

Chapter 5: Exempt Organizations

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Note. Corrections were made to this workbook through January of 2023. No subsequent modifications were made. For terms used in this chapter, see the **Acronyms and Abbreviations** section following the index.

For your convenience, in-text website links are also provided as short URLs. Anywhere you see **uofi.tax/xxx**, the link points to the address immediately following in brackets.

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The tax rules governing nonprofits are numerous and complex, and violations of these rules may endanger an organization's exempt status. Therefore, it is important to understand the basic rules for exempt entities. The following chapter discusses major issues and filing requirements for exempt organizations. In-depth research may be required for specific situations.

Note. Detailed information about exempt organizations can be found in several IRS publications: IRS Pub. 4220, *Applying for 501(c)(3) Tax-Exempt Status*, IRS Pub. 4221-NC, *Compliance Guide for 501(c)(3) Tax-Exempt Organizations*, and IRS Pub. 557, *Tax-Exempt Status for Your Organization*.

Note. This chapter generally uses the IRS's terminology for "exempt organizations." They are exempt from **income** tax to the extent that they follow the exempt purposes for which they were established. They may incur income tax when they receive revenue for purposes other than those for which they originally sought exemption. They may be liable for other taxes, such as use tax, sales tax, and excise taxes.¹ Although they are exempt from taxation, they are not necessarily precluded from making a profit.²

CRITERIA FOR EXEMPT STATUS

An exempt organization is statutorily defined in IRC §501(a). Its first paragraph states organizations qualifying under §§501(c) or (d) "shall be exempt from taxation..." It proceeds to list 29 types of organizations that together comprise a huge portion of the United States' economy. They may be segregated into two broad classes of organizations: nonprofit and not-for-profit organizations.

- A **nonprofit organization** is defined under state law.³ A nonprofit organization is not precluded from making a profit from its own operations if used to further the exempt purpose and maintain or improve the organization. Many of these organizations generate substantial profits and may pay reasonable compensation to officers and directors for services rendered. But the nonprofit organization may not make distributions of its assets, income, or profits to any individual or group in control of the organization.⁴
- A **not-for-profit organization** typically serves a narrower social cause than a nonprofit.⁵ A not-for-profit organization may also promote business conditions for its members, acting as a trade organization.

¹ IRC §501(a). The text of this section refers to exemption "from taxation under this subtitle." Because this section exists in subtitle A, only income tax is exempted.

² *Nonprofit Organization*. Sep. 10, 2021. Digital Media Law Project, Berkman Center for Internet and Society. [www.dmlp.org/legal-guide/nonprofit-organization] Accessed on Apr. 18, 2022.

³ *Frequently Asked Questions About Applying for Tax Exemption*. Feb. 24, 2022. IRS. [www.irs.gov/charities-non-profits/frequently-asked-questions-about-applying-for-tax-exemption] Accessed on Jun. 20, 2022.

⁴ *Draft Revision of the Model Nonprofit Corporation Act*. §640, p. 135. Beaser, Lawrence and Clark Jr., William. May 28, 2021. American Bar Association. [www.americanbar.org/content/dam/aba/administrative/business_law/nonprofit/mnca.pdf] Accessed on Jun. 20, 2022.

⁵ *Not-for-Profit Organizations*. Sep. 6, 2021. Corporate Finance Institute. [corporatefinanceinstitute.com/resources/knowledge/strategy/not-for-profit-organizations/] Accessed on Jun. 20, 2022.

NONPROFIT ORGANIZATIONS VS. NOT-FOR-PROFIT ORGANIZATIONS⁶

These two classes of organizations have similar names, and neither can return profits to their members. Both may qualify for exemption from income taxes under §501, although this is more common for nonprofit organizations. However, subtle differences distinguish them, and a few of the differences are discussed next.

Purpose

While their founders establish **nonprofit** organizations to serve a broad community need, **not-for-profit** organizations typically are more narrowly focused on serving a particular need. They may even focus on serving a particular membership, such as a local baseball team. Nonprofit organizations may be identified as public benefit corporations or donative nonprofits because their primary source of revenue is donations. Not-for-profit organizations may be commercial nonprofits, serving as mutual benefit corporations. The IRS distinguishes mutual benefit corporations and public benefit corporations as follows.⁷

A mutual benefit corporation is a corporation typically formed to serve a limited number of members. A public benefit corporation is a corporation formed to benefit the general public.

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Legal Entity

Nonprofits can have a separate legal identity from their founders. Indeed, the IRS requires an organization to file for incorporation before considering an application for exemption from income tax. It is common for **not-for-profit** organizations to have no separate legal organization.

Revenue Generation

The managers of **nonprofit** organizations typically attempt to run it like a business and earn a profit, even though the profit cannot be distributed to members or employees. In contrast, the volunteers operating a **not-for-profit** organization attempt to raise funds to cover costs only.

Employees

While **nonprofit** organizations may have employees who earn wages or salaries, **not-for-profit** organizations usually carry out their exempt purpose with unpaid volunteers.

⁶ *Sample Questions — Organizational and Administrative Requirements*. Oct. 21, 2021. IRS. [www.irs.gov/charities-non-profits/other-non-profits/exempt-organization-sample-questions-organizational-and-administrative-requirements] Accessed on Jun. 20, 2022.

⁷ Ibid.

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TAX-EXEMPT STATUS

Different rules for tax exemption apply to different types of organizations based on the organization's IRS classification. The following table shows the applicable code section for each type of nonprofit organization.⁸

Code Section	Tax-Exempt Organization
501(c)(1)	Corporations organized under an act of Congress
501(c)(2)	Title-holding corporations for exempt organizations
501(c)(3)	Charitable, religious, educational, scientific, and certain other organizations
501(c)(4)	Civic leagues, social welfare organizations, and local associations of employees
501(c)(5)	Labor, agricultural, and horticultural organizations
501(c)(6)	Business leagues, chambers of commerce, real estate boards, etc.
501(c)(7)	Social and recreation clubs
501(c)(8) & (10)	Fraternal beneficiary (8) and domestic fraternal (10) societies and associations
501(c)(9)	Voluntary employees' beneficiary associations
501(c)(11)	Teachers' retirement fund associations
501(c)(12)	Benevolent life insurance associations, mutual ditch or irrigation companies, mutual or cooperative telephone companies, etc.
501(c)(13)	Cemetery companies
501(c)(14)	State chartered credit unions, mutual reserve funds
501(c)(15)	Insurance companies or associations other than life insurance
501(c)(16)	Cooperative organizations to finance crop operations
501(c)(17)	Supplemental unemployment benefit trusts
501(c)(18)	Employee-funded pension trusts (created before June 25, 1959)
501(c)(19) & (23)	Post or organization of past or present members of the armed forces
501(c)(21)	Black lung benefit trusts
501(c)(22)	Withdrawal liability payment funds
501(c)(25)	Title-holding corporations or trusts with multiple parents
501(c)(26)	State-sponsored organizations providing health coverage for high-risk individuals
501(c)(27)	State-sponsored workmen's compensation and insurance and reinsurance organizations
501(d)	Religious and apostolic associations
501(e)	Cooperative hospital service organizations
501(f)	Cooperative service organizations of operating educational organizations
501(k)	Child care organizations
501(n)	Charitable risk pools
527	Political organizations

REQUIREMENTS TO QUALIFY FOR §501(C)(3) STATUS

Many exempt organizations strive to achieve §501(c)(3) status. Although organizations listed in §§501(c), (d), (e), (f), (k), and (n) are generally exempt from federal tax, §501(c)(3) organizations have a distinct fundraising advantage because donors may deduct donations made to organizations qualifying under this code section.

Exempt organizations must satisfy four requirements to qualify for tax-exempt status under §501(c)(3).

1. The organization must be organized and operated exclusively for religious, charitable, scientific, educational, literary, or other listed purposes.
2. The organization's net earnings or assets must not be used for the advantage of any individual or shareholder.
3. No substantial part of the organization's activity may attempt to influence legislation.
4. The organization must not intervene in political campaigns.

⁸ Instructions for Form 990.

EXEMPT PURPOSES UNDER §501(C)(3)

The first requirement listed previously is the most important in determining an organization's tax status. Depending on state law, an organization should state its purpose clearly in its articles of incorporation, bylaws, or other organizing documents.⁹ The qualifying purpose may be religious, charitable, scientific, educational, or "other."

Religious

Treas. Reg. §1.511-2(a)(3)(ii) provides the following guidance for determining whether an organization's purpose may be construed as religious.

What constitutes conduct of religious worship or the ministration of sacerdotal functions depends on the interests and practices of a particular religious body constituting a church.

To avoid charges of discrimination, the government is very careful not to limit the definition of a **religious** purpose. The following are examples of characteristics commonly attributed to churches.¹⁰

- Recognized creed and form of worship
- Definite and distinct ecclesiastical government
- Code of doctrine and discipline
- Distinct religious history
- Ordained ministers complete prescribed courses of study
- Regular religious services led by ordained ministers

Charitable¹¹

Because this area may cover a broad spectrum of purposes, the Code does not limit this category by providing specific definitions. Charitable purposes may include activities undertaken for:

- The building and maintenance of public buildings and monuments;
- Assistance to the poor, underprivileged, or distressed; or
- Other similar activities.

Scientific¹²

To qualify under this category, an organization must have a scientific purpose benefiting the general public instead of private interests. This category includes nonprofit hospitals, cooperative hospital service organizations, and medical research organizations. Research for commercial activities does not qualify. However, commercial research activities made available to the public on a nondiscriminatory basis, such as cancer research, may qualify.

Educational¹³

The regulations provide a broad definition of education. Entities such as colleges, universities, and professional schools qualify, but museums, zoos, and planetariums may also qualify.

⁹ An organization's purposes, at a minimum, must be included in the articles of organization. Stating the purpose solely in the bylaws is insufficient. See Treas. Regs. §§1.501(c)(3)-1(b)(1) and (2).

¹⁰ IRS Pub. 1828, *Tax Guide for Churches & Religious Organizations*.

¹¹ "Charitable" Purposes. Jan. 21, 2022. IRS. [www.irs.gov/charities-non-profits/charitable-purposes] Accessed on Mar. 15, 2022.

¹² Treas. Reg. §1.501(c)(3)-1(d)(5).

¹³ Treas. Reg. §1.501(c)(3)-1(d)(3).

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Organizations are considered educational if they present a full and fair discussion of all the pertinent facts to allow the public to form an independent opinion. However, organizations are not considered educational if their primary purpose is merely presenting an unsupported position.

Other Purposes¹⁴

Other qualified organizational purposes may include providing low-income housing for the elderly or handicapped, testing for public safety, or preventing cruelty to children or animals.

EXAMPLES OF §501(C)(3) ORGANIZATIONS

The following list itemizes examples of organizations that may qualify for §501(c)(3) status.¹⁵

- Nonprofit elderly homes
- Parent-teacher associations
- Charitable hospitals
- Alumni associations
- Schools
- Red Cross or Salvation Army chapters
- Boys or Girls Clubs
- Churches

An organization cannot be considered exempt simply based on its activities, nor can it be considered exempt based on the use of tax-exempt type wording in its title.

Example 1. In 1970, atheist Madalyn Murray O’Hair and her husband Richard organized “The Poor Richard’s Universal Life Church.” The purpose of this organization was tax evasion. This purpose did not qualify under §501(c)(3), and the “church” was not granted tax-exempt status.

CLASSIFICATION OF §501(C)(3) ORGANIZATIONS¹⁶

An organization qualifying under §501(c)(3) may be classified as either a public charity or a private foundation. The distinction lies in the source of financial support. A public charity has a broad base of support, whereas a private foundation receives support from a small number of donors. Donations to a private foundation are limited more than a public charity. A private foundation may also be subject to excise taxes.

APPLICATION PROCESS FOR §501(C)(3)¹⁷

Before applying for §501(c)(3) status, an organization must obtain an employer identification number (EIN). Qualifying organizations then request approval from the IRS. Applications for exempt status are filed on Form 1023, *Application for Recognition under Section 501(c)(3) of the Internal Revenue Code*. For smaller organizations seeking status as exempt organizations, the IRS released a shorter version, Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*.

¹⁴ Treas. Reg. §1.501(c)(3)-1.

¹⁵ IRS Pub. 557, *Tax-Exempt Status for Your Organization*, p. 22 (2021).

¹⁶ *EO Operational Requirements: Private Foundations and Public Charities*. Sep. 3, 2021. IRS. [www.irs.gov/charities-non-profits/co-operational-requirements-private-foundations-and-public-charities] Accessed on Mar. 18, 2022.

¹⁷ See instructions for Forms 1023 and 1023-EZ.



Practitioner Planning Tip

The IRS is required by law to make approved exemption applications public information. Practitioners assisting exempt organizations with their applications should ensure that social security numbers or other private information do not appear on Form 1023, Form 1023-EZ, or any attachment.

Form 1023

Form 1023 is a 26-page application consisting of detailed questions regarding an organization's structure, history, activities, purpose, compensation arrangements, and financial data. In addition to those pages, Form 1023, Schedules A through H, also must be submitted as required. Generally, organizations with anticipated gross receipts exceeding \$50,000 and assets with a fair market value (FMV) exceeding \$250,000 are ineligible to file Form 1023-EZ. This form is described later.¹⁸

User Fee. An organization filing Form 1023 must pay a fee of \$600 through [pay.gov](https://www.pay.gov).¹⁹ The IRS does not refund it if it rejects the application.²⁰

Attachments.²¹ A copy of an organization's articles of organization, including amendments, bylaws, and bylaw amendments, must be submitted with the application. A Form 2848, *Power of Attorney and Declaration of Representative*, or Form 8821, *Tax Information Authorization*, may also be included. The applicant must consolidate all attachments into a single PDF document.

Filing Deadline and Effective Date. An organization normally files Form 1023 within 27 months of its incorporation.²² If the organization meets this deadline and the IRS approves the application, its exempt status is retroactively effective on the date of incorporation.

If the organization applies for exempt status 27 or more months after incorporation, the IRS may award exempt status effective with the application's date. The organization may request an exemption as of the date of its formation in separate correspondence.

Where to File. Organizations can only file Form 1023 electronically using [pay.gov](https://www.pay.gov) by entering "1023" in the site search and then completing the form.

1. Register for an account at [pay.gov](https://www.pay.gov).
2. Enter "1023" in the search box and select Form 1023 or Form 1023-EZ.
3. Complete the form as presented. Create a PDF file that contains the following documents as noted under *Attachments* earlier.

¹⁸ See the instructions for Form 1023-EZ for an eligibility worksheet to determine whether an organization is eligible to file the Form 1023-EZ.

¹⁹ *Form 1023 and 1023-EZ: Amount of User Fee*. Jan 19, 2022. IRS. [www.irs.gov/charities-non-profits/form-1023-and-1023-ez-amount-of-user-fee] Accessed on Feb. 9, 2022.

²⁰ Rev. Proc. 2014-8, 2014-1 IRB 251. See §10.01.

²¹ *Form 1023: Required Attachment to Form 1023*. Dec. 30, 2021. IRS. [www.irs.gov/charities-non-profits/form-1023-required-attachment-to-form-1023] Accessed on Feb. 9, 2022.

²² Rev. Proc. 2021-5, 2021-1 IRB 250.

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Application Checklist. The IRS provides a useful checklist (shown next) to prevent submitting an incomplete Form 1023. Applicants should answer all questions or indicate “not applicable.” The IRS will return forms with missing information.

Form 1023 Checklist

(Revised December 2017)

Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code

Note: Retain a copy of the completed Form 1023 in your permanent records. Refer to the General Instructions regarding Public Inspection of approved applications.

Check each box to finish your application (Form 1023). Send this completed Checklist with your filled-in application. If you have not answered all the items below, your application may be returned to you as incomplete.

- Assemble the application and materials in this order.
 - Form 1023 Checklist
 - Form 2848, *Power of Attorney and Declaration of Representative* (if filing)
 - Form 8821, *Tax Information Authorization* (if filing)
 - Expedite request (if requesting)
 - Application (Form 1023 and Schedules A through H, as required)
 - Articles of organization
 - Amendments to articles of organization in chronological order
 - Bylaws or other rules of operation and amendments
 - Documentation of nondiscriminatory policy for schools, as required by Schedule B
 - Form 5768, *Election/Revocation of Election by an Eligible Section 501(c)(3) Organization To Make Expenditures To Influence Legislation* (if filing)
 - All other attachments, including explanations, financial data, and printed materials or publications. Label each page with name and EIN.

- User fee payment placed in envelope on top of checklist. DO NOT STAPLE or otherwise attach your check or money order to your application. Instead, just place it in the envelope.

- Employer Identification Number (EIN)

- Completed Parts I through XI of the application, including any requested information and any required Schedules A through H.
 - You must provide specific details about your past, present, and planned activities.
 - Generalizations or failure to answer questions in the Form 1023 application will prevent us from recognizing you as tax exempt.
 - Describe your purposes and proposed activities in specific easily understood terms.
 - Financial information should correspond with proposed activities.

- Schedules. Submit only those schedules that apply to you and check either “Yes” or “No” below.

Schedule A	Yes ___	No ___	Schedule E	Yes ___	No ___
Schedule B	Yes ___	No ___	Schedule F	Yes ___	No ___
Schedule C	Yes ___	No ___	Schedule G	Yes ___	No ___
Schedule D	Yes ___	No ___	Schedule H	Yes ___	No ___

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- An exact copy of your complete articles of organization (creating document). Absence of the proper purpose and dissolution clauses is the number one reason for delays in the issuance of determination letters.
 - Location of Purpose Clause from Part III, line 1 (Page, Article and Paragraph Number) _____
 - Location of Dissolution Clause from Part III, line 2b or 2c (Page, Article and Paragraph Number) or by operation of state law _____
- Signature of an officer, director, trustee, or other official who is authorized to sign the application.
 - Signature at Part XI of Form 1023.
- Your name on the application must be the same as your legal name as it appears in your articles of organization.

Send completed Form 1023, user fee payment, and all other required information, to:

Internal Revenue Service
Attention: EO Determination Letters
Stop 31
P.O. Box 12192
Covington, KY 41012-0192

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If you are using express mail or a delivery service, send Form 1023, user fee payment, and attachments to:

Internal Revenue Service
Attention: EO Determination Letters
Stop 31
201 West Rivercenter Boulevard
Covington, KY 41011

Form 1023-EZ

Form 1023-EZ may be a preferable alternative for smaller organizations seeking exempt status, as it is a fraction of the length of the full Form 1023. The primary qualifications to use this shorter and less expensive version are the following.²³

- Annual gross receipts did not exceed \$50,000 in any of the past three years
- Projected gross receipts are not expected to exceed \$50,000 in any of the next three years
- Total assets of \$250,000 or less

Caution. Churches, schools, and hospitals are not eligible to use Form 1023-EZ.²⁴

User Fee.²⁵ An organization filing Form 1023-EZ pays a **\$275 fee**.

Attachments. Form 1023-EZ does not require submission of any additional forms. Instead, the person filing the form must attest that they are eligible to file the form and have read and understand the requirements for exemption under §501(c)(3).²⁶

Filing Deadline and Effective Date. An organization normally files Form 1023-EZ within 27 months of its incorporation. If the organization meets this deadline and the IRS approves the application, its exempt status is retroactively effective on the date of incorporation.

²³ Rev. Proc. 2014-40, 2014-30 IRB 229.

²⁴ Ibid.

²⁵ *Form 1023 and 1023-EZ: Amount of User Fee*. Jan. 19, 2022. IRS. [www.irs.gov/charities-non-profits/form-1023-and-1023-ez-amount-of-user-fee] Accessed on Feb. 9, 2022.

²⁶ Rev. Proc. 2014-40, 2014-30 IRB 229. See §4.05.

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If the organization applies for exempt status 27 or more months **after** incorporation, the IRS may award exempt status effective with the application's date. The organization may request an exemption as of the date of its formation in separate correspondence.

Where to File. Organizations can only file Form 1023-EZ electronically, using **pay.gov** by entering "1023-EZ" in the search box and then completing the form.

Application Checklist. The IRS has not published a checklist for Form 1023-EZ. However, the Form 1023-EZ instructions contain a worksheet that an exempt organization can use to ensure it is eligible to use the shorter form.



Practitioner Planning Tip

Practitioners should retain a completed worksheet in their records for reference to prove an organization is eligible to file the shorter form.

Exemption from Requirement to File Form 1023 or Form 1023-EZ. The following organizations are considered tax-exempt regardless of whether they file a Form 1023 or Form 1023-EZ. However, these organizations still may wish to receive a determination letter recognizing their exempt status and confirming the tax deductibility of any contributions donated to them.

- Churches, synagogues, temples, and mosques
- Integrated auxiliaries of churches and conventions or associations of churches
- Organizations with gross annual receipts of \$5,000 or less

Note. IRS Pub. 78, *Cumulative List of Organizations Described in Section 170(c) of the Internal Revenue Code of 1986*, lists organizations eligible to receive tax-deductible contributions. However, it is not a complete listing of all eligible organizations because it does not include organizations exempt from filing Form 1023.

LOSING §501(C)(3) STATUS²⁷

Organizations qualifying as §501(c)(3) entities must adhere to specific rules and avoid engaging in prohibited transactions. The following activities can result in the assessment of an excise tax or the **loss of an organization's tax-exempt status**.

1. **Using an organization's net earnings for the advantage of any private shareholder or individual or to provide a substantial benefit to a nonqualifying private interest.** Advantages to insiders may include, but are not limited to, the payment of unreasonable compensation or the transfer of property for less than FMV. This prohibition is absolute, and failure to comply can result in the loss of an organization's tax-exempt status and subject the insider and organization's managers to an excise tax.

Providing a private benefit must be for a charitable, educational, religious, or another exempt purpose. The recipients should not be insiders within the exempt organization. Examples of qualifying outside private beneficiaries are the poor or distressed or the community at large. Violations of the private benefit rule are usually substantial before an organization's tax-exempt status is jeopardized.

²⁷ *How to lose your 501(c)(3) tax-exempt status (without really trying).* IRS. [www.irs.gov/pub/irs-tege/How%20to%20Lose%20Your%20Tax%20Exempt%20Status.pdf] Accessed on Apr. 13, 2022.

- 2. Devoting a substantial part of an organization's activities to influencing legislation (lobbying).** Attempting to influence legislation includes contacting or urging the public to contact members or employees of a legislative body to propose, support, or oppose legislation or advocate the adoption or rejection of legislation.

The penalty for excessive lobbying activities may include revoking an organization's exempt status, resulting in all income becoming taxable. The IRS may impose a 5% excise tax on lobbying expenditures of the organization.²⁸ A separate 5% excise tax may be imposed against organizational managers who knowingly authorize such expenditures.²⁹ Nevertheless, the penalties do not apply if the organization made a §501(h) election before the revocation of its exempt status, is a §501(h)(5) disqualified organization,³⁰ or is a private foundation.³¹

Note. The IRS provides several resources to guide exempt organizations in complying with lobbying restrictions at **uofi.tax/22a5x1** [www.irs.gov/charities-non-profits/charitable-organizations/charities-churches-and-educational-organizations-political-campaign-intervention].

- 3. Participating in a political campaign.** Contributions to political campaign funds or public position statements generally violate this rule. Voter education activities, public forums, and get-out-to-vote drives conducted in a nonpartisan manner are acceptable activities.³² Candidates may be invited to speak at organizational functions if opposing candidates have an equal opportunity to speak and no political fundraising occurs.³³

This prohibition does not restrict individuals from expressing their personal opinions if they indicate that the opinion is their own and not the organization's position. They should make no political comments within organizational activities, meetings, or publications.³⁴

Violations of this rule may result in the revocation of an organization's exempt status and the assessment of excise taxes. The excise tax imposed on charitable organizations is 10% of the political expenditures. An excise tax of 2.5% also may be imposed on the organization's managers, up to \$5,000 per expenditure.³⁵

The law provides a period to correct expenditures to the extent possible. If left uncorrected, an additional tax of 100% may be imposed against the organization and 50% on the managers, not to exceed \$10,000. The IRS is very serious in these matters, and tax practitioners should advise organizations of the consequences of engaging in these activities.³⁶

²⁸ IRC §4912(a).

²⁹ IRC §4912(b).

³⁰ IRC §501(h)(5) disqualified organizations include churches, integrated auxiliaries of churches, conventions or associations of churches or members of an affiliated group of organizations if at least one member is a church, an auxiliary of a church or a convention of churches.

³¹ IRC §4912(c)(2).

³² *The Restriction of Political Campaign Intervention by Section 501(c)(3) Tax-Exempt Organization*. Sep. 23, 2021. IRS. [www.irs.gov/charities-non-profits/charitable-organizations/the-restriction-of-political-campaign-intervention-by-section-501c3-tax-exempt-organizations] Accessed on Mar. 29, 2022.

³³ *Frequently Asked Questions About the Ban on Political Campaign Intervention by 501(c)(3) Organizations: Inviting a Candidate to Speak*. Nov. 22, 2021. IRS. [www.irs.gov/charities-non-profits/charitable-organizations/frequently-asked-questions-about-the-ban-on-political-campaign-intervention-by-501c3-organizations-inviting-a-candidate-to-speak] Accessed on Apr. 12, 2022; See Treas. Reg. 1.501(c)(3)-1(c)(3)(iii).

³⁴ IRC §501(c)(3).

³⁵ IRC §4955.

³⁶ *Ibid.*

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4. **Having too much unrelated business income (UBI).** If too much of the organization's revenue originates from trade or business unrelated to its exempt purpose, the IRS may question its tax-exempt status.
5. **Not filing its annual reports.**³⁷ Being tax-exempt does not excuse an exempt organization from filing one of the 990 series of returns. The exempt status for an organization is automatically revoked for not filing its annual return for three years in a row.
6. **Operating outside of its stated exempt purpose.** An organization should act in line with the exempt purposes for which it sought exemption status. If its original purpose changes, the organization should advise the IRS. The IRS could revoke the exempt status of an organization that engages in illegal activities or violates fundamental public policies.

Example 2. The Girvin Independent Church, an autonomous congregation, is a staunch advocate for Governor Rob Smith in his 2022 reelection campaign. In a series of sermons during the campaign, Pastor Jim strongly advocated that all church members vote for Governor Rob. The church spent \$5,000 to print a color brochure extolling Governor Rob's virtuous character.

Given these circumstances, the IRS could impose excise taxes for prohibited involvement in a political campaign.³⁸

- 10% on the excess benefit to a disqualified person — Girvin Independent Church, \$500 ($\$5,000 \times 10\%$)
- 2.5% on the organization manager — Pastor Jim, \$125 ($\$5,000 \times 2.5\%$)

If the excess benefit is not corrected, the additional excise taxes may apply. The IRS could also seek to revoke the church's §501(c)(3) tax exemption.

Request for Miscellaneous Determination³⁹

Exempt organizations under §501(c)(3) use Form 8940, *Request for Miscellaneous Determination*, to request the IRS make certain determinations relative to the organization's status. The form facilitates the following determinations.

- The advance approval of amounts set aside that a private foundation may make in pursuit of projects to be completed within five years.⁴⁰
- The advance approval that voter registration activities undertaken by a §501(c)(3) exempt organization are permitted, even though they are intended to influence elections in at least five states.⁴¹
- The advance approval of scholarship procedures for individual grants awarded on an objective and nondiscriminatory basis.⁴²
- Exemption from Form 990, *Return of Organization Exempt from Income Tax*, filing requirements.
- Other matters listed on Form 8940.

³⁷ IRC §6033(j).

³⁸ IRC §4955(a).

³⁹ See instructions for Form 8940.

⁴⁰ IRC §4942(g)(2).

⁴¹ IRC §§4945(d)(2) and (f).

⁴² IRC §4945(g).

CHURCHES

Churches, conventions and associations of churches, and integrated auxiliaries of churches receive a tax exemption under §501(c)(3). The Code extends some privileges to churches that it does not extend to other religious organizations, even though they may also be exempt organizations. Examples include nondenominational ministries, interdenominational and ecumenical organizations, and organizations promoting the study or advancement of religion, even though they may be exempt organizations.⁴³

One major advantage of qualifying as a church is the exemption from filing Form 990.⁴⁴ However, an exempt church still is required to file employment tax returns and Forms 1099 and 990-T, *Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))*, if applicable.⁴⁵

The IRS evaluates the following items when determining whether an organization qualifies as a church (other factors also may be considered).⁴⁶

- The organization must be a distinct legal entity.
- The entity must be organized and operated exclusively for exempt purposes.
- None of the organization's net earnings may benefit any private individual.
- The organization must have a recognized creed and form of worship.
- The organization must have a definite and distinct ecclesiastical government.
- The organization may not engage in substantial efforts to influence legislation.
- The organization must not intervene or participate in political campaigns.
- The organization must advocate a formal code of doctrine and discipline.
- There must be an established place of worship, regular congregations, and regular religious services.

The UBI tax applies to churches. Activities that can produce this tax include advertising, rental income on debt-financed property, bookstores, gift shops, concerts, and parking lots. These activities and others may create **unrelated business taxable income (UBTI)**, depending on the facts of each case.

The income of a church is not automatically exempt from taxation.⁴⁷ The following two items illustrate the subtleties needing resolution before determining whether a church's income from concert ticket sales is taxable.

1. In one case, the IRS ruled that income from selling tickets for a gospel concert was exempt from UBTI.⁴⁸
2. In another case, it ruled income from the sale of tickets to a fundraising concert was subject to UBTI because the concert **did not further the charity's exempt purpose.**⁴⁹

This subtle distinction emphasizes an important point, that small details regarding a charitable activity can affect its tax treatment.

⁴³ IRS Pub. 1828, *Tax Guide for Churches and Religious Organizations*. p. 1 (2015).

⁴⁴ IRC §6033(a)(3)(A)(i).

⁴⁵ IRC §3121(w) excludes wages paid by churches opposed to payment of employment taxes for religious reasons, provided the church states it is opposed to these taxes. In Treas. Reg. §301.7611-1, the IRS takes the position that inquiries into these matters is routine. Within this regulation, the answers to question 4 states that the IRS assumes that employment by a church results in employment taxes unless the church has explicitly taken action to establish the contrary position.

⁴⁶ IRS Pub. 1828, *Tax Guide for Churches and Religious Organizations* p. 33 (2015); Treas. Reg. §1.511-2(a)(3)(ii); *Lutheran Social Services of Minn. v. U.S.* 758 F.2d 1283 (8th Cir. 1985).

⁴⁷ IRC §512(b)(12). *Omnibus Budget Reconciliation Act of 1990*, PL 101-508, removed previous language excluding all gross income of a church connected with a trade or business conducted before May 27, 1969.

⁴⁸ Ltr. Rul. 9325062 (Apr. 2, 1993).

⁴⁹ Ltr. Rul. 9712001 (Oct. 17, 1996).

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NON-§501(C)(3) TAX EXEMPTION

The following types of organizations file Form 1024, *Application for Recognition of Exemption Under Section 501(a) or Section 521 of the Internal Revenue Code*, to seek tax-exempt status outside of §501(c)(3).⁵⁰

- Civil leagues
- Social clubs
- Cemetery companies
- Voluntary employees' beneficiary associations
- Fraternal societies
- Agricultural organizations

Form 1024

On January 3, 2022, the IRS revised Form 1024, enabling electronic filing online. Organizations using Form 1024 must file the following requests for tax-exempt status electronically.⁵¹

- Applications under §§501(c)(11), (14), (16), (18), (21), (22), (23), (26), (27), (28), (29), or §501(d)
- Organizations described in §501(c) (other than (c)(3) and (c)(4)) and §501(d) applying for tax-exempt status (§501(c)(4) organizations request tax-exempt status electronically on Form 1024-A, *Application for Recognition of Exemption Under Section 501(c)(4) of the Internal Revenue Code*)

Note. Farmers' cooperative associations requesting tax-exempt status under IRC §521 may now apply online using Form 1024 rather than Form 1028, *Application for Recognition of Exemption Under Section 521 of the Internal Revenue Code*.

User Fee.⁵² Generally, the user fee for Form 1024 is \$600.

Attachments.⁵³ To expedite the processing of an organization's exemption request, it must attach a supporting statement to the application. The organizing document for the organization is required, as well as associated amendments and bylaws with their amendments. If any answers to questions exceed the length provided, they must be placed in a supporting statement.

Filing Deadline and Effective Date. An organization normally files Form 1024 or 1024-A within 27 months of its incorporation. If the organization meets this deadline and the IRS approves the application, its exempt status is retroactively effective on the date of incorporation.

If the organization applies for exempt status 27 or more months **after** incorporation, the IRS may award exempt status effective with the application's date. The organization may request an exemption as of the date of its formation in separate correspondence.

⁵⁰ See a more complete list at *Other Tax-Exempt Organizations*. Oct. 22, 2021. IRS. [www.irs.gov/charities-non-profits/other-tax-exempt-organizations] Accessed on Mar. 23, 2022.

⁵¹ Rev. Proc. 2022-8, 2022-04 IRB 451.

⁵² Rev. Proc. 2022-5, 2022-1 IRB 256.

⁵³ Instructions for Form 1024.

Political Organizations⁵⁴

Political organizations receive contributions and spend funds on political campaigns and activities on federal, state, or local levels. IRC §527(e) provides an exemption from income tax for the following types of political organizations formed to influence elections, nominations, or appointments.

- Party
- Committee
- Association
- Fund
- Other organizations (whether or not incorporated) organized and operated primarily to directly or indirectly accept contributions or make expenditures, or both, for an exempt function

To qualify as an exempt organization, each must electronically file Form 8871, *Political Organization Notice of Section 527 Status*, within 24 hours of when the organization was established. If not timely filed, the organization incurs tax on income earned before its filing. The same deadline applies to material changes. If an organization does not file Form 8871 within 24 hours of a material change, the organization may incur tax on income earned between the material change and the filing. The form is available at www.irs.gov/polorgs and requests basic information, such as the organization's federal EIN, the identity of its records' custodian, the name of a contact person, and an election authority identification number.

Note. First-time users must take an additional step and paper file Form 8453-X, *Political Organization Declaration for Electronic Filing of Notice of Section 527 Status*. Directions for filing Form 8453-X are in the instructions for Form 8871.

Political organizations or committees are not required to file Form 8871 in the following situations.

- The political organization always expects to have annual gross receipts of less than \$25,000.
- It is a political committee that reports under the Federal Election Campaign Act of 1971.
- It is a political committee of a state or local candidate.
- It is a state or local committee of a political party.
- It is a §501(c) organization that is treated as having political organization taxable income under §527(f)(1).

⁵⁴ Instructions for Form 8871.

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APPEALING AN ADVERSE DETERMINATION⁵⁵

The IRS does not approve all requests for exempt status. Fortunately, there is a well-established path to appeal an adverse determination. The IRS maintains instructions about contesting a denial of an exempt status application. The IRS has established several standards for appealing an adverse determination.

- Protest letters can be sent to the IRS employee who denied the application for exemption or to their manager. IRS Pub. 892, *How to Appeal an IRS Determination on Tax-Exempt Status*, itemizes the required information to include on the protest letter.
- Attorneys, enrolled agents, and CPAs may represent exempt organizations.
- Exempt organizations may file protests within 30 days of the date appearing on the adverse determination.
- The Appeals Office of the IRS is the official venue for reconsidering matters denied by the IRS's Exempt Organizations and Government Entities Division.
- The organization can pursue several venues beyond the Appeals Office, such as the U.S. Tax Court, the U.S. Court of Federal Claims, or the U.S. District Court for the District of Columbia. None of these courts issues judgments until it determines a client has exhausted all avenues of appeal administratively.

RETURN FILING REQUIREMENTS FOR EXEMPT ORGANIZATIONS

Exempt organizations may be required to file one or more income tax returns in the 990 series. Requirements for filing the following forms vary for different organizations.

- Form 990, *Return of Organization Exempt from Income Tax*
- Form 990-EZ, *Short Form Return of Organization Exempt From Income Tax*
- Form 990-T, *Exempt Organization Business Tax Return*
- Form 990-PF, *Return of Private Foundation or Section 4947(a)(1) Trust Treated as a Private Foundation*
- Form 990-N, *Electronic Notice (e-Postcard) for Tax Exempt Organizations Not Required to File Form 990 or Form 990-EZ*

Observation. A key function of the exempt organization's return is disclosure. Its contents are considered public information and are readily available on the Internet.

⁵⁵ IRS Pub. 892, *How to Appeal an IRS Determination on Tax-Exempt Status*.

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FORM 990 OR 990-EZ⁵⁶

Unless an exempt organization meets an exception, it must annually file either Form 990 or Form 990-EZ. There are 14 specific exceptions listed in the instructions for Form 990/Form 990-EZ. These exceptions include churches, schools, private foundations, governmental units, and certain political organizations.

As mentioned previously, an organization meeting both the following criteria may file Form 990-EZ.

- Its annual gross receipts are more than \$50,000 and less than \$200,000.
- Its total assets at year-end are less than \$500,000.

Organizations exceeding either limit generally file Form 990.

For these rules, gross receipts include all amounts received from all sources during the accounting year without subtracting any costs or expenses. In determining the \$50,000 gross receipts threshold, an organization is presumed to be under \$50,000 if:⁵⁷

- It has been in existence for one year or less and received donations, or pledged to give, \$75,000 or less during its first tax year;
- It has been in existence between one and three years and averaged \$60,000 or less in gross receipts during each of its first two tax years; or
- It has been in existence for three or more years and averaged \$50,000 or less in gross receipts for the immediately preceding three tax years, including the year for which the return would be filed.

To reduce the risk of receiving a notice regarding nonfiling,⁵⁸ an organization with a pending application for exempt status should check the “application pending” checkbox near the top left of Form 990 and complete the return as otherwise required.⁵⁹ Similarly, an organization required to file a return in a previous year but is no longer required to file should notify the IRS to update its filing status.⁶⁰ Failure to file can jeopardize donors’ deductions of their contributions.⁶¹

Due Dates

Forms 990 and 990-EZ are due by the 15th day of the 5th month after an organization’s accounting year ends. Form 8868, *Application for Automatic Extension of Time To File an Exempt Organization Return*, is used to request an automatic six-month extension.

A late-filing penalty of \$20 per day, not to exceed the smaller of \$11,000 or 5% of the organization’s gross receipts for the year, is imposed on tardy returns **required to be filed in 2023** unless an organization can show it filed late due to reasonable cause.⁶² A larger organization with more than \$1,129,000 of annual gross receipts is subject to a late-filing penalty of \$110 per day, not to exceed \$56,000 per return.⁶³

How to File

Exempt organizations must file their returns electronically. If an exempt organization chooses to file its return on paper, **it is deemed to have failed to file its return.**

⁵⁶ Instructions for Form 990 and Form 990-EZ.

⁵⁷ Rev. Proc. 2011-15, 2011-3 IRB 322. See §4(1).

⁵⁸ IRC §6033(j)(1)(A).

⁵⁹ Instructions for Form 990 and Form 990-EZ.

⁶⁰ Treas. Reg. §1.6033-6(b)(2).

⁶¹ IRC §6033(j)(1)(B).

⁶² Rev. Proc. 2021-45, 2020-48 IRB 764.

⁶³ Ibid.

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Schedules A and B

IRC §501(c)(3) organizations should attach a completed Form 990 or 990-EZ, Schedule A, *Public Charity Status and Public Support*, to their returns. This schedule provides information justifying its existence as a public charity, documenting its sources of public support, and providing information about its supporting organizations.

Form 990/990-EZ, Schedule B, *Schedule of Contributors*, must be filed by organizations unless they certify that it does not have a filing requirement for Schedule B. Schedule B lists contributors who directly or indirectly donated money, securities, or any other type of property aggregating \$5,000 or more to the organization during the year. If Schedule B is not required, the organization **must check one** of the following boxes (depending on which return it is filing) for the return to be considered complete.⁶⁴

- **Form 990 question 2**

Form 990 (2021) Page **3**

Part IV Checklist of Required Schedules

	Yes	No
1 Is the organization described in section 501(c)(3) or 4947(a)(1) (other than a private foundation)? If "Yes," complete Schedule A	1	
2 Is the organization required to complete Schedule B, Schedule of Contributors? See instructions		X

- **Form 990-EZ**

Application pending

G Accounting Method: Cash Accrual Other (specify) ▶ _____

H Check if the organization is **not** required to attach Schedule B (Form 990). ?

I Website: ▶ _____

J Tax-exempt status (check only one) — 501(c)(3) 501(c) () ◀ (insert no.) 4947(a)(1) or 527

Organization: Corporation Trust Association Other

Practitioner Planning Tip

Frequently managed by volunteers, most exempt organizations may not maintain details of their activities in sufficient detail to complete Form 990 accurately. Tax practitioners should anticipate the need to ask probing questions about activities that may at first seem in line with the organization's exempt purpose.

⁶⁴ Instructions for Form 990, Form 990-EZ, and Schedule B (Form 990).

FORM 990-T⁶⁵

An exempt organization reports its UBI and computes any UBTI liability on Form 990-T. Exempt organizations use this form to report proxy tax liability and claim a refund of income tax paid by a regulated investment company or a real estate investment trust on any undistributed long-term capital gain. Any domestic or foreign organization exempt under §§501(a) or 529(a) must file Form 990-T if it has gross income from an unrelated trade or business totaling \$1,000 or more.⁶⁶

Organizations filing Form 990-T should make **estimated tax payments** if the expected tax for the year is \$500 or more.⁶⁷ These deposits must be made using electronic funds transfer mechanisms, such as Electronic Federal Tax Payment System (EFTPS). Exempt organizations that are not exempt trusts must make estimated tax payments by the 15th day of the 4th, 6th, 9th, and 12th months of the tax year to avoid penalties.⁶⁸ The tax can be estimated using Form 990-W, *Estimated Tax on Unrelated Business Taxable Income for Tax-Exempt Organizations*, discussed later.

Forms filed for an employee's trust, individual retirement arrangement (IRA), Roth IRA, Coverdell education savings account, and Archer medical savings account are **due** on the 15th day of the fourth month after the end of the organization's tax year. All other entities must file by the 15th day of the fifth month after the tax year-end. The **penalty for late filing** is 5% of the unpaid tax for each month or part of a month the return is late, up to 25%. The minimum penalty for a return more than 60 days late is the smaller of the tax due, or \$435.⁶⁹ The **penalty for late tax payment** is one-half of 1% of the unpaid tax for each month or part of a month, not to exceed 25% of the unpaid tax.

Form 990-T must be filed electronically.

FORM 990-PF⁷⁰

Form 990-PF is used to calculate tax based on investment income and to report charitable distributions and activities. The following organizations must file it.

- Exempt private foundations
- Taxable private foundations
- Organizations that agree to private foundation status while their application is pending
- Organizations that claim private foundation status, have not yet applied for exempt status, and whose application is not untimely under IRC §508(a) for retroactive recognition of exemption
- Organizations that made an election under IRC §41(e)(6)(D)(iv), which pertains to organizations choosing to perform research as private foundations
- Private foundations making an IRC §507 termination
- IRC §4947(a)(1) nonexempt charitable trusts that are treated as private foundations

Form 990-PF is due by the 15th day of the fifth month following the close of a foundation's tax year. Failure to file a timely return bears the same penalties as Forms 990 and 990-EZ. However, large organizations are subject to a \$110-per-day fine rather than \$20 per day.⁷¹ The IRS requires organizations to file Form 990-PF electronically.⁷²

⁶⁵ Instructions for Form 990-T.

⁶⁶ Form 990-T can also be used to request a credit for some federal excise taxes or for small employer health insurance premiums paid.

⁶⁷ IRM 21.3.8.10.3.5 (2011).

⁶⁸ IRC §6655(c)(2).

⁶⁹ IRC §6651(a).

⁷⁰ Instructions for Form 990-PF.

⁷¹ In 2022, a large organization has gross receipts exceeding \$1,129,000; Rev. Proc. 2021-45, 2020-48 IRB 764.

⁷² IRC §6033(i)(1).

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FORM 990-N⁷³

Small exempt organizations with normal annual gross receipts of \$50,000 or less are generally eligible to file a Form 990-N. An eligible organization to file a Form 990-N may alternatively choose to file a Form 990 or 990-EZ. The instructions for the form have technical requirements for registering and filing Form 990-N, such as the following.⁷⁴

- Closing multiple browsers
- Avoiding the use of smartphones to register or complete the form
- Using only accepted text characters (up to 35 characters), which include only letters, numbers, and hyphens
- Checking spam or junk email folders for email correspondence

As with other forms in the 990 series, the IRS accepts only electronically filed Forms 990-N.

UNFILED RETURNS

Exempt organizations may fail to file an annual information return with the IRS for a variety of reasons. However, the IRS terminates the exempt status of such organizations that do not file returns for three consecutive years.⁷⁵ Two years of unfiled returns prompts the IRS to send a warning letter advising the exempt organization that it risks losing its exemption should it fail to file one additional information return.



Practitioner Planning Tip

Tax practitioners who prepare returns for exempt organizations should have contact information for multiple officers of the organization. This allows for backup contacts when an officer does not respond. Additionally, having either Form 2848 or Form 8821 in place ensures the practitioner receives copies of any notices regarding the possible loss of tax exemption.

⁷³ *Annual Electronic Filing Requirement for Small Exempt Organizations — Form 990-N (e-Postcard)*. Feb. 24, 2022. IRS. [www.irs.gov/charities-non-profits/annual-electronic-filing-requirement-for-small-exempt-organizations-form-990-n-e-postcard] Accessed on Mar. 31, 2022.

⁷⁴ *IRS Form 990-N Electronic Filing System (e-Postcard) User Guide*. p. 2. Mar. 2018. IRS. [www.irs.gov/pub/irs-pdf/p5248.pdf] Accessed on Feb. 15, 2022.

⁷⁵ *Taxpayer First Act*. PL 116-25, §3102(a).

Exempt organizations are afforded an exemption from income tax on activities related to their exempt purpose. If an organization engages in a trade or business unrelated to its exempt purpose, the exempt organization must use Form 990-T to report and pay tax. This requirement helps prevent an exempt entity from competing unfairly against tax-paying businesses.⁷⁷

Example 3. The local college, an exempt organization, sells branded athletic gear to the general public at its on-campus bookstore. The college must include these sales on its Form 990-T filing. With this filing, the bookstore pays income tax on the sales of athletic gear. Other area stores, all privately owned, sell the same merchandise and pay income tax on the sale.

Because the on-campus bookstore pays tax via the Form 990-T, the on-campus bookstore does not operate at a competitive advantage over the for-profit store that must pay income tax on their sales of the same product.

An organization subject to the unrelated business tax is taxed at the corporate tax rates or trust rates, depending on the nature of the organization.

UBTI is defined as the gross income derived from any unrelated trade or business that is regularly carried on and not substantially related to the organization's exempt purpose or function aside from the need for income or funds or the use it makes of the profits. A trade or business is any activity carried on to produce income from selling goods or performing services.⁷⁸

The "not substantially related to" requirement means the activity producing the income does not contribute primarily to the organization's exempt purpose.⁷⁹ The exempt organization should determine this on a case-by-case basis. The following are some examples of unrelated activities as determined by the IRS.

- The sale of membership lists to business firms⁸⁰
- A miniature golf course open to the public, operated by a youth welfare organization⁸¹
- Rental income from the lease of an exempt university's football stadium to a professional football team⁸²

Additional examples can be found in IRS Pub. 598, *Tax on Unrelated Business Income of Exempt Organizations*.

INCOME EXCLUDED FROM UBTI

Exempt organizations may exclude specific types of income when computing UBTI. The following exclusions are subject to special rules and generally do not need to be included in UBTI.

1. Dividends, interest, income from lending securities, income from entering into lending agreements, annuities, and other investment income unless the investment income is earned by a controlled foreign corporation under IRC §951(a)(1)(A). In this case, the investment income is subject to tax as UBTI.
2. Royalties and overriding royalties, although this exclusion does not apply to social clubs, voluntary employee benefit associations, and trusts for supplemental unemployment benefits

⁷⁶ IRC §§511 and 512.

⁷⁷ See Ltr. Rul. 200622052 (May 15, 2005).

⁷⁸ IRC §513.

⁷⁹ IRC §513(a).

⁸⁰ Ltr. Rul. 9248001 (May 18, 1992).

⁸¹ Rev. Rul. 79-361, 1979-2 CB 237.

⁸² Rev. Rul. 80-298, 1980-2 CB 197.

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3. Rents from real property and associated personal property but only if rents from personal property are less than 10% of all rents from the property⁸³
4. Gains and losses from sale or disposition of property that is not inventory or normally sold to customers
5. Investment activity, including income that is derived from the lapse or disposition of options on securities, unless the organization writes options as a part of its business
6. Net operating losses
7. Income from research
8. Income from services provided under federal license
9. Gain or loss on disposition of property acquired from a financial institution in receivership or conservatorship
10. Member income of mutual or cooperative electric companies
11. Gain or loss on disposition of certain brownfield property

Certain types of exempt organizations may not exclude investment income from their UBTI, including the following.

- Social clubs exempt under §501(c)(7)
- Voluntary employee benefit associations under §501(c)(9)
- Trusts for plans providing supplemental unemployment benefits under §501(c)(17)

ACTIVITIES EXCLUDED FROM UBTI⁸⁴

Income from the following activities is also specifically excluded from UBTI.

1. An activity in which substantially all the work is performed for the organization by volunteers working without compensation, such as a charity golf tournament
2. Activities carried on by a §501(c)(3) organization primarily for the convenience of its members, students, patients, officers, or employees
3. Soliciting and receiving qualified sponsorship payments
4. The sale of merchandise received as gifts or contributions (e.g., a thrift shop)
5. An association selling work-related clothes and equipment and items normally sold through vending machines to members at their usual place of employment
6. Bingo games meeting specific criteria
7. A qualified pole rental by a mutual or cooperative telephone or electric company described in §501(c)(12)(D)
8. Qualified convention or trade show activities
9. A qualified public entertainment activity
10. Exchange or rental of member lists between §501 organizations
11. Hospital services described in §501(e)(1)(A) to other exempt hospitals subject to IRC §513(e)

Special rules apply to the sale of advertising in a periodical published by an exempt organization. Additional research is required to determine the taxability of income associated with this activity.⁸⁵

⁸³ Treas. Reg. §1.512(b)-1(c)(2)(ii).

⁸⁴ IRC §513.

⁸⁵ Treas. Reg. §1.513-1(d)(4)(iv) contains numerous examples illustrating the difficulty of characterizing advertising that is distributed in a nonprofit organization's publications.

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DEDUCTIONS

UBTI deductions include expenses, depreciation, and similar items that qualify as deductions allowed by IRC §§162, 167, or other applicable code sections. These deductions **must be directly connected** to the operation of the unrelated trade or business activity. To be directly connected, there must be a close and primary relationship with the business.

Dual-use of facilities or personnel should be allocated on a reasonable basis. For example, if 10% of an organization's building is used for an unrelated business purpose, 10% of the expenses of that building (e.g., utilities, insurance, and depreciation) must be allocated. Expenses are not deductible if the unrelated business use exploits the exempt activity. However, there is an exception if all these three criteria apply.⁸⁶

1. The unrelated business exploits the exempt activity in the sense that it produces income for the exempt organization incidental to the exempt purpose of the organization and is not directly connected to the unrelated trade or business activity.
2. The unrelated business is a type normally carried on for profit by taxable organizations.
3. The exempt activity is a type normally conducted by taxable organizations in carrying on that type of business.

Example 4. The Fraternal Organization of Merrymakers qualifies as a §501(c)(7) exempt organization with 100 members. The organization owns a banquet hall where it holds weekly dinners and dances for its members. It also rents the hall to members and occasionally to a nonmember. Profits from these functions are donated back to charitable organizations in the organization's community.

In 2021, it rents the banquet hall to nonmembers for two wedding receptions. Therefore, it has some UBTI and must file Form 990-T with its Form 990.

The information regarding the rental of the banquet hall follows.

	Amount	Percentage
Income		
Rental to members	\$ 8,499	75%
Rental to nonmembers	<u>2,851</u>	<u>25%</u>
	\$11,350	100%
	Direct Expense	25% of Expense
Rental Expense		
Insurance	\$ 459	\$ 115
Utilities	3,073	768
Repairs	850	213
Real estate tax	610	153
Depreciation	400	100
Refunds	<u>1,400</u>	<u>0</u> (none are unrelated)
Total rental expense	\$ 6,792	\$1,349

The organization prepares the Form 990-T shown on the following pages.

⁸⁶ Treas. Reg. §1.512(a)-1(d)(1).

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For Example 4

Form 990-T	Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e))	OMB No. 1545-0047
For calendar year 2021 or other tax year beginning _____, 2021, and ending _____, 20		2021
Department of the Treasury Internal Revenue Service		Open to Public Inspection for 501(c)(3) Organizations Only
▶ Go to www.irs.gov/Form990T for instructions and the latest information. ▶ Do not enter SSN numbers on this form as it may be made public if your organization is a 501(c)(3).		
A <input type="checkbox"/> Check box if address changed.	Name of organization (<input type="checkbox"/> Check box if name changed and see instructions.) Fraternal Organization of Merrymakers	D Employer identification number 99-9999901
B Exempt under section <input checked="" type="checkbox"/> 501(c) (7) <input type="checkbox"/> 408(e) <input type="checkbox"/> 220(e) <input type="checkbox"/> 408A <input type="checkbox"/> 530(a) <input type="checkbox"/> 529(a) <input type="checkbox"/> 529A	Print or Type Number, street, and room or suite no. If a P.O. box, see instructions. 123 Main St	E Group exemption number (see instructions)
	City or town, state or province, country, and ZIP or foreign postal code Donnellson, IL 62019	
C Book value of all assets at end of year ▶ 2,004		F <input type="checkbox"/> Check box if an amended return.
G Check organization type ▶ <input checked="" type="checkbox"/> 501(c) corporation <input type="checkbox"/> 501(c) trust <input type="checkbox"/> 401(a) trust <input type="checkbox"/> Other trust		
H Check if filing only to ▶ <input type="checkbox"/> Claim credit from Form 8941 <input type="checkbox"/> Claim a refund shown on Form 2439		
I Check if a 501(c)(3) organization filing a consolidated return with a 501(c)(2) titleholding corporation ▶ <input type="checkbox"/>		
J Enter the number of attached Schedules A (Form 990-T) ▶ 1		
K During the tax year, was the corporation a subsidiary in an affiliated group or a parent-subsidiary controlled group? ▶ <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No If "Yes," enter the name and identifying number of the parent corporation ▶		
L The books are in care of ▶ Mary Smith Telephone number ▶ 217-555-1212		
Part I Total Unrelated Business Taxable Income		
1	Total of unrelated business taxable income computed from all unrelated trades or businesses (see instructions)	1,502
2	Reserved	
3	Add lines 1 and 2	1,502
4	Charitable contributions (see instructions for limitation rules)	
5	Total unrelated business taxable income before net operating losses. Subtract line 4 from line 3	1,502
6	Deduction for net operating loss. See instructions	
7	Total of unrelated business taxable income before specific deduction and section 199A deduction. Subtract line 6 from line 5	1,502
8	Specific deduction (generally \$1,000, but see instructions for exceptions)	1,000
9	Trusts. Section 199A deduction. See instructions	
10	Total deductions. Add lines 8 and 9	1,000
11	Unrelated business taxable income. Subtract line 10 from line 7. If line 10 is greater than line 7, enter zero	502
Part II Tax Computation		
1	Organizations taxable as corporations. Multiply Part I, line 11 by 21% (0.21) ▶	105
2	Trusts taxable at trust rates. See instructions for tax computation. Income tax on the amount on Part I, line 11 from: <input type="checkbox"/> Tax rate schedule or <input type="checkbox"/> Schedule D (Form 1041) ▶	
3	Proxy tax. See instructions ▶	
4	Other tax amounts. See instructions	
5	Alternative minimum tax (trusts only)	
6	Tax on noncompliant facility income. See instructions	
7	Total. Add lines 3 through 6 to line 1 or 2, whichever applies	105
For Paperwork Reduction Act Notice, see instructions. Cat. No. 11291J Form 990-T (2021)		

2022 Workbook

For Example 4

Form 990-T (2021)

Page **2**

Part III Tax and Payments

1a Foreign tax credit (corporations attach Form 1118; trusts attach Form 1116)	1a			
b Other credits (see instructions)	1b			
c General business credit. Attach Form 3800 (see instructions)	1c			
d Credit for prior year minimum tax (attach Form 8801 or 8827)	1d			
e Total credits. Add lines 1a through 1d	1e			0
2 Subtract line 1e from Part II, line 7	2			105
3 Other amounts due. Check if from: <input type="checkbox"/> Form 4255 <input type="checkbox"/> Form 8611 <input type="checkbox"/> Form 8697 <input type="checkbox"/> Form 8866 <input type="checkbox"/> Other (attach statement)	3			
4 Total tax. Add lines 2 and 3 (see instructions). <input type="checkbox"/> Check if includes tax previously deferred under section 1294. Enter tax amount here	4			105
5 Current net 965 tax liability paid from Form 965-A, Part II, column (k)	5			
6a Payments: A 2020 overpayment credited to 2021	6a			
b 2021 estimated tax payments. Check if section 643(g) election applies <input type="checkbox"/>	6b			
c Tax deposited with Form 8868	6c			
d Foreign organizations: Tax paid or withheld at source (see instructions)	6d			
e Backup withholding (see instructions)	6e			
f Credit for small employer health insurance premiums (attach Form 8941)	6f			
g Other credits, adjustments, and payments: <input type="checkbox"/> Form 2439 <input type="checkbox"/> Form 4136 <input type="checkbox"/> Other Total	6g			
7 Total payments. Add lines 6a through 6g	7			0
8 Estimated tax penalty (see instructions). Check if Form 2220 is attached <input type="checkbox"/>	8			
9 Tax due. If line 7 is smaller than the total of lines 4, 5, and 8, enter amount owed	9			105
10 Overpayment. If line 7 is larger than the total of lines 4, 5, and 8, enter amount overpaid	10			
11 Enter the amount of line 10 you want: Credited to 2022 estimated tax <input type="checkbox"/> Refunded <input type="checkbox"/>	11			

Part IV Statements Regarding Certain Activities and Other Information (see instructions)

	Yes	No
1 At any time during the 2021 calendar year, did the organization have an interest in or a signature or other authority over a financial account (bank, securities, or other) in a foreign country? If "Yes," the organization may have to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts. If "Yes," enter the name of the foreign country here		X
2 During the tax year, did the organization receive a distribution from, or was it the grantor of, or transferor to, a foreign trust? If "Yes," see instructions for other forms the organization may have to file.		X
3 Enter the amount of tax-exempt interest received or accrued during the tax year . . . ▶ \$ 0		
4 Enter available pre-2018 NOL carryovers here ▶ \$. . . Do not include any post-2017 NOL carryover shown on Schedule A (Form 990-T). Don't reduce the NOL carryover shown here by any deduction reported on Part I, line 6.		
5 Post-2017 NOL carryovers. Enter available Business Activity Code and post-2017 NOL carryovers. Don't reduce the amounts shown below by any NOL claimed on any Schedule A, Part II, line 17 for the tax year. See instructions.		
Business Activity Code	Available post-2017 NOL carryover	
_____	\$ _____	
_____	\$ _____	
_____	\$ _____	
_____	\$ _____	
6a Did the organization change its method of accounting? (see instructions)		X
b If 6a is "Yes," has the organization described the change on Form 990, 990-EZ, 990-PF, or Form 1128? If "No," explain in Part V.		

Part V Supplemental Information

Provide the explanation required by Part IV, line 6b. Also, provide any other additional information. See instructions.

Sign Here	Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.			
	Signature of officer _____	Date _____	President _____	Title _____
Paid Preparer Use Only	Print/Type preparer's name Sam Preparer		Preparer's signature _____	Date 5/14/22
	Firm's name ▶ _____		Check <input type="checkbox"/> if self-employed PTIN P09999999	
	Firm's address ▶ _____		Firm's EIN ▶ _____ Phone no. _____	

Form **990-T** (2021)

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2022 Workbook

For Example 4

**SCHEDULE A
(Form 990-T)**

**Unrelated Business Taxable Income
From an Unrelated Trade or Business**

OMB No. 1545-0047

2021

Department of the Treasury
Internal Revenue Service

▶ Go to www.irs.gov/Form990T for instructions and the latest information.
▶ Do not enter SSN numbers on this form as it may be made public if your organization is a 501(c)(3).

Open to Public Inspection for
501(c)(3) Organizations Only

A Name of the organization Fraternal Organization of Merrymakers	B Employer identification number 99-9999901
C Unrelated business activity code (see instructions) ▶ 530000	D Sequence: 1 of 1

E Describe the unrelated trade or business ▶ **Rental of Banquet Hall**

Part I	Unrelated Trade or Business Income	(A) Income	(B) Expenses	(C) Net
1a	Gross receipts or sales			
b	Less returns and allowances			
	c Balance ▶			
2	Cost of goods sold (Part III, line 8)			
3	Gross profit. Subtract line 2 from line 1c			
4a	Capital gain net income (attach Sch D (Form 1041 or Form 1120)). See instructions			
b	Net gain (loss) (Form 4797) (attach Form 4797). See instructions			
c	Capital loss deduction for trusts			
5	Income (loss) from a partnership or an S corporation (attach statement)			
6	Rent income (Part IV)	2,851	1,349	1,502
7	Unrelated debt-financed income (Part V)			
8	Interest, annuities, royalties, and rents from a controlled organization (Part VI)			
9	Investment income of section 501(c)(7), (9), or (17) organizations (Part VII)			
10	Exploited exempt activity income (Part VIII)			
11	Advertising income (Part IX)			
12	Other income (see instructions; attach statement)			
13	Total. Combine lines 3 through 12	2,851	1,349	1,502

Part II	Deductions Not Taken Elsewhere	See instructions for limitations on deductions. Deductions must be directly connected with the unrelated business income	
1	Compensation of officers, directors, and trustees (Part X)		1
2	Salaries and wages		2
3	Repairs and maintenance		3
4	Bad debts		4
5	Interest (attach statement). See instructions		5
6	Taxes and licenses		6
7	Depreciation (attach Form 4562). See instructions	7	100
8	Less depreciation claimed in Part III and elsewhere on return	8a	100
9	Depletion		9
10	Contributions to deferred compensation plans		10
11	Employee benefit programs		11
12	Excess exempt expenses (Part VIII)		12
13	Excess readership costs (Part IX)		13
14	Other deductions (attach statement)		14
15	Total deductions. Add lines 1 through 14		15
16	Unrelated business income before net operating loss deduction. Subtract line 15 from Part I, line 13, column (C)		1,502
17	Deduction for net operating loss. See instructions		17
18	Unrelated business taxable income. Subtract line 17 from line 16		1,502

For Paperwork Reduction Act Notice, see instructions. Cat. No. 740360 Schedule A (Form 990-T) 2021

SPECIAL UBTI CALCULATIONS FOR CERTAIN ORGANIZATIONS⁸⁷

The following three types of organizations must calculate UBTI without excluding investment income such as dividends, interest, rent, royalties, etc.

1. Social clubs described in section §501(c)(7)
2. Voluntary employees' beneficiary associations described in §501(c)(9)
3. Supplemental unemployment compensation benefit trusts described in §501(c)(17)

Additionally, there are other special rules for veterans' organizations and foreign organizations.⁸⁸

- UBTI for a §501(c)(17) veterans' organization does not include an insurance business's net income, provided it is not used for anything except the insurance business.⁸⁹
- The UBTI of a **foreign** organization includes the following in its UBTI.⁹⁰
 - ♦ UBTI from sources within the United States if unconnected with the conduct of a trade or business inside the United States
 - ♦ UBTI connected with a trade or business in the United States regardless of the income's origin

ESTIMATED UBTI TAX PAYMENTS WITH FORM 990-W WORKSHEET⁹¹

Estimated tax payments on UBTI are facilitated with Form 990-W. If an exempt organization owes \$500 or more in tax for a tax year, the Code requires it to make estimated tax payments.⁹² The following types of exempt organizations use Form 990-W.

- Tax-exempt corporations
- Tax-exempt trusts
- Domestic private foundations

Form 990-W is not filed but is used by the exempt organization and kept in its records. The worksheet considers the tax liability, credits, other taxes, such as the base erosion tax and recaptured tax credits, and any credit for federal tax on fuels. Exempt organizations use the form to estimate the annual tax to make it easier to pay it. Any associated payment is submitted electronically.

⁸⁷. IRC §512(a)(3) and IRS Pub. 598, *Tax on Unrelated Business Income of Exempt Organizations*.

⁸⁸. *Ibid.*

⁸⁹. IRC §512(a)(4).

⁹⁰. IRC §§861-865.

⁹¹. *Form 990-W: Estimated Tax on Unrelated Business Taxable Income for Tax-Exempt Organizations*. pp. 4-7. 2022. IRS. [www.irs.gov/pub/irs-pdf/f990w.pdf] Accessed on Apr. 19, 2022.

⁹². IRC §§6655(f) and (g)(3).

OFFICER ISSUES⁹³

As exempt organizations normally pay no taxes, the IRS has an understandable interest in what the organizations and their officers do to fulfill their purposes. The IRS is interested in exempt organizations' officers and their activities, particularly in that their identities and relationships may provide clues about activities that may not be evident from the financial results reported in their annual returns.

OFFICER'S COMPENSATION

Form 990, part VII, requests information about compensation for any officer, director, trustee, and key employee. It asks for the number of hours they work in a typical week and their compensation from the organization filing the report and any related organizations. The form presents checkboxes so that the organization can explicitly report if:

- Any former officers are listed in part VII because of their compensation,
- Any individual had total reportable compensation greater than \$100,000, and
- Any person was compensated by an unrelated organization for services provided to the reporting organization.

Example 5. Jeff is the chief operating officer and the top management official of the Greater Girvin Food Pantry, Inc. (GGFP), a §501(c)(3) organization that makes food available to underprivileged children.⁹⁴ Under GGFP's bylaws, Jeff does not have the authority to remove or replace other governing board members. Thus, Jeff does not control GGFP, even though he is its CEO and a member of its governing board.

In addition to the modest annual compensation of \$12,000 from GGFP, Jeff is also paid by the landscaping business for which he works, Girvin Grass, LLC, for the work he performs for GGFP. Jeff also owns a 40% capital interest in Girvin Grass, LLC, although it is an unrelated organization. The officers and directors of GGFP are aware of the compensation arrangement between Jeff and Girvin Grass, and GGFP does not include wages paid by Girvin Grass to Jeff for services to GGFP on Jeff's Form W-2, *Wage and Tax Statement*. Jeff is listed as an officer in Form 990, part VII, section A. Additionally, the amounts paid by Girvin Grass to Jeff require that GGFP mark the "Yes" checkbox beside the following question in Form 990:

Did any person listed on line 1a receive or accrue compensation from any unrelated organization or individual for services rendered to the organization?

Form 990, Schedule J, *Compensation Information*, asks detailed questions about compensation arrangements for officers, directors, and persons listed on Form 990, section A, line 1a. The questions involve benefits such as first-class travel, discretionary spending accounts, housing allowances, and health club dues. It asks about the process used to determine executive compensation. It reflects the IRS's concern that exempt organizations may use complicated payment arrangements to ensure that they compensate their leadership well while avoiding appearances that might call into question its frugality.

⁹³ See instructions for Form 990 and Form 990-EZ.

⁹⁴ Example adapted from instructions for Form 990.

2022 Workbook

Example 6. Use the same facts as **Example 5**. GGFP is required to complete Schedule J (Form 990) disclosing information about Jeff’s relationship and compensation. Girvin Grass, LLC pays Jeff a salary of \$40,000 annually. Jeff meticulously maintains time records showing that 5% of his time working for Girvin Grass during 2021 was associated with GGFP’s business. Although GGFP’s board is aware of this relationship, it is also aware that Girvin Grass does **not** treat any portion of the salary it pays to Jeff as a charitable deduction. Because Girvin Grass does not claim a charitable contribution for this portion of Jeff’s salary, it falls into a reporting exception for Form 990. GGFP is not required to include the \$2,000 allocation of Jeff’s salary from Girvin Grass on its Form 990 part VII compensation.

If Girvin Grass had treated the portion of income it paid to Jeff as a charitable contribution, GGFP would be required to include a portion of Jeff’s salary in its column (d), *Reportable compensation from the organization (W-2/1099-MISC/1099-NEC)*. The income paid by Girvin Grass would not qualify for the taxable organization employee exception.

Because GGFP’s board is aware of this relationship, its Form 990 lists Jeff’s compensation as \$14,000 (\$12,000 paid by GGFP + (\$40,000 paid by Girvin Grass × 5% time spent on GGFP property)). This number is shown on Form 990, part VII, section A, page 7. On its income tax return, Girvin Grass treats the portion of Jeff’s salary allocable to GGFP as a charitable contribution. Portions of pages 7 and 8 from GGFP’s Form 990 information return are shown below, followed by Schedule J.

Form 990 (2021)

Page **7**

Part VII Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors

Check if Schedule O contains a response or note to any line in this Part VII

Section A. Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees

1a Complete this table for all persons required to be listed. Report compensation for the calendar year ending with or within the organization’s tax year.

- List all of the organization’s **current** officers, directors, trustees (whether individuals or organizations), regardless of amount of compensation. Enter -0- in columns (D), (E), and (F) if no compensation was paid.
- List all of the organization’s **current** key employees, if any. See the instructions for definition of “key employee.”
- List the organization’s five **current** highest compensated employees (other than an officer, director, trustee, or key employee) who received reportable compensation (box 5 of Form W-2, Form 1099-MISC, and/or box 1 of Form 1099-NEC) of more than \$100,000 from the organization and any related organizations.
- List all of the organization’s **former** officers, key employees, and highest compensated employees who received more than \$100,000 of reportable compensation from the organization and any related organizations.
- List all of the organization’s **former directors or trustees** that received, in the capacity as a former director or trustee of the organization, more than \$10,000 of reportable compensation from the organization and any related organizations.

See the instructions for the order in which to list the persons above.

Check this box if neither the organization nor any related organization compensated any current officer, director, or trustee.

(A) Name and title	(B) Average hours per week (list any hours for related organizations below dotted line)	(C) Position (do not check more than one box, unless person is both an officer and a director/trustee)						(D) Reportable compensation from the organization (W-2/1099-MISC/1099-NEC)	(E) Reportable compensation from related organizations (W-2/1099-MISC/1099-NEC)	(F) Estimated amount of other compensation from the organization and related organizations
		Individual trustee or director	Institutional trustee	Officer	Key employee	Highest compensated employee	Former			
(1) Jeff Walker CEO	8 0	X		X				12,000	0	0
(2)										

2022 Workbook

For Example 6

reportable compensation from the organization		Yes	No
3	Did the organization list any former officer, director, trustee, key employee, or highest compensated employee on line 1a? <i>If "Yes," complete Schedule J for such individual</i>		X
4	For any individual listed on line 1a, is the sum of reportable compensation and other compensation from the organization and related organizations greater than \$150,000? <i>If "Yes," complete Schedule J for such individual</i>		X
5	Did any person listed on line 1a receive or accrue compensation from any unrelated organization or individual for services rendered to the organization? <i>If "Yes," complete Schedule J for such person</i>	X	

Section B. Independent Contractors

SCHEDULE O (Form 990)

Department of the Treasury
Internal Revenue Service

Supplemental Information to Form 990 or 990-EZ

Complete to provide information for responses to specific questions on Form 990 or 990-EZ or to provide any additional information.

▶ Attach to Form 990 or Form 990-EZ.

▶ Go to www.irs.gov/Form990 for the latest information.

OMB No. 1545-0047

2021

Open to Public Inspection

Name of the organization

Greater Girvin Food Pantry

Employer identification number

99-9999902

Form 990, Part VI, Line 11b - Form 990 Review Process

No review was or will be conducted.

Form 990, Part VI, Line 19 - Other Organization Documents Publicly Available

No other documents publicly available to the public.

Form 990, Part VII - Compensation Explanation

Jeff Walker

Reported compensation includes \$2,000 paid as salary from an unrelated organization, Girvin Grass, LLC,

which was treated as a tax deduction.

2022 Workbook

For Example 6

SCHEDULE J (Form 990)

Department of the Treasury
Internal Revenue Service

Name of the organization

Compensation Information

For certain Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees

▶ Complete if the organization answered "Yes" on Form 990, Part IV, line 23.

▶ Attach to Form 990.

▶ Go to www.irs.gov/Form990 for instructions and the latest information.

OMB No. 1545-0047

2021

Open to Public Inspection

Greater Girvin Food Pantry, Inc.

Employer identification number

99-9999902

Part I Questions Regarding Compensation

1a Check the appropriate box(es) if the organization provided any of the following to or for a person listed on Form 990, Part VII, Section A, line 1a. Complete Part III to provide any relevant information regarding these items.

- | | |
|--|--|
| <input type="checkbox"/> First-class or charter travel | <input type="checkbox"/> Housing allowance or residence for personal use |
| <input type="checkbox"/> Travel for companions | <input type="checkbox"/> Payments for business use of personal residence |
| <input type="checkbox"/> Tax indemnification and gross-up payments | <input type="checkbox"/> Health or social club dues or initiation fees |
| <input type="checkbox"/> Discretionary spending account | <input type="checkbox"/> Personal services (such as maid, chauffeur, chef) |

b If any of the boxes on line 1a are checked, did the organization follow a written policy regarding payment or reimbursement or provision of all of the expenses described above? If "No," complete Part III to explain.

2 Did the organization require substantiation prior to reimbursing or allowing expenses incurred by all directors, trustees, and officers, including the CEO/Executive Director, regarding the items checked on line 1a?

3 Indicate which, if any, of the following the organization used to establish the compensation of the organization's CEO/Executive Director. Check all that apply. Do not check any boxes for methods used by a related organization to establish compensation of the CEO/Executive Director, but explain in Part III.

- | | |
|--|--|
| <input checked="" type="checkbox"/> Compensation committee | <input checked="" type="checkbox"/> Written employment contract |
| <input type="checkbox"/> Independent compensation consultant | <input type="checkbox"/> Compensation survey or study |
| <input type="checkbox"/> Form 990 of other organizations | <input type="checkbox"/> Approval by the board or compensation committee |

4 During the year, did any person listed on Form 990, Part VII, Section A, line 1a, with respect to the filing organization or a related organization:

- | | | | |
|--|----|--|---|
| a Receive a severance payment or change-of-control payment? | 4a | | X |
| b Participate in or receive payment from a supplemental nonqualified retirement plan? | 4b | | X |
| c Participate in or receive payment from an equity-based compensation arrangement? | 4c | | X |
- If "Yes" to any of lines 4a–c, list the persons and provide the applicable amounts for each item in Part III.

Only section 501(c)(3), 501(c)(4), and 501(c)(29) organizations must complete lines 5–9.

5 For persons listed on Form 990, Part VII, Section A, line 1a, did the organization pay or accrue any compensation contingent on the revenues of:

- | | | | |
|------------------------------------|----|--|---|
| a The organization? | 5a | | X |
| b Any related organization? | 5b | | X |
- If "Yes" on line 5a or 5b, describe in Part III.

6 For persons listed on Form 990, Part VII, Section A, line 1a, did the organization pay or accrue any compensation contingent on the net earnings of:

- | | | | |
|------------------------------------|----|--|---|
| a The organization? | 6a | | X |
| b Any related organization? | 6b | | X |
- If "Yes" on line 6a or 6b, describe in Part III.

7 For persons listed on Form 990, Part VII, Section A, line 1a, did the organization provide any nonfixed payments not described on lines 5 and 6? If "Yes," describe in Part III.

8 Were any amounts reported on Form 990, Part VII, paid or accrued pursuant to a contract that was subject to the initial contract exception described in Regulations section 53.4958-4(a)(3)? If "Yes," describe in Part III.

9 If "Yes" on line 8, did the organization also follow the rebuttable presumption procedure described in Regulations section 53.4958-6(c)?

	Yes	No
1a		
1b		
2		
3		
4a		X
4b		X
4c		X
5a		X
5b		X
6a		X
6b		X
7		X
8		X
9		

5

For Paperwork Reduction Act Notice, see the Instructions for Form 990.

Cat. No. 50053T

Schedule J (Form 990) 2021

2022 Workbook

For Example 6

Schedule J (Form 990) 2021

Page 2

Part II Officers, Directors, Trustees, Key Employees, and Highest Compensated Employees. Use duplicate copies if additional space is needed.

For each individual whose compensation must be reported on Schedule J, report compensation from the organization on row (i) and from related organizations, described in the instructions, on row (ii). Do not list any individuals that aren't listed on Form 990, Part VII.

Note: The sum of columns (B)(i)–(iii) for each listed individual must equal the total amount of Form 990, Part VII, Section A, line 1a, applicable column (D) and (E) amounts for that individual.

(A) Name and Title		(B) Breakdown of W-2 and/or 1099-MISC and/or 1099-NEC compensation			(C) Retirement and other deferred compensation	(D) Nontaxable benefits	(E) Total of columns (B)(i)–(D)	(F) Compensation in column (B) reported as deferred on prior Form 990
		(i) Base compensation	(ii) Bonus & incentive compensation	(iii) Other reportable compensation				
1 Jeff Walker CEO	(i)	14,000	0	0	0	0	14,000	0
	(ii)	0	0	0	0	0	0	0
	(i)							

Schedule J (Form 990) 2021

Page 3

Part III Supplemental Information

Provide the information, explanation, or descriptions required for Part I, lines 1a, 1b, 3, 4a, 4b, 4c, 5a, 5b, 6a, 6b, 7, and 8, and for Part II. Also complete this part for any additional information.

Compensation reported on this Schedule J for Jeff Walker, CEO of Greater Girvin Food Pantry, Inc., includes \$2,000 paid by Girvin Grass, LLC, an unrelated taxable organization. This amount is the portion of his salary and wages that Girvin Grass allocated to his work on behalf of Greater Girvin Food Pantry, Inc. Following the instructions for Form 990, this allocated amount is not included in the compensation included for Jeff Walker on Form 990, Part VII, line 1 because Girvin Grass meets the taxable organization employee exception that is only applicable for that form, part and line. Girvin Grass, LLC, does not treat the allocated amount of Jeff Walker's salary and wages as a charitable contribution on its tax return.

The questions are probing and may take some effort to produce a meaningful answer. The root issue is whether the exempt organization's activities focus on the fulfillment of its exempt purpose or whether its activities inordinately benefit insiders or another private interest.⁹⁵

RELATIONSHIPS AMONG THE OFFICERS

Complex compensation arrangements are not the only clue that an exempt organization may not be making decisions in line with its exempt purpose. Part VI of Form 990 reports how the exempt organization's governance supports its exempt purpose. It examines this issue from the following three angles.

Governing Body and Management

Section A of part VI has nine questions about the exempt organization's self-governance. It asks specifically about how many voting members of the governing body are **independent**. Members who are not independent could have a misplaced allegiance. The section asks whether any directors are aware of a "significant diversion" of assets. Additionally, there are questions about practices for documenting decisions by the organization's governing body. Taking the questions collectively, they infer an interest on the part of the IRS in whether the exempt organization's leaders maintain their focus on its purpose or whether the focus is blurred by relationships among members of its governing body.

The question of independence among members of an exempt organization is important enough to warrant its own schedule, Schedule L (Form 990), *Transactions with Interested Persons*. An individual member of the governing body is considered independent if they meet the following three requirements during the entire year.

1. The individual is not paid as an officer or employee of the organization unless a religious exception applies.
2. The individual did not receive total compensation exceeding \$10,000 during the organization's tax year as an independent contractor. Reasonable compensation is excluded from this determination.
3. Neither the individual nor any family member had a role in a transaction required to be reported on Schedule L for the tax year.

⁹⁵ *How to lose your 501(c)(3) tax-exempt status (without really trying)*. p. 1. IRS. [www.irs.gov/pub/irs-tege/How%20to%20Lose%20Your%20Tax%20Exempt%20Status.pdf] Accessed on Apr. 13, 2022.

The previous requirements also apply to the organizations related to the exempt organization. This situation might involve a family member of someone on the governing body of the exempt organization. If that family member had a transaction of interest with a related organization, the exempt organization should report it on Schedule L (Form 990). Although neither the board member nor the exempt organization is directly involved, the transaction must still be disclosed.

Policies

Section B of part VI has seven questions regarding any policies the organization has implemented that protect the organization's focus on its exempt purpose. It asks whether the following types of policies exist.

- Conflict of interest policy
- Whistleblower policy
- Document retention and destruction policy

In addition, it asks about whether the organization's compensation process provides for the inclusion of independent persons who can provide an independent view on fair compensation for its leadership. Taking these questions collectively, they focus on the extent to which the organization's policies provide for transparency and independent scrutiny of its activities.

Disclosure

Section C of part VI is the shortest of the three, asking just four questions about how the exempt organization discloses its Form 990, its original application for exemption, and how it makes public its policies and governing documents. In this way, it anticipates the involvement of interested outsiders. A final question concerns who maintains the organization's books and records and how that individual may be contacted.

SIGNING TAX DOCUMENTS

The instructions for Form 990 provide a broad list of officers who can sign the exempt organization's tax returns. One of the following officers may sign.

- President
- Vice president
- Treasurer
- Assistant treasurer
- Chief accounting officer
- Another corporate officer, such as a chief tax officer

Any officer with the legal authority to bind the exempt organization can sign Form 2848.⁹⁶ A slightly broader list of individuals is authorized to sign Form 8821.

- An officer to whom authority is granted by state law to legally bind the corporation
- An individual to whom signing authority has been delegated by the exempt organization's governing body
- Other officers or employees to whom signing authority has been delegated by written request by any principal officer (this request must include an attestation by the organization's secretary or other officer)

Once the corporation has been dissolved, any person authorized by state law or by another individual authorized by the Secretary of the Treasury to act on behalf of the exempt organization.

⁹⁶ Instructions for Form 2848.

BYLAW ISSUES⁹⁷

The IRS requests bylaws when considering an examination of an exempt organization.⁹⁸ However, bylaws are not considered an exempt organization's "governing instrument."⁹⁹

Bylaws are dependent on the requirements imposed by states in which exempt organizations are incorporated.¹⁰⁰ Regardless of their state of incorporation, the IRS requires all exempt organizations to maintain books and records, just like all corporations.¹⁰¹ Treasury regulations impose additional requirements on exempt organizations to comply with the requirements of IRC §6033.¹⁰² Typically, state laws require the governing board members to follow the organization's bylaws, and they may have personal liability if the bylaws are not followed. Substantial changes to bylaws may require mention in Schedule O (Form 990), *Supplemental Information to Form 990 or 990-EZ*.¹⁰³

An exempt organization's bylaws may authorize lobbying activities, gaming and raffle activities, creation of donor-advised funds, foreign offices, or conservation easements. The complexity of these topics puts them beyond the scope of this discussion.

REPRESENTING THE EXEMPT ORGANIZATION BEFORE THE IRS

An exempt organization may benefit by filing a Form 2848, authorizing an eligible tax practitioner to represent it. This form normally directs the IRS to send a copy of any correspondence to the tax practitioner.¹⁰⁴ Because the exempt organization may be operated by volunteers having outside commitments, the involvement of a tax professional may enable the organization to resolve IRS issues more quickly. Membership of an exempt organization's board may change, and the consistent involvement of a tax professional brings continuity to its relationship with the IRS.

As discussed previously, the IRS is required to revoke the exempt status of an organization not filing its annual return or notice for three years.¹⁰⁵ If two consecutive returns are not filed, the organization receives correspondence from the IRS. For this reason, having a Form 2848 on file with the IRS ensures the exempt organization has another avenue to address IRS issues. If an issue arises that could compromise the organization's exempt status, having an independent person advised of the issue makes it more likely that the issue will be addressed.

A tax practitioner may make it a practice to file an automatic extension for an exempt organization unless an officer or board member explicitly instructs the preparer not to do so. Language supporting this practice could be inserted into engagement letters to minimize possible confusion over the practice.

⁹⁷ *Exempt Organization — Bylaws*. Jan. 21, 2022. IRS. [www.irs.gov/charities-non-profits/other-non-profits/exempt-organization-bylaws] Accessed on Apr. 15, 2022.

⁹⁸ IRM 4.75.10.2 (2017).

⁹⁹ Treas. Reg. §1.508-3(c).

¹⁰⁰ *Exempt Organization — Bylaws*. Jan. 21, 2022. IRS. [www.irs.gov/charities-non-profits/other-non-profits/exempt-organization-bylaws] Accessed on Apr. 15, 2022.

¹⁰¹ IRC §6001.

¹⁰² See Treas. Regs. §§1.6033-1–1.6033-3.

¹⁰³ *Exempt Organization Annual Reporting Requirements — Changes to Governing Documents*. Jan. 21, 2022. IRS. [www.irs.gov/charities-non-profits/exempt-organization-annual-reporting-requirements-governance-and-related-issues-changes-to-governing-documents] Accessed Apr. 15, 2022.

¹⁰⁴ See Form 2848.

¹⁰⁵ IRC §6033(j).

Example 7. The Blackhawk Swimming Club (BSC) was organized as an exempt organization in 1995 to provide swimming lessons to children residing in an underprivileged neighborhood adjoining a large lake. Over the years, BSC provided swimming lessons to many children, resulting in a substantial decline in the number of water accidents at the lake. The organization depended on charitable contributions to hire staff to teach swimming lessons at the lake and its indoor swimming facility.

Because of this demonstrable success, BSC's leaders shared a greater interest in water sports and water safety than in its tax returns. Its responsibility to file Form 990-EZ returns was delegated to an individual with heavy career time commitments who did not file extensions. Several notices arrived from the IRS imposing heavy penalties on BSC. Because the IRS letter threatened loss of exempt status, the organization's long-term viability was jeopardized.

Working with its tax practitioner, the leadership of BSC responded to the IRS. In its letter, the leadership cited how the classes it offers provide safety benefits to the community. It explained that contributions in the past years had declined to a level not much greater than the penalties proposed by the IRS. Included with the letter was a newspaper clipping that reported how a BSC graduate had rescued another child's parent from drowning the previous summer. In concluding the letter, the BSC's president explicitly and respectfully requested that the IRS abate the late filing penalties in view of BSC's exempt purpose and its impact on the community.

Rather than signing the letter with the simple closing "Sincerely," the practitioner advised the president of BSC to end the letter with the following closing.

I declare under penalties of perjury that the above information is true, correct, and complete to the best of my knowledge.

The letter was read to the board before the president signed it, and no board member expressed concern about the accuracy of any part of the letter. It was mailed the next day by U.S. Postal Service Priority Mail and included Form 2848 with copies of the notices BSC had received.

Several months later, BSC received notices removing the penalty charges. Although relieved by the outcome, the board of BSC decided to use this circumstance as an opportunity to examine its operations. Its board of directors operating manual now stipulates that each board member review and sign off on the annual tax filing after discussing it at a board meeting. Working with its attorney, the board adopted a formal conflict of interest policy and a formal whistleblower policy. Discussion of BSC's financial reports now appears as a standing item on each board meeting's agenda.

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EXAMINATIONS OF CHURCHES¹⁰⁶

The IRS may initiate a tax inquiry on a church only on a limited basis as provided under IRC §7611. Provisions in this code section require that the Treasury must reasonably believe that an organization does not qualify for an exemption or that the organization should be paying taxes on UBTI.

These beliefs must be supported by a written statement of the facts and circumstances. These restrictions do not apply to inquiries regarding employment tax, criminal investigations, or to the investigation of any person connected with the church.

If circumstances satisfy the reasonable belief standard in the IRS's view, the examination commences as follows.

1. The IRS issues a written notice explaining its concerns.
2. The church is allowed a reasonable amount of time to respond.
3. If the church fails to respond or its response is inadequate, the IRS may issue a second notice informing the church that the IRS needs to examine the books and records.
4. The church then may request a conference with an IRS official.
5. If the examination proceeds, generally, it must be completed within two years from the date of the second notice.
6. If at any time during the inquiry, adequate information is provided to answer the original concerns, the matter is closed.

IRC §7611 also protects churches from subsequent examinations for a period of five years unless the previous inquiry resulted in a revocation, notice of deficiency, assessment, or request for a significant change in church operations, including a significant change in accounting practices.

Note. The loss of exemption for a church is a very serious matter. It is prudent for the governing board of a church to review the church's operations and activities annually to confirm the church's continued compliance.

¹⁰⁶. IRC §7611; Treas. Reg. §301.7611-1.

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EXEMPT ORGANIZATION QUESTIONNAIRE

The nonfinancial information that an exempt organization must provide on Form 990 or 990-EZ is detailed and involves knowledge of how the organization's board of directors operates. The following list of questions may be helpful to assist tax practitioners to accurately collect information for preparing these forms.

Question	Answer	
Has your organization's mission changed since last year?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Did your organization significantly change its program services since the last return was filed?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Does your organization receive more than 33.3% of its support from gifts, grants, contributions, or membership fees?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Did your organization receive contributions of \$5,000 or more from any one contributor?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Did your organization attempt to influence legislation last year, either by directly influencing legislators or by an attempt to build grassroots support for any position?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Did your organization receive any membership dues or assessments?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Did your organization receive any conservation easements as gifts during its last tax year?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Does your organization hold any assets in donor-restricted endowments?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Did your organization have expenses exceeding \$15,000 for professional fundraising?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
How many members did your board of directors have at the end of the tax year?	_____	
How many of them were independent?	_____	
Did any officer, director, trustee, or key employee have either a family relationship or business relationship with any other officer, director, trustee, or key employee?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Did your organization delegate control over management duties to an external management company?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Has your organization made significant changes to its articles of incorporation, articles of organization, or bylaws since the beginning of the last tax year?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Did the organization become aware of a significant diversion of the organization's assets?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Does the organization have members or stockholders?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
If YES, do they have the ability to appoint members of the board of directors?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
If YES, can they make governance decisions?	<input type="checkbox"/> YES	<input type="checkbox"/> NO

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Question	Answer	
Does your organization promptly produce minutes of board meetings?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
If YES, for the board of directors or other governing body?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
If YES, for other committees with authority to act on behalf of the board of directors?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Will the organization provide a copy of Form 990 or 990-EZ to each board member after it is prepared and before it is filed?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Please describe the process your organization uses to review its Form 990 or 990-EZ:		
<hr/>		
Does the organization have a written conflict of interest policy?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
If YES, year adopted: _____		
Are directors, officers, trustees, and key employees required to disclose annually interests that could result in conflicts?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
Does your organization have a written whistleblower policy?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
If YES, year adopted: _____		
Does your organization have a written document retention and destruction policy?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
If YES, year adopted: _____		
Does the organization determine the compensation of the CEO, Executive Director, or other top management official based on a review and approval by independent persons using comparability data and documentation of how the compensation decision was made?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
	<input type="checkbox"/> Not compensated	
Does the organization determine the compensation of other officers or key employees based on a review and approval by independent persons using comparable data and documentation of how the compensation decision was made?	<input type="checkbox"/> YES	<input type="checkbox"/> NO
	<input type="checkbox"/> Not compensated	