Holding on to your nonprofit's exempt status

If you think that, once your not-for-profit receives its official tax-exempt status from the IRS, you don't have to revisit it, think again. Whether your organization is a Section 501(c)(3), Sec. 501(c)(7) or other type, be careful. The activities you conduct, the ways you generate revenue and how you use that revenue could potentially threaten your exempt status. It's worth reviewing the IRS's exempt-status rules to make sure your organization is operating within them.

Hot buttons

There are many categories of tax exemption — each with its own rules. But certain hot-button issues apply to most tax-exempt entities. These include:

Lobbying. Having a Sec. 501(c)(3) status limits the amount of lobbying a charitable organization can undertake. This doesn't mean lobbying is totally prohibited. But according to the IRS, your organization shouldn't devote "a substantial part of its activities" trying to influence legislation.
For nonprofits that are exempt under other categories of Sec. 501(c), there are fewer restrictions on lobbying activities. Lobbying activities these groups undertake must relate to the accomplishment of the group's purpose. For instance, an association of teachers can lobby for education reform without risking its tax exemption.

Campaign activities. The IRS considers lobbying to be different from campaign activities, which are completely off limits to Sec. 501(c)(3) organizations. This means they can't participate or intervene in any political campaign for or against a candidate for public office. If you're not a 501(c)(3) organization, campaign restrictions vary.

Excess profit and private inurement. The cardinal rule about profits is that a nonprofit can't be operated to benefit private interests. If your fundraising is successful and you have extra income, you must put it back into the organization through additional services or by creating a reserve or an endowment. You can't use extra income to reward an individual or a person's related entities.

Unrelated revenue. If you're generating income through a trade or business you conduct regularly and it's outside the scope of your mission, you may be subject to unrelated business income tax (UBIT). Examples include a university that rents performance halls to nonuniversity users or a charity selling advertising in its newsletter.

Almost all nonprofits are subject to this provision of the tax code, and, if you ignore it, you could risk your exempt status. That said, losing an exempt status from unrelated business income is rare.

Know the rules

IRS Publication 557, *Tax-Exempt Status for Your Organization*, outlines the rules for all nonprofits that qualify for exempt status. We can help your nonprofit interpret and apply the information based on its specific situation.