal office and at its regional or district offices, and to provide copies of these forms upon request or make them publicly available (for example, on the organization's website).

Organizations are encouraged to establish procedures to ensure that the forms are made available to the public upon request. Appendix D of the instructions explains the public inspection requirements in more detail. [Chapter 10](#) offers more information on disclosure.

Step 9: Part I – Summary (Form 990 p.1) and Part IV – Checklist of Required Schedules (Form 990 p.3)

Although the summary is located at the beginning of the form, it should be one of the last pieces of the core form that you complete because it requires you to provide key financial, governance and operational information from other parts of the form as well as from the prior tax year.

Complete Part IV, *Checklist of Required Schedules*, to determine which schedules or parts of schedules you need to complete.

Step 10: Schedules to Complete

Complete any schedules or parts of schedules you need to complete after answering the questions in Part IV.

Step 11: Part II, Signature (Form 990 p. 1)

Complete Part II of Form 990, Signature Block.

Schedule A – Public Charity Status and Public Support

What? [Schedule A](#) collects information about an organization's public charity status and public support.

Who? If you are a Section 501(c)(3) organization and you file a Form 990 or 990-EZ, you must also file Schedule A. Non-501(c)(3) organizations should not file Schedule A.

How? Schedule A contains two separate support schedules:

- The support schedule in Part II is used to compute the public support of charities under Sections 509(a)(1) and 170(b)(1)(A)(vi).
- The support schedule in Part III is used to compute the public support of charities under Section 509(a)(2).

Both support schedules feature a five-year testing period, which includes the current tax year.

In completing Schedule A, you must use the same accounting method you used to complete the core form (the method you checked in Part XII, line 1 of the core form, whether cash or accrual).

Schedule B – Schedule of Contributors

What? [Schedule B](#) provides information on certain contributors of contributions the organization reported on line 1 of Form 990, Part VIII or Form 990-EZ, Part I.

Who? All organizations must attach a completed Schedule B to their Form 990 or 990-EZ unless they certify that they do not meet the filing requirements of Schedule B by checking the "No" box on Form 990, Part IV, line 2 or Box H in the heading of Form 990-EZ.



An organization is required to file Schedule B if it is:

- A Section 501(c)(3) organization that met the 33⅓ percent support test under Sections 509(a)(1) and 170(b)(1)(A)(vi) and received one or more contributions that exceeded the greater of \$5,000 or 2 percent of the amount on line 1h of Form 990, Part VIII from any one contributor;
- A Section 501(c)(3) organization that did not meet the 33⅓ percent support test under Sections 509(a)(1) and 170(b)(1)(A)(vi) and received one or more contributions of \$5,000 or more from any one contributor;
- A Section 501(c)(7), (8) or (10) organization that received during the tax year:
 - a. contributions of any amount for use exclusively for religious, charitable, literary or educational purposes, or for prevention of cruelty to children or animals; or
 - b. contributions of \$5,000 or more not exclusively for such purposes from any one contributor; or
- Any other organization that received, during the year, a contribution of \$5,000 or more from any one contributor.

How? Part I asks for the name and address of the contributor, the aggregate amount of the contribution and the type of contribution. Noncash contributions must be described and a fair market value stated, in Part II.

Except for Section 527 political organizations, an organization may elect not to disclose the names and addresses of contributors listed on Schedule B when making its Form 990 available for public inspection.

Contributor

“Contributor” includes individuals, fiduciaries, partnerships, corporations, associations, trusts, tax-exempt organizations and government units.

Schedule D – Supplemental Financial Statements

Schedule D is a collection of financial statements to supplement the financial reporting on Part X of the core form, including reporting of donor advised funds, conservation easements, escrow accounts, endowment funds, and art and museum collections. Other information on Schedule D had previously been solicited as statements whose layouts were left largely to the discretion of each filer. Schedule D places these statements in a single schedule and gives each a consistent format.

Schedule M – Noncash Contributions

Schedule M is devoted exclusively to the reporting of noncash contributions. It must be completed by any organization that reported more than \$25,000 of aggregate noncash contributions during the year in Part VIII, line 1g of the core form or that received contributions of art, historical treasures or qualified conservation contributions. Schedule M requires reporting of all noncash contributions, not just charitable contributions deductible under Code Section 170, made to any organizations required to file Schedule M, not just those organizations eligible to receive tax-deductible contributions.

Note: Schedule M reports the types of noncash contributions received during the year. There are 24 different types of property listed on separate lines in Part I of the schedule with four additional lines to add types that are not specifically listed in lines 1–24.

Do Not Disclose Social Security Numbers - Avoid Identity Theft

The IRS generally doesn't ask organizations for SSNs and in the form instructions cautions filers not to provide them on the form. By law, both the IRS and most tax-exempt organizations are required to publicly disclose most parts of form filings, including schedules and attachments. Public release of SSNs and other personally identifiable information about donors, clients or benefactors could give rise to identity theft.

The IRS also urges tax-exempt organizations to file forms electronically to reduce the risk of inadvertently including SSNs or other unneeded personal information. Details are on [IRS.gov](https://www.irs.gov).

Tax-exempt forms that must be made public by the IRS are clearly marked “Open to Public Inspection” in the top right corner of the first page. These include Form 990, 990-EZ, 990-PF and others.



Resources

IRS.gov/EO

While the Form 990 instructions are an effective resource, there are many other **resources** available to help you ensure that your form is properly completed.

EO Life Cycle

During its existence, a public charity has numerous interactions with the IRS – from filing an application for recognition of tax-exempt status, to filing the required annual information returns, to making changes in its mission and purpose. The IRS provides information, explanations, guides and forms and publications on all of these subjects.

EO Update

Subscribe to Exempt Organizations' EO Update, a periodic newsletter with information for tax-exempt organizations and tax practitioners who represent them.

StayExempt Website

StayExempt is an educational micro-site for 501(c)(3) organizations. It offers a “Virtual Workshop covering the tax basics,” mini-courses on other topics of interest to exempt organizations, a large FAQs section, a glossary and links to related forms and publications.

For More Information

- **Form 990**, *Return of Organization Exempt from Income Tax*
- **Form 990-EZ**, *Short Form Return of Organization Exempt from Income Tax*
- **Instructions** for Form 990
- **Instructions** for Form 990-EZ
- **Schedule A**, *Public Charity Status and Public Support*
- **Schedule B**, *Schedule of Contributors*
- **Schedule D**, *Supplemental Financial Statements*
- **Schedule M**, *Noncash Contributions*
- **Schedule O**, *Supplemental Information*
- **Form 990-N**, *Electronic Notice (e-Postcard) for Tax-Exempt Organizations not Required to File Form 990 or 990-EZ*
- **Form 8868**, *Application for Extension of Time to File an Exempt Organization Return*



Exhibit E



Annual Form 990 Filing Requirements for Tax-Exempt Organizations

Forms 990, 990-EZ, 990-PF and 990-N (e-Postcard)

Most tax exempt organizations, are required to file annual information forms with the IRS. Forms include the Form 990, 990-EZ, 990-PF or the 990-N (e-Postcard). Filing the form is necessary to maintain an organization's tax-exempt status. (For more information, see "Organizations Not Required To File Form 990 or 990-EZ" in the instructions for Form 990.)

Which Form to File

The size and type of tax-exempt organization determines which annual information form the organization must file.

Smaller tax-exempt organizations with annual gross receipts of \$50,000 or less may file the Form 990-N (e-Postcard). This notice, which must be electronically filed, asks for only a few basic pieces of information: the organization's taxpayer identification number, its tax period, legal name and mailing address, any other names used, an Internet address if one exists, the name and address of a principal officer and a statement confirming that the organization's annual gross receipts are normally \$50,000 or less.

These organizations also have the option of using Form 990-EZ or 990 if they prefer, as long as they complete the entire form. Most supporting organizations cannot file Form 990-N.

Larger tax-exempt organizations file either the Form 990 or 990-EZ, depending on their annual gross receipts and total assets.

- Organizations with annual gross receipts less than \$200,000, and total assets less than \$500,000 can file either Form 990-EZ or Form 990.
- Organizations with gross receipts of \$200,000 or more or total assets of \$500,000 or more must file Form 990.

All private foundations must file a Form 990-PF, Return of Private Foundation.

When to File Form 990 Returns

Unlike personal income tax returns, the 990-series forms do not have a single due date. The returns are due by the 15th day of the fifth month after the close of an organization's tax year. For example, if an organization's tax year closes on December 31, its form is due by the following May 15.

Preserve Your Tax-Exempt Status

Filing required forms on time is critical. The tax-exempt status of an organization that does not timely file its required annual information form for three consecutive years will be AUTOMATICALLY REVOKED as of the due date of the third unfiled return. Revoked organizations must file Form 1120, U.S. Corporation Income Tax Return, or a Form 1041, U.S. Income Tax Return for Estates and Trusts, and may need to pay income taxes. To reapply for exemption, submit Form 1023 or Form 1024 and pay the appropriate application fee.

Although the three-year auto-revocation rule applies only to the 990-series forms, now is a good time to make sure other IRS-related filings are up-to-date, including the organization's Form 941, Employer's Quarterly Federal Tax Return, and Form 990-T, Exempt Organization Business Income Tax Return. If an organization has tax liability issues, it should consider entering into a closing agreement to resolve them.

More Information

Charities/Non-Profit page

www.irs.gov/Charities-&-Non-Profits

Free e-Newsletter

Sign up and stay informed of the latest IRS news for exempt organizations

StayExempt.irs.gov

Interactive web-based workshops and mini-courses for exempt organizations

Life Cycle

Explains how to establish and maintain an exempt organization. Select the "Life Cycle" link at www.irs.gov/Charities-&-Non-Profits

Toll-free Customer Account Services

877-829-5500



9 | Audit, Compliance and Complaint Processes

IRS Examination, Compliance Check and Complaint Processes

IRS Exempt Organizations promotes voluntary compliance through its examination and compliance check programs. EO strives to ensure consistency and fairness in these programs. Organizations are selected for reviews using a variety of methods, including:

- IRS examination initiatives and projects
- Data analytics - Risk modeling from analysis of data reported on the Form 990
- Complaints (referrals) about potential noncompliance with the tax law

See [Public Complaints Related to Alleged Abuse of Tax-Exempt Status](#) below for information on how EO handles complaints about the activities of exempt organizations.

Examinations versus Compliance Checks

A review of a tax-exempt organization falls into one of two categories: compliance checks or examinations.

Examinations, also known as audits, are authorized under Section 7602 of the Code. For exempt organizations, an examination determines an organization's qualification for tax-exempt status. EO conducts two different types of examinations: correspondence and field (described below).

A compliance check is a review to determine whether an organization is adhering to record keeping and information reporting requirements. It isn't an examination since it isn't related to the determination of a tax liability for any particular period.

EO does not presume that an organization is violating the tax laws before it begins an examination or sends a compliance check letter.

Correspondence Examination versus Field Examination

IRS examiners conduct audits of exempt organizations in various ways:

- **Correspondence examination** – The examiner conducts the audit orally or in correspondence with the organization's officers or representatives. These audits are often limited in scope, focusing on only one or two items on a return. On occasion, if the issues become complex or if the organization does not respond to correspondence efforts, EO may require representatives from the organization to bring their records to an IRS office. EO may also convert a correspondence examination into a field examination.
- **Field examination** – The examiner conducts the audit at the organization's place of business. Generally, these exams are the most comprehensive.

There are two distinct types of EO field examinations:

1. EO Team Examination Program for examinations which necessitate a team of specialists.
2. EO General Program, in which an examination is performed by an individual revenue agent.

The IRS typically uses team exams for the largest exempt organizations.

Initial Contact by the IRS

For field audits, the agent assigned to examine an organization will contact it by telephone or letter to schedule an initial appointment. The organization will receive [Publication 1, Your Rights as a Taxpayer](#), with the appointment letter.

The IRS has adopted a [Taxpayer Bill of Rights](#), which groups the dozens of existing rights in the Internal Revenue Code into ten fundamental rights, and makes these rights more clear, more understandable, and more quickly available to taxpayers.



Records for Field Examination

In the appointment letter, the examiner will specify the records he or she wants to have available at the beginning of the audit. These generally include:

- Governing instruments (articles of incorporation, charter or constitution, including all amendments; bylaws, including all amendments)
- Pamphlets, brochures and other printed literature describing the organization's activities
- Copies of Forms 990 for the years before and after the year under audit

In addition, the examiner will generally request the following information for the year under examination (at a minimum):

- Minutes of meetings of the board of directors and standing committees or councils
- All books and records of assets, liabilities, receipts and disbursements
- Auditor's report, if any
- Copies of other federal tax returns filed and any related work papers (Forms 990-T, 1120-POL, etc.)
- Copies of employment tax returns and any related work papers (Forms W-2, W-3, 941, 1096, 1099)

Many of these records may also be required for a correspondence examination.

Field Examination Opening Conference and Initial Interview

During an opening conference with the organization's officers or representatives, the examiner will explain the audit plan he or she has developed and the reason the organization has been selected for audit.

The examiner will usually conduct a comprehensive interview and tour the organization's facilities to gain a basic understanding of its purposes and activities.

Length of Field Examinations

The length of the examination depends upon several factors including the size of the organization, the complexity of its activities and the issues that may arise during the examination. Some audits are completed in a few days, while others last for weeks or months.

Field Examination Closing Conference

Every field examination ends with a closing conference. The agent will discuss the audit findings with the organization officials and its representatives and, if necessary, furnish a report explaining the examination results and any proposed adjustments to the organization's returns or exempt status.

If the organization disagrees with the examiner's findings, it may request a meeting with the examiner's manager to discuss the disagreement. If the manager cannot resolve the differences, the organization may pursue its case through the IRS appeals process.

For more information, see [Publication 5](#), *Your Appeal Rights and How to Prepare a Protest If You Don't Agree*, or [Publication 892](#), *How to Appeal an IRS Decision on Tax-Exempt Status*.



Compliance Checks

EO uses compliance checks to help educate organizations about their reporting requirements and to increase voluntary compliance. Compliance checks are intended to determine whether specific items have been reported properly or whether an organization's activities are consistent with its stated exempt purpose. Compliance checks are an accountability tool but are simpler, less burdensome and more limited in scope than examinations. EO specialists conduct the checks by corresponding with organization representatives.

An officer or representative of any exempt organization may refuse to participate in a compliance check without penalty. However, EO has the option of opening a formal examination, whether or not the organization agrees to participate in a compliance check. Because a compliance check is not an examination it is possible to have more than one compliance check for a tax year if facts and circumstances warrant. For more information, see [Publication 4386](#), *Compliance Checks*.

Public Complaints Related to Alleged Abuse of Tax-Exempt Status

The IRS gives serious consideration to complaints made alleging the abuse of the tax-exempt status granted to certain organizations.

A complaint (also called a referral) is any communication alleging that a tax-exempt organization is in potential noncompliance with the tax law. EO receives complaints from the general public, members of Congress, federal and state governmental agencies, as well as from other parts of the IRS. A referral of an exempt organization may be made by submitting [Form 13909](#), *Tax-Exempt Organization Complaint (Referral) Form*.

After a referral is made, the IRS will send an acknowledgement letter to the referral source unless it was made anonymously. Code Section 6103 prohibits the IRS from disclosing whether it has initiated an examination or the results of any examination. Therefore, the IRS can't communicate with the original source of a referral beyond the acknowledgement letter. For details on the review process, see [Fact Sheet 2008-13](#).

For More Information

- [Fact Sheet 2008-13](#), *IRS Complaint Process for Tax-Exempt Organizations*
- [Fact Sheet 2008-14](#), *Examination and Compliance Check Processes for Exempt Organizations*
- [Form 13909](#), *Tax-Exempt Organization Complaint (Referral) Form*
- [Publication 1](#), *Your Rights as a Taxpayer*
- [Publication 5](#), *Your Appeal Rights and How to Prepare a Protest If You Don't Agree*
- [Publication 892](#), *How to Appeal an IRS Decision on Tax-Exempt Status*
- [Publication 4386](#), *Compliance Checks*



10 | Required Disclosures

The majority of exempt organizations must disclose to the IRS or the public certain information about their activities. An organization discloses this information by entering it on the appropriate lines of its annual information return. Separate rules govern disclosures relating to quid pro quo contributions and the sale of government information or services that are available for free. In addition, donors must have a written acknowledgment to claim a charitable deduction for certain donations. Exempt organizations may provide these, although they are not required.

Public Inspection and Copying of Annual Returns and Exemption Applications

An exempt organization must make its exemption application, annual information returns and Forms 990-T (501(c)(3) organizations only) available for public inspection. Anyone may request them during regular business hours at the organization's principal business office and also at the organization's regional or district offices, providing they have three or more employees.

The organization must provide a copy without charge, other than a reasonable fee for reproduction and postage costs, of all or any part of any application or return. Organizations may place reasonable restrictions on the time, place and manner of in-person inspection and copying.

Annual Information Returns

An exempt organization must disclose its annual information return (Form 990 series) with schedules, attachments and supporting documents filed with the IRS. An organization need not disclose the names and addresses of contributors, but all other information, including the amount of contributions, the description of noncash contributions and any other information, is releasable unless it identifies the contributor. An organization must make its annual information return available for a period of three years beginning on the date the return is required to be filed or is actually filed, whichever is later.

Additional information on information returns can be found in [Chapter 8](#).

Annual Business Income Tax Return

A 501(c)(3) organization is required to disclose its unrelated business income tax returns (Form 990-T).

Exemption Application

An organization must disclose its exemption application (Form 1023 or 1024) along with:

- All documents submitted with Form 1023 or Form 1024
- All documents the IRS requires the organization to submit in support of its application
- The exemption ruling letter issued by the IRS

Public Inspection of Application for Exemption for a Subordinate Organization

If a subordinate organization covered by a group ruling receives a request for inspection of its application for exemption and supporting materials, it must make available a copy of documents submitted to the IRS by the parent organization within a reasonable amount of time.

Anyone may also ask to see the documents at the parent organization's principal office.

Public Inspection of Annual Returns for a Subordinate Organization

A subordinate organization that doesn't file its own Form 990 must acquire a copy of the group return filed on its behalf by the parent organization and make the material available to anyone in a reasonable amount of time.

Anyone may ask to inspect the group return at the principal office of the parent organization, as well.



Information that may be Withheld from Public Inspection

Information that may be withheld from public inspection includes:

- Information relating to a trade secret, patent, style of work or apparatus that, if released, would adversely affect the organization (requires prior approval by the IRS to withhold)
- Information that would adversely affect the national defense (requires prior approval by the IRS to withhold)
- Unfavorable rulings or determinations
- Rulings or determination letters revoking or modifying a favorable determination letter
- Certain other memoranda or letters filed with or issued by the IRS

See [Publication 557](#), *Tax-Exempt Status for Your Organization*, for details.

Organizations Without Permanent Offices

An organization must allow anyone to inspect its application for exemption or annual returns at a reasonable location of the organization's choice. It should occur within a reasonable amount of time (normally not more than two weeks) and at a reasonable time of day. The organization may opt to mail a copy of the application or return in lieu of allowing an inspection within two weeks of receiving the request.

The same rule applies to organizations that maintain a permanent office that has no office hours or very limited hours during certain times of the year.

Making Applications and Returns Widely Available

An exempt organization does not have to comply with requests for copies of its annual return, Form 990-T and exemption applications if it makes them widely available. However, making these documents available does not relieve the organization from providing its documents for public inspection.

The organization can make its application and returns widely available by posting the application and returns on the Internet. The organization must notify any individual requesting a copy where the documents are available, including the Web address, if applicable.

For requests made in person, the notice must be provided immediately. For requests made in writing, the notice must be provided within seven days.

Penalties for Failure to Comply with Public Inspection Requirements

A person who fails to make an annual return available for inspection must pay a penalty of \$20 for each day the failure continues, up to \$10,000 per return.

For the exemption application, the penalty is \$20 per day, with no limit on the total amount of the penalty. No penalty will be imposed if the failure is due to reasonable cause.

Any person who willfully delivers or discloses a fraudulent return or materially false statements to any IRS official or employee must either pay a penalty of up to \$10,000 or be imprisoned for a maximum of one year, or possibly be subject to both. Additionally, any person who fails to comply with the public inspection requirement for any return or application will pay a penalty of \$5,000 for each such return or application, or copies of such.



Multiple Requests for Documents

An organization may receive a series of requests for documents that the organization believes are intended to disrupt its operation rather than to be for the collection of information. Under certain circumstances, the organization may be able to disregard some of the requests.

Harassment campaign

If an organization believes it's the subject of a harassment campaign, it can ask the IRS for a ruling that would allow it to disregard the requests. A harassment campaign involves a group of requests for publicly available documents that are made by several individuals or groups as part of a single coordinated effort with the intent to disrupt an exempt organization's operations. In making its ruling, the IRS will look at the facts and circumstances. [Revenue Procedure 2015-4](#) (updated annually) explains how to request a ruling.

Multiple requests from a single individual or address for the same document or part of the same document

If an organization receives multiple requests for copies of all or part of a document from the same individual or same address, the organization may be able to disregard some of the requests without getting a ruling from the IRS.

- For requests for all or some of the same document received during a 30-day period, after the first two requests have been received and responded to, the organization can disregard additional requests for the same information received during the 30-day period.
- For requests for all or some of the same document received within a one-year period, after the first four requests have been received and responded to, the organization can disregard additional requests for the same information received during the one-year period.

Quid Pro Quo Contributions

A quid pro quo contribution may only be deducted to the extent that the contribution exceeds the fair market value of the goods or services the donor receives in return for the contribution.

If an organization receives a quid pro quo contribution in excess of \$75, the organization must provide a written statement that:

- Informs the donor of the rule on deductibility
- Provides the donor with a good-faith estimate of the fair market value of the goods or services

Example: A donor gives a charitable organization \$100 in exchange for a concert ticket with a fair market value of \$40. The donor's tax deduction may not exceed \$60. Because the donor's payment exceeds \$75, the charitable organization must furnish a disclosure statement to the donor, even though the deductible amount does not exceed \$75.

Exceptions to Written Disclosure

A written disclosure statement is not required:

- Where the goods or services given to a donor meet the "token exception," the "membership benefits exception" or the "intangible religious benefits exception" described on pages 74 and 75.
- When there is no donation involved, such as in a typical museum gift shop sale

Written Disclosure: Penalty

Charities are penalized for not meeting the written disclosure requirement involving quid pro quo contributions. The penalty is \$10 per contribution, not to exceed \$5,000 per fundraising event or mailing. An organization may avoid the penalty if it can show reasonable cause.



Disclosure or Sale of Information or Services Available Free From the Government

If an exempt organization offers to sell goods or services that are available for free from the federal government, the organization must disclose that fact in a conspicuous and easily recognized format.

An organization will be penalized if it fails to comply with this requirement, particularly if the failure is intentional. The penalty is the greater of \$1,000 for each day the failure occurred, or 50 percent of the total cost of all offers and solicitations that were made by the organization the same day that it failed to meet the requirement. See [Notice 88-120](#) for further guidance.

Substantiation of Contributions

An organization has no disclosure requirements for cash or noncash contributions for which the organization provides no goods or services in return.

However, a donor must obtain a written acknowledgement from a charity for any single contribution of \$250 or more before the donor can claim a charitable contribution on his or her federal income tax return.

Cash Contributions

A donor cannot claim a tax deduction for any contribution of cash, check or other monetary gift made on or after January 1, 2007, unless the donor maintains a record of the contribution in the form of either a bank record (such as a canceled check) or a written communication from the charity (such as a receipt or a letter) showing the name of the charity and the date and amount of the contribution.

Vehicle Donations

If a donor contributes a motor vehicle, boat or airplane with a claimed value of more than \$500, the recipient organization must furnish a written acknowledgment of the contribution using [Form 1098-C](#), *Contributions of Motor Vehicles, Boats, and Airplanes*. Otherwise, the donor cannot claim a deduction of more than \$500. See the Instructions for Form 1098-C, or [Publication 4302](#), *A Charity's Guide to Vehicle Donations*, for more information.

Written Acknowledgement: Requirements

A donor can't claim a tax deduction for any single contribution of \$250 or more unless the donor obtains a contemporaneous, written acknowledgment of the contribution from the recipient organization. Although it's a donor's responsibility to obtain a written acknowledgment, an organization can assist a donor by providing a timely, written statement containing:

- Name of organization
- Amount of cash contribution
- Description (but not the value) of noncash contribution
- Statement that no goods or services were provided by the organization in return for the contribution, if that was the case
- Description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution
- Statement that goods or services consisted entirely of intangible religious benefits, if that was the case

It isn't necessary to include either the donor's SSN or TIN on the acknowledgment. A separate acknowledgment may be provided for each single contribution of \$250 or more, or one acknowledgment, such as an annual summary, may be used to substantiate several single contributions of \$250 or more.

There are no IRS forms for the acknowledgment. Letters, postcards or computer-generated forms are acceptable. An organization can provide either a paper copy or an email addressed to the donor.

A donor should not attach the acknowledgment to his or her individual income tax return, but must retain it to substantiate the contribution. Separate contributions of less than \$250 won't be aggregated. An example of this could be weekly offerings to a donor's church of less than \$250, even though the donor's annual total contributions are \$250 or more.



Written Acknowledgement: Contemporaneous Defined

Recipient organizations typically send written acknowledgments to donors no later than January 31 of the year following the donation. A donor must receive the acknowledgment by the earlier of the date on which the donor actually files his or her individual federal income tax return for the year of the contribution, or the due date (including extensions) of the return.

Written Acknowledgement: Describing Goods and Services

The acknowledgment must describe goods or services an organization provides in exchange for a contribution of \$250 or more. It must also provide a good faith estimate of the value of the goods or services. A donor must generally reduce the amount of the contribution deduction by the fair market value of the goods and services provided by the organization. Goods or services include cash, property, services, benefits or privileges.

Goods and Services - Token Exception

Insubstantial goods or services don't have to be described in the acknowledgment. Goods and services are considered to be insubstantial if the payment occurs in the context of a fundraising campaign in which a charitable organization informs the donor of the amount of the contribution that is deductible, and the:

- Fair market value of the benefits received does not exceed the lesser of 2 percent of the payment or \$105 (for tax year 2015).
- Payment is at least \$52.50 (for tax year 2015), the only benefits received in connection with the payment are token items bearing the organization's name or logo (for example, calendars, mugs or posters), and the cost of all the benefits in the aggregate, are within the limits for low-cost articles, which is \$10.50 (for tax year 2015). The low-cost amount is set annually.

Free, unordered, low-cost articles are also considered insubstantial.

Example: If a charitable organization gives a coffee mug bearing its logo and costing the organization \$10.50 or less to a donor who contributes \$52.50 or more, the organization may state that no goods or services were provided in return for the contribution. The contribution is deductible.

Goods and Services - Membership Benefits Exception

An annual membership benefit is also considered to be insubstantial if it is provided in exchange for an annual payment of \$75 or less and consists of annually recurring rights or privileges, such as:

- Free or discounted admissions to the charitable organization's facilities or events
- Discounts on purchases from the organization's gift shop
- Free or discounted parking
- Free or discounted admission to member-only events sponsored by an organization, where a per-person cost (not including overhead) is within the low-cost articles limits

Example: If a charitable organization offers a \$75 annual membership that allows free admission to all of its weekly events, plus a \$20 poster, a written acknowledgment need only mention the \$20 value of the poster, since the free admission would be considered insubstantial.



Intangible Goods and Services - Religious Benefits Exception

If a religious organization provides only intangible religious benefits to a contributor, the acknowledgment doesn't need to describe or value those benefits. It can simply state that the organization provided intangible religious benefits to the contributor.

Intangible religious benefits are those provided by a tax-exempt organization operated exclusively for religious purposes and are not usually sold in commercial transactions outside a gift context.

Examples include admission to a religious ceremony and a de minimis tangible benefit, such as wine used in a religious ceremony. Benefits that don't count as intangible religious benefits include education leading to a recognized degree, travel services and consumer goods.

Written Acknowledgement: Payroll Deductions

When a donor makes a single contribution of \$250 or more by payroll deduction, the donor doesn't need an acknowledgment. But if the donor's employer withheld \$250 or more from a single paycheck, the donor must keep:

- A pay stub, Form W-2, *Wage and Tax Statement*, or other document furnished by the employer that proves the amount withheld
- A pledge card or other document that states the organization does not provide goods or services in return for any contribution made to it by payroll deduction

The donor must also keep these records for any contribution by payroll deduction, regardless of amount. The pledge card or other document must include the statement regarding goods and services only if the employer withheld \$250 or more from a single paycheck.

Written Acknowledgement: Unreimbursed Expenses

If a donor makes a single contribution of \$250 or more in the form of unreimbursed expenses (for example, out-of-pocket transportation expenses incurred to perform donated services for an organization), then the donor must obtain a written acknowledgment from the organization containing:

- A description of the services provided by the donor,
- A statement of whether the organization provided goods or services in return for the contribution,
- A description and good faith estimate of the value of goods or services, if any, that the organization provided in return for the contribution, and
- A statement that goods or services consisted entirely of intangible religious benefits, if that was the case.

In addition, the donor must maintain adequate records of the unreimbursed expenses.

Example: A representative attending an annual convention of a charitable organization purchases an airline ticket to travel to the event. The organization doesn't reimburse the delegate for the \$500 ticket. The representative should keep a record of the expenditure, such as a copy of the ticket. The representative should also request that the organization produce a description of the services that the representative provided and a statement that the representative received no goods or services in return.



Examples of Written Acknowledgements

The following are examples of written acknowledgements:

- “Thank you for your cash contribution of \$300 that (organization’s name) received on December 12, 2015. No goods or services were provided in exchange for your contribution.”
- “Thank you for your cash contribution of \$350 that (organization’s name) received on May 6, 2015. In exchange for your contribution, we gave you a cookbook with an estimated fair market value of \$60.”
- “Thank you for your contribution of a used oak baby crib and matching dresser that (organization’s name) charity received on March 15, 2015. No goods or services were provided in exchange for your contribution.”

The following is an example of a written acknowledgment where a charity accepts contributions in the name of one of its activities:

- “Thank you for your contribution of \$450 to (organization’s name) made in the name of its Special Relief Fund program. No goods or services were provided in exchange for your contribution.”

No Penalty

An organization that does not acknowledge a contribution (other than a quid pro quo contribution greater than \$75 — see page 72, “Written Disclosures”) incurs no penalty; but without a written acknowledgment, the donor cannot claim the tax deduction.

Written Acknowledgement: Contributions of Motor Vehicles, Boats and Airplanes

A donor may not claim a deduction greater than \$500 for contributing a motor vehicle, boat or airplane unless the organization provides the donor with a properly completed **Form 1098-C**, *Contributions of Motor Vehicles, Boats and Airplanes*, and the donor attaches a copy of the form to the income tax return on which he or she claims the deduction. If the organization sells the donated vehicle, the donor’s deduction is limited to the gross proceeds of the sale.

The organization is required to give the donor a written acknowledgement on Form 1098-C within 30 days of the sale of the vehicle. In addition, the organization must file a copy of the Form 1098-C with the IRS by March 2 (March 31, if filing electronically) of the year after the year it sends the copy of Form 1098-C to the donor.

Different rules apply if the organization makes significant intervening use or material improvement to the donated vehicle, or transfers the vehicle at significantly below fair market value to a poor or needy individual in furtherance of the organization’s charitable purposes. In those instances, the organization must give the donor a written acknowledgment on Form 1098-C within 30 days of the donation. For further information, see **Publication 4302**, *A Charity’s Guide to Vehicle Donation*.

For More Information

- **Form 1098-C**, *Contributions of Motor Vehicles, Boats and Airplanes*
- **Publication 526**, *Charitable Contributions*
- **Publication 557**, *Tax-Exempt Status for Your Organization*
- **Publication 1771**, *Charitable Contributions - Substantiation and Disclosure Requirements*
- **Publication 4221-PC**, *Compliance Guide for 501(c)(3) Public Charities*
- **Publication 4302**, *A Charity’s Guide to Vehicle Donation*
- **Instructions to Form 990**
- **Notice 88-120**



11 | Closing

Exempt Organizations and the Internal Revenue Service

The IRS promotes compliance with the tax laws governing exempt organizations. It does this:

- Through outreach and educational efforts
- By issuing rulings that apply tax laws to an exempt organization's specific set of facts
- By issuing general guidance made available to the public, including revenue procedures
- Through examinations and other compliance activities

Ways Exempt Organizations Can Get Help from the IRS

The IRS has several ways representatives of exempt organizations can get help on tax issues:

Customer Account Services

Call 877-829-5500 (toll free). Ask EO specialists general questions about exempt organizations or questions about a specific organization's account. You must have the organization's employer identification number (EIN) handy and know the organization's legal name.

For some account-specific questions, you'll need to establish your right to access the information. You must be an authorized officer or representative of the organization with power-of-attorney rights.

EO Website

Point your browser to www.irs.gov/eo for a wealth of information and how-to assistance including:

- Descriptions, rules and requirements for different types of exempt organizations
- Life cycle of an EO
- Published guidance
- Tips on how to avoid filing errors

More Ways Exempt Organizations Can Get Help from the IRS

Web-based Training

Go to www.stayexempt.irs.gov to participate in a virtual workshop or to view online mini-courses on a variety of EO topics.

Forms and Publications

Call 800-829-3676 to order free IRS publications and forms, or download them from the IRS website at www.irs.gov.

EO Update

Subscribe to this free IRS email service to receive news releases, new forms, guidance and other publications, changes and additions to the EO website and information about upcoming training and outreach events.



Appendix I | Glossary

Backup Withholding

The withholding of tax that applies to reportable prizes or payments to employees and non-employees when the recipient fails to provide a taxpayer identification number obtained by filing Form W-9.

Bingo

A game of chance played with cards that are printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a pre-selected pattern such as a horizontal, vertical or diagonal line, or all four corners. The first participant to form the pre-selected pattern wins the game.

Church

Certain characteristics are generally attributed to churches. These attributes of a church have been developed by the IRS and by court decisions. They include: distinct legal existence, recognized creed and form of worship, definite and distinct ecclesiastical government, formal code of doctrine and discipline, distinct religious history, membership not associated with any other church or denomination, organization of ordained ministers, ordained ministers selected after completing prescribed courses of study, literature of its own, established places of worship, regular congregations, regular religious services, Sunday schools for the religious instruction of the young, schools for the preparation of its ministers. The IRS uses a combination of these characteristics, together with other facts and circumstances, to determine whether an organization is considered a church for federal tax purposes. A convention or association of churches is treated like a church for federal tax purposes.

Compensation

Includes all forms of cash and noncash payments or benefits provided in exchange for services, including salary and wages, bonuses, severance payments, deferred payments, retirement benefits, fringe benefits and other financial arrangements or transactions such as personal vehicles, meals, housing, personal and family educational benefits, below-market loans, payment of personal or family travel, entertainment and personal use of the organization's property. Compensation includes payments and other benefits provided to both employees and independent contractors in exchange for services.

Conflict of Interest Policy

A policy that defines conflict of interest, identifies the classes of individuals within the organization covered by the policy, facilitates disclosure of information that can help identify conflicts of interest and specifies procedures to be followed in managing conflicts of interest. A conflict of interest arises when a person in a position of authority over an organization, such as an officer, director or manager, can benefit financially from a decision he or she could make in such capacity, including indirect benefits such as to family members or businesses with which the person is closely associated. For this purpose, a conflict of interest does not include questions involving a person's competing or respective duties to the organization and to another organization, such as by serving on the boards of both organizations, that do not involve a material financial interest of, or benefit to, such person.

Corporate Director

As classified by statute, a director of a corporation in his/her capacity as director is not an employee of the corporation.

Corporate Officer

As classified by statute, an officer of a corporation is an employee unless he or she performs no services, or only minor services, and neither receives nor is entitled to receive any remuneration, directly or indirectly.



Disqualified Person

For purposes of Section 4958, Form 990, Parts IX and X, and Schedule L (Form 990 or 990-EZ), *Transactions With Interested Persons*, Parts I and II, any person (including an individual, corporation or other entity) who was in a position to exercise substantial influence over the affairs of the applicable tax-exempt organization at any time during a five-year period ending on the date of the transaction. Persons who hold certain powers, responsibilities or interests (such as a voting member of the governing body, the president or chief executive officer, and the treasurer or chief financial officer), are among those who are in a position to exercise substantial influence over the affairs of the organization.

Employee

Under common-law rules, generally anyone who performs services for you is your employee if you can control what will be done and how it will be done. This is so even when you give the employee freedom of action. What matters is that you have the right to control the details of how the services are performed. Additionally, any individual treated as an employee under Code Section 3121(d).

To determine whether an individual is an employee or independent contractor under the common law, the relationship of the worker and the organization for whom he or she is working must be examined. All evidence of control and independence must be considered. Facts that provide evidence of the degree of control and independence fall into three categories: behavioral control, financial control and the type of relationship of the parties.

Employer Identification Number (EIN)

A nine-digit number in the format: xx-xxxxxxx that the IRS assigns. The IRS uses the number to identify taxpayers that are required to file various tax and information returns. EINs are used by employers, sole proprietors, corporations, partnerships, associations, trusts, estates of decedents, government agencies, certain individuals and other business entities.

Excess Benefit Transaction

Any transaction in which an economic benefit is provided by a 501(c)(3), (4) or (29) organization, directly or indirectly, to or for the use of a disqualified person (as defined in Code Section 4958), and the value of the economic benefit provided by the organization exceeds the value of the consideration received by the organization (including services).

Excise Tax

A tax imposed on the manufacture, sale or use of goods, on an occupation or activity, or on a disqualified person or organization manager involved in an excess benefit transaction.

Governing Body

The group of one or more persons authorized under state law to make governance decisions on behalf of the organization and its shareholders or members, if applicable. The governing body is, generally speaking, the board of directors (sometimes referred to as board of trustees) of a corporation or association, or the trustee or trustees of a trust (sometimes referred to as the board of trustees).

Gross Receipts

The gross amount the organization received from all sources without reduction for any costs or expenses. An organization should keep supporting documents that show the amounts and sources of its gross receipts.

Group Ruling (group exemption)

A ruling or determination, which is embodied in a group exemption letter, issued to a central or parent organization (generally a state, regional or national organization) that one or more subordinate organizations (usually a post, unit, chapter or local) are exempt from federal income tax by virtue of being subordinate organizations of the central or parent organization under its general supervision or control.



Highest Compensated Employee

For purposes of Form 990, one of the five highest compensated employees of the organization (including employees of a disregarded entity of the organization) other than current officers, directors, trustees or key employees, whose aggregate reportable compensation from the organization and related organizations is greater than \$100,000. The five highest compensated employees are determined by the amounts of reportable compensation they received during the calendar year ending with or within the organization's tax year.

Independent Contractor

A person who is compensated for providing services to an organization, but is not treated as an employee of that organization. Generally, a worker is an independent contractor if the employer has the right to control or direct only the result of the work done, and not the means and methods of accomplishing the result.

Insider

A person having a personal and private interest in the activities of the organization.

Inurement

The doctrine that prohibits a tax-exempt organization from engaging in any activities that will permit any of the organization's income or assets to unduly benefit a person who has some close relationship to the organization (an insider).

Key Employees

For purposes of Form 990, an employee of an organization (other than an officer, director or trustee) who meets all three of the following tests applied in the following order:

- 1. \$150,000 Test** – Receives reportable compensation from the organization and all related organizations in excess of \$150,000 for the calendar year ending with or within the organization's tax year.
- 2. Responsibility Test**
 - a. Has responsibilities, powers or influence over the organization as a whole similar to those of officers, directors or trustees;
 - b. Manages a discrete segment or activity of the organization that represents 10 percent or more of the activities, assets, income or expenses of the organization, as compared to the organization as a whole; or
 - c. Has or shares authority to control or determine 10 percent or more of the organization's capital expenditures, operating budget or compensation for employees.
- 3. Top 20 Test** – Is one of the 20 employees (that satisfy the \$150,000 Test and Responsibility Test) with the highest reportable compensation from the organization and related organizations for the calendar year ending with or within the organization's tax year.

Legislation

Includes action by Congress, any state legislature, any local council or similar governing body with respect to acts, bills, resolutions or similar items, or actions by the public in a referendum, ballot initiative, constitutional amendment or similar procedure. It does not include actions by executive, judicial or administrative bodies.

Lobbying Activities

Such activities include direct lobbying (attempting to influence the legislators) and grassroots lobbying (attempting to influence legislation by influencing the general public). A 501(c)(3) organization can engage in some lobbying, as long as it is not a substantial part of the organization's activities.



Lottery

In general, any game or method for distributing prizes among persons who have paid (or promised consideration) for a chance to win prizes, usually determined by matching the numbers or symbols on tickets to those drawn from a lottery wheel or other receptacle, or by the outcome of an event.

Officer

For purposes of Form 990, unless otherwise provided (for example, signature block in Part II, principal officer in heading), a person elected or appointed to manage the organization's daily operations, such as a president, vice-president, secretary, treasurer and, in some cases, board chair. The officers of an organization are determined by reference to its organizing document, bylaws or resolutions of its governing body, or as otherwise designated consistent with state law, but at a minimum include those officers required by applicable state law. For purposes of Form 990, treat the organization's top management official and top financial official as officers.

Pickle Jars

A form of pull-tabs that get their name from the empty pickle jars in which the cards are placed.

Political Campaign Activity

Directly or indirectly participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for elective public office. A candidate is one who offers himself or is proposed by others for public office. A Section 501(c)(3) organization is absolutely prohibited from engaging in political campaign activity. Political campaign activity does not include any activity to encourage participation in the electoral process, such as voter registration or voter education, provided that the activity does not directly or indirectly support or oppose any candidate.

Private Benefit

The doctrine that prohibits a tax-exempt organization from engaging in activities which will substantially benefit the private interest of any individual or organization.

Private Foundation

A Section 501(c)(3) tax-exempt charitable organization that does not qualify as a public charity. Generally, a private foundation is a charitable organization that is funded from one source, its ongoing funding is in the form of investment income and it makes grants for charitable purposes to other persons or organizations. There is a rebuttable presumption that a charitable entity is a private foundation.

Pull-tabs

Games in which an individual places a wager by purchasing preprinted cards that are covered with pull-tabs. Winners are revealed when the individual pulls back the sealed tabs on the front of the card and compares the patterns under the tabs with the winning patterns preprinted on the back of the card. Instant bingo, mini bingo and similar scratch-off cards are all types of pull-tabs.

Quid Pro Quo Contribution

A contribution made by a donor partially in exchange for goods or services.

Reasonable Compensation

The value that would ordinarily be paid for like services by like enterprises under like circumstances.



Related Organization

For purposes of Form 990, an organization, including a nonprofit organization, a stock corporation, a partnership or limited liability company, a trust, and a governmental unit or other government entity, that stands in one or more of the following relationships to the filing organization at any time during the tax year.

- **Parent** – an organization that controls the filing organization
- **Subsidiary** – an organization controlled by the filing organization
- **Brother/Sister** – an organization controlled by the same person or persons that control the filing organization
- **Supporting/Supported** – an organization that is (or claims to be) at any time during the organization’s tax year:
 - (i) a supporting organization of the filing organization within the meaning of Section 509(a)(3), if the filing organization is a supported organization within the meaning of Section 509(f)(3); or
 - (ii) a supported organization, if the filing organization is a supporting organization
- **Sponsoring Organization of a VEBA** – an organization that establishes or maintains a Section 501(c)(9) voluntary employees’ beneficiary association (VEBA) during the tax year
- **Contributing Employer of a VEBA** – an employer that makes a contribution or contributions to the VEBA during the tax year

The organization must determine its related organizations for purposes of completing Form 990, Parts VI (Governance), VII (Compensation), VIII (Statement of Revenue) and X (Balance Sheet); Schedule D (Form 990), Part V; Schedule J (Form 990) and Schedule R (Form 990). See instructions for those parts and schedules for related organization reporting requirements.

Religious Organization

An organization that is organized and operated exclusively for a religious purpose or purposes under Section 501(c)(3). The term includes churches as well as other organizations that do not carry out the functions of a church, such as mission organizations, speakers’ organizations, non-denominational ministries, ecumenical organizations or faith-based social agencies.

Statute of Limitations

The deadline before which an organization can amend its tax returns to claim a credit or refund and the IRS can assess additional tax.

Unrelated Trade or Business

Any regularly carried on trade or business, the conduct of which is not substantially related to the exercise or performance by the organization of its charitable, educational or other purpose or function constituting the basis for its exemption.

Volunteer

A person who serves the organization without compensation. “Compensation” for this purpose includes tips and noncash benefits, except for:

- Reimbursement of expenses under a reimbursement or other expense allowance arrangement in which there is adequate accounting to the organization,
- Working condition fringe benefits described in Section 132,
- Liability insurance coverage for acts performed on behalf of the exempt organization, and
- De minimis fringe benefits.



Wager

The amount risked by the person placing the bet, not the prize amount.

Withholding

The withholding of income tax from prizes or an employee's pay by the employer. The regular withholding rate for gaming prizes is 25 percent. Employers determine how much federal income tax to withhold from an employee's pay based on the employee's marital status, the number of withholding allowances the employee claims, any additional amount the employee wants to be withheld, and any exemptions from withholding the employee claims, as listed on Form W-4.



Appendix II | Other Information

Section A. Chapter 3 Case Studies and Answers

Case Study 1

Jane Doe founded XYZ Charity, a 501(c)(3) organization, to aid the victims of severe injuries resulting from motor vehicle accidents, stroke, drowning and other related causes. XYZ provides funds and therapeutic equipment, runs fundraising affairs and social functions to aid victims and exchanges and disseminates information concerning recent breakthroughs in care and treatment of injuries in all stages of recovery.

Jane's family has supported her efforts by financially supporting the organization and serving as members of the Board of Directors. The Doe family maintains complete control of XYZ Charity.

Wanda Doe, Jane's daughter, was the victim of a motor vehicle accident. Through the Charity, she receives services and assistance. Roughly 30 percent of the organization's income is expended for Wanda's benefit.

Q: Does this scenario show private benefit or inurement? Why?

A: This scenario shows a clear case of private inurement. The distribution of funds for the benefit of Wanda assists the Doe family in providing for her care. This relieves the family from the economic burden of providing that care. Depending on all the facts and circumstances, the agent might propose additional sanctions on the organization and/or revocation of its exemption.

Q: If there is private benefit or inurement, what could the organization have done to prevent it?

A: The organization needs to diversify the Board of Directors. By seeking new board members representing the community that XYZ serves, the organization decreases the likelihood that the Charity's assets will be used to benefit one individual or a small group of individuals. Many inurement issues may be resolved by having the organization expand its Board of Directors so that control is not concentrated within one or two families. The board should have control over salaries, contracts, distribution of benefits, etc. The organization could also formalize the selection process for recipients of their funds.

Case Study 2

Charity B was formed by parents of children attending a private school. Charity B's sole purpose is to provide bus transportation to and from the school for the members' children. The Board of Directors and all positions within the charity are filled by the parents. The parents pay an initial fee and an additional charge for each child. The organization's income equals the operation's expenses.

Q: Does this scenario show private benefit or inurement? Why?

A: This scenario shows unacceptable private benefit. When a group of individuals create an organization to provide a cooperative service for themselves, they are servicing a private interest. Under the circumstances described, by providing bus transportation for school children, the organization enables the participating parents to fulfill their individual responsibility of transporting their children to school. Depending on all the facts and circumstances, the agent might propose additional sanctions on the organization and/or revocation of its exemption.

Case Study 3

Charity C was formed to preserve a lake as a public recreational facility and to improve the condition of the water in the lake to further enhance its recreational features. The lake is large and borders several municipalities. The public uses it extensively for recreation. Along its shores are public beaches, launching ramps and other public facilities. Charity C is financed by contributions from lake front property owners, members of the adjacent community and municipalities bordering the lake. The improved water quality and recreational opportunities surrounding the lake have increased the property values of the lake front residences.



Q: Does this scenario show private benefit or inurement? Why?

A: No. The benefits from Charity C's activities flow principally to the general public through well maintained and improved public recreational facilities. Any private benefit derived by the lake front property owners does not lessen the public benefits flowing from the organization's operations. In fact, it would be impossible for the organization to accomplish its purposes without providing benefits to the lake front property owners.

Q: If there is private benefit or inurement, what could the organization have done to prevent it?

A: There is no private benefit or inurement in this scenario.

Case Study 4

Scenario A – Individual Activity by an Organization's Leader

B is the president of University K, a 501(c)(3) organization. University K publishes a monthly alumni newsletter. In each issue, President B has a column titled "My Views." The month before the election, President B states in the "My Views" column, "It is my personal opinion that Candidate U should be re-elected." For that one issue, President B pays from his personal funds the portion of the cost of the newsletter attributable to the "My Views" column.

Q: What factors should be considered in determining whether the prohibition against political intervention has been violated?

A: The following factors should be considered: For that one issue, President B pays from his personal funds the portion of the cost of the newsletter attributable to the "My Views" column. Even though he paid part of the cost of the newsletter, the newsletter is an official publication of the university.

Q: After considering these factors, do you think President B's actions constitute political campaign intervention attributable to University K? Why or why not?

A: Because the endorsement appeared in an official publication of University K, it constitutes campaign intervention by University K.

Scenario B – Candidate Appearances

E is the president of N, a historical society with a 501(c)(3) exemption. In the month prior to an election, President E invites the four Congressional candidates for the district in which Society N is located to address the members, one each at a regular meeting held in successive weeks. Each candidate is given an equal opportunity to address and field questions on a wide variety of topics from the members. One of the candidates declines the invitation. Society N's publicity announces the dates for each of the candidate's speeches, states that the order of the speakers was determined at random and indicates that one invited candidate has declined. President E's introduction of each candidate includes no comments on their qualifications or any indication of a preference for any candidate.

Q: What factors should be considered in determining whether the prohibition against political intervention has been violated?

A: The following factors should be considered:

- Each candidate is given an equal opportunity to address and field questions on a wide variety of topics from the members
- Society N's publicity announcing the dates for each of the candidate's speeches and President E's introduction of each candidate include no comments on their qualifications

Q: After considering these factors, has Society N engaged in political activity by inviting the speakers? Why or why not?

A: Since Society N's publicity announcing the dates for each of the candidate's speeches and President E's introduction of each candidate includes no comments on their qualifications or any indication of a preference for any candidate, Society N's actions do not constitute political campaign intervention.



Section B. Chapter 6 Employment Issues Quiz and Answers

Scenario 1

ABC Foundation placed the following advertisement in the newspaper.

A friendly individual who enjoys working with people is needed to answer a multi-line telephone, greet visitors, make coffee and perform other tasks when time permits. This qualified individual must be able to work from 8:00 a.m. – 5:00 p.m. The position pays \$10.00 an hour.

Q: Would this person be an employee or independent contractor?

A: This person is an employee. ABC Foundation, the employer, has the right to direct and control the worker.

Scenario 2

DEF Country Club is looking for an experienced accountant who specializes in working with tax-exempt organizations. The accountant must be able to prepare a compilation of the financial statements, present these statements to the board of directors, perform the annual gambling audit and prepare the 990 and 990-T returns at the end of the year by the due date.

Q: Would this person be an employee or independent contractor?

A: Given the facts in this scenario, the accountant is an independent contractor.

Scenario 3

The president of ABC Foundation manages the day-to-day activities of the organization, supervises managers, signs the organization's checks, presides over monthly board meetings and performs other tasks as necessary to ensure the successful operation of the organization.

Q: Would this person be an employee or independent contractor?

A: The president is a corporate officer by statute. See Internal Revenue Code Section 3121(d)(1). Furthermore, the president is performing duties of a corporate officer and is, therefore, an employee.

Scenario 4

GHI Private School for the Gifted hired a janitor to clean up the school after hours. The janitor must provide all necessary equipment and supplies. He must clean three times a week when the schools is not in session. The janitor is provided a key to the school. The school is billed monthly for the services of the janitor. The janitor has several other clients.

Q: Would this person be an employee or independent contractor?

A: Given the facts in this scenario, the janitor is an independent contractor.

Scenario 5

JKL Youth Bowling League was sued as a result of a youth dropping a bowling ball on a spectator's foot. The spectator filed suit in district court and is suing for \$250,000. JKL Youth Bowling League contracts with a local attorney who specializes in this type of lawsuit. The attorney charges \$250 per hour.

Q: Would the attorney be an employee or independent contractor?

A: Given the facts in this scenario, the attorney is an independent contractor.

**Scenario 6**

The MNO Little League organization hired coaches selected by the league's officers. The board sets the times and places for all the games. The coaches are fathers or mothers of the children who play on the team. The organization has established policies and procedures that coaches are required to follow. Generally, the officers do not interfere with the coaching unless there is a problem. The coaches receive \$500 per season.

Q: Would these coaches be employees or independent contractors?

A: Given the facts in this scenario, the coaches are employees.

Scenario 7

PQR Theatre places the following advertisement in the newspaper.

Needed: ushers, ticket takers and ticket sellers. Hourly rate is negotiable based on experience and reliability.

Q: Would these workers be employees or independent contractors?

A: The ushers, ticket takers and ticket sellers are all employees of PQR Theatre.

Scenario 8

A salaried golf professional and his assistants manage the country club's pro shop. In addition, the club requires them to give lessons to the club's members at its established rates.

Q: Would these persons be employees or independent contractors?

A: The individuals are employees of the club. See Rev. Rul. 68-626, 1968-2 C.B. 466.

Scenario 9

A golf professional sells lessons and equipment on golf club premises. She sets prices, makes appointments and carries on her activities with permission of the club, but without orders or instructions from club members or officials.

Q: Would this person be an employee or independent contractor?

A: The individual is not an employee. She is engaged in a trade or business and the income therefrom must be considered in computing net earning from self-employment.

Scenario 10

The STU Foundation hires van drivers to transport physically disabled individuals to their medical appointments. The STU Foundation owns the vans, pays the insurance and all other related expenses for the vans and uses the vans only for this purpose. The van drivers are not allowed to take side trips. Their purpose is solely to transport physically disabled individuals to their medical appointments.

Q: Would these drivers be employees or independent contractors?

A: The van drivers are employees of STU Foundation.

Scenario 11

The STU Foundation hires van drivers to transport physically disabled individuals to their appointments. The drivers own their own vans and pay for the gas, insurance and maintenance. The drivers charge \$1 per mile and are willing to stop anywhere.

Q: Would these drivers be employees or independent contractors?

A: The van drivers are independent contractors.

**Scenario 12**

XYZ Anonymous engages in charitable gambling. It hired a gambling manager who supervises employees conducting the pull-tab games, prepares the monthly reports, audits the games, makes the deposits and reports at the monthly meetings.

Q: Would this person be an employee or independent contractor?

A: The gambling manager is an employee.

Section C - List of Exhibits

Chapter 2 – Exhibit A, Organization Reference Chart

Chapter 3 – Exhibit B, Jeopardizing Section 501(c)(3) Status - Case Studies

Exhibit C, Tax-Exempt Health Care Organizations Revised Conflicts of Interest Policy

Chapter 6 – Exhibit D, Employment Issues - Quiz

Chapter 8 – Exhibit E, Publication 4839, *Annual Form 990 Filing Requirements for Tax-Exempt Organizations (8-13)*

