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## **Maintaining 501(c)(3) Tax-Exempt Status IRS Overview Course**

Welcome to the Maintaining 501(c)(3) Tax-Exempt Status Overview course. The information listed below is taken from the “Maintaining your Federal Tax-exempt Status” listed on the IRS Website. (See links at end of document). This outline format was developed directly from their training video to make it easier to read quickly. If you would rather watch the video, please find it at this link:

<https://www.stayexempt.irs.gov/home/existing-organizations/maintaining-501c3-tax-exempt-status>

This information is for organizations that have already been preapproved as a 501(c)3 nonprofit entity and need to understand what is required to maintain this status. You’ll also find it helpful to familiarize yourself with the charitable solicitation rules of your state - and learn a bit about “good governance” practices. \*\*Please also see the companion to this course: “CMSC’s Annual 501c3 Maintenance Checklist” on our Website.

### **REQUIRED FILINGS:**

1. Annual Exempt organization returns;
2. Unrelated business income tax filings;
3. Other returns and reports

### **ONGOING COMPLIANCE:**

1. Jeopardizing exemption;
2. Employment taxes;
3. Public disclosure requirements;
4. Other ongoing compliance issues

### **SIGNIFICANT EVENTS:**

1. Audits;
2. Private letter rulings;
3. Termination proceedings

### **Required Filings**

If you don’t keep accurate and detailed records of your organization’s activities, you won’t have the information you need to complete the filing requirements. Your organization has all kinds of financial records and must keep permanent records as well.

1. Accounting Files – either on paper or in a computer software program.
2. Permanent Records:



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- a. organizing document (which is sometimes called your Articles of Incorporation or your Charter),
  - b. a copy of your Form 1023 (the exemption application you submitted), and the
  - c. determination letter from the IRS you just mentioned. Vernon:
3. Copies of any returns and attachments you send to the IRS.
  4. Keep the records you used to prepare the returns.
  5. Information about your organization's programs,
  6. Meeting minutes for the governing board, and
  7. Minutes for any standing committees - like an executive or compensation committee.

*\*The IRS suggests keeping copies of returns and any supporting information for at least three years after you file the return.*

## **Financial Records:**

*There are four basic types of financial records you should keep: \*If your organization has more than one program, your recordkeeping system should allow you to track the income and expenses for each program separately. Also, your records should include a summary of transactions. This summary can be listed in your books (including journals and ledgers). Or many small organizations use checkbooks as the main source for entries into the books.*

1. Money coming in:
  - a. This includes cash register receipts,
  - b. bank deposit slips,
  - c. receipt books,
  - d. invoices,
  - e. credit card slips
  - f. Form 1099-MISC documents you send to the IRS
2. Money going out (documents that show expenses you incurred while running your organization and its programs)
  - a. including account statements,
  - b. canceled checks,
  - c. cash register receipts,
  - d. credit card sales slips,
  - e. invoices and petty cash slips.
  - f. If your organization produces and sells items, save documents on the materials you purchased to produce those items.
3. Employment tax records (You should save all employment tax records)
  - a. including any documents that show salaries, wages, benefits paid and taxes withheld.



- b. You may think employment tax records sound like “money going out,” but these documents are really a separate category.
- c. Employment records should be kept for at least 4 years.
- d. There are other employment-related items that deserve special attention. For those, take a look at IRS Publication 15 (Circular E), Employer’s Tax Guide, for more information.
- 4. Asset records (Asset records are documents showing the items your organization owns and uses in its activities, such as investments, buildings and furniture.):
  - a. When and how the asset was acquired
  - b. Whether any debt was used to acquire it
  - c. Purchase price
  - d. Selling price and expense of sale
  - e. Cost of any improvements
  - f. Deductions taken for depreciation or for casualty losses, such as fires or storms
  - g. How the asset is or was used
  - h. When and how the asset was disposed of
  - i. *\*Some example documents include purchase and sales invoices, real estate closing statements, cancelled checks or certain financial account statements as well as financing documents.*

**NOTES:**

*\*Save these records for three years after the date the return is due or filed, whichever is later, because during that time, you can amend a return to claim a credit or refund. Generally, this is also the period when the IRS can assess penalties or additional tax. In either case, you’ll need those records. And remember that some interested parties, such as a grantor, insurance company, creditor, or state agency, may require you to keep certain records for a longer time. However, with Asset documents, you should keep these documents for as long as you own the asset, plus three years after you dispose of the item.*

**Accounting Periods and Methods:**

- 1. Organization reporting to the IRS using a calendar year or a fiscal year.
- 2. Choose whether your organization will use a cash or accrual accounting method - or some sort of combination of the two.
  - a. Under the cash accounting method, revenue and expenses are recorded in the period they are actually received or expended in cash.
  - b. Under the accrual method, revenue and expenses are recorded in the period they are earned or incurred, regardless of whether cash is received or disbursed in that period.
  - c. With a combination – or “hybrid” accounting method, cash accounting is used for some items and accrual is used for others.



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*Every organization must use a consistent accounting method, which is a set of rules for determining when to report income and expenses. Under the cash method, generally, you report income in the tax year you received it; and you deduct expenses in the tax year you paid them. Generally, under an accrual method, you report income in the tax year you earn it, regardless of when payment is received. You deduct expenses in the tax year you incur them, regardless of when payment is made.*

*An organization typically makes these decisions when it begins operating and before it files its first annual tax return. When you applied for exemption, you used your application to tell the IRS what tax year and accounting method you planned to use. **Make sure you know what your organization told the IRS, so you report the right items at the right time - using the right method.** The following publications offer more information on recordkeeping: Publication 538, Accounting Periods and Methods Publication 583, Starting a Business and Keeping Records*

**Required Filings:**

Form 990 Options (There are details on annual filing requirements on the Required Filings page of the Lifecycle at IRS.gov.)

1. One of the Form 990-series returns – which is the annual information return required for most tax-exempt organizations. Depends on:
  - a. The type of your organization,
  - b. the amount of your annual gross receipts and the
  - c. total of your organization’s assets at the end of the tax year.
  - d. [www.irs.gov/990filing](http://www.irs.gov/990filing) shows the dollar thresholds for different forms.

*It’s important to note that there are serious consequences for not filing a required annual information return. If your organization doesn’t file for three years in a row, its tax-exempt status will be automatically revoked on the due date of the third return. If your tax-exempt status is revoked for not filing - and you want to get your status back - you’ll have to redo the application process, including filing Form 1023 and paying the appropriate user fees. Once revoked, if you want your reinstatement to be retroactive (which means “dated back to the day it was revoked”), you’ll have to show you had reasonable cause for not filing. More info: Publication 4221-PC, Compliance Guide for 501(c)(3) Public Charities*

2. Submit filings for your unrelated business income, or UBI.
  - a. Generally, unrelated business income is any income from trade or business activity that your organization conducts on a regular basis - that’s not substantially related to your organization’s exempt purpose.



- b. There are lots of activities that can generate UBI, such as commercial advertising in publications created by your organization - or selling goods or services to the public. Income from unrelated activities like these might be taxable.
  - c. Calculating and reporting UBI is a requirement for maintaining your tax-exempt status. Keep in mind that too much unrelated business can jeopardize your tax exemption.
  - d. Also see Publication 598, Tax on Unrelated Business Income of Exempt Organizations
3. You might need to file other returns depending on your organization's activities. You can find out about those on the IRS website as well, but Form 990 is the biggest and most important.

**Ongoing Compliance:**

1. There is an annual filing requirement.
2. Watch the amount of unrelated business income (UBI) that may not directly promote the organization's exempt purpose.
3. Many activities can jeopardize your tax-exempt status, such as political activity, lobbying, or permitting private benefit or inurement.
4. Another challenge facing exempt organizations is accurately classifying and reporting on any paid workers they have.
  - a. If your organization compensates anyone for services – either employees or independent contractors – there are rules you need to follow.
5. Public Inspection: What do tax-exempt organizations have to share with the public?
  - a. The exemption application, the determination letter and the three most recently-filed annual information returns available to the public, upon request and without charge (except for a reasonable charge for copying).
  - b. If your organization is a 501(c)(3) and files Form 990-T, Exempt Organization Business Income Tax Return, the three most recent of that return must be made available as well.
  - c. You only have to disclose the forms themselves, any attachments or separate items you sent in with the forms, and any correspondence you may have had with the IRS about the forms.
  - d. There is an exception, though. If you had to file Schedule B of Form 990, that schedule is NOT required to be open for public inspection.
  - e. Internal books and records you use to prepare your Form 990 ARE NOT subject to the inspection requirements, because you didn't send them in as part of your Form 990 filing – you just used them to prepare it.
  - f. Documents must be available at the organization's principal office during regular business hours - as requests can be made in person or in writing.



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**Significant Events.** What is a significant event? The significant events all have to do with your tax-exempt status. The events include, but aren't limited to:

1. Audits
2. Private letter rulings and
3. Termination proceedings.

### **Jeopardizing Your Tax-Exempt Status**

There are four major categories of activities that can jeopardize your tax-exempt status.

1. **Lobbying:** Lobbying and political campaign intervention are two different things; Lobbying is any activity designed to influence legislation, while political campaign intervention is participating in a political campaign on behalf of, or in opposition to, a candidate for public office. Though they are both related to politics, the activities are different - as are the rules for exempt organizations participating in them. 501(c)(3) organizations can conduct a little lobbying without jeopardizing exemption; it just can't be a principal activity of the organization.
2. **Activities generating excessive unrelated business income (UBI):** Unrelated Business Income is any income you generate from business activities that occur on a regular basis and are not substantially related to the exempt purpose of your organization.
  - a. First, funds generated through unrelated business activities can be subject to taxes.
  - b. Second, if too many of your activities are not related to your exempt purpose, you are jeopardizing your exempt status. *\*Remember, your organization received tax-exempt status because you told the IRS it would pursue an exempt purpose. If it's not doing that, the reason for tax-exempt status isn't there either.*
3. **Private benefit/Inurement.** Private benefit and inurement are two separate but closely related concepts.
  - a. **Private Benefit** is any activity that substantially benefits the private interest of an individual or organization. A 501(c)(3)s must avoid all activities that provide primarily private benefit. The 501(c)(3)'s activities must serve a public interest. It means the organization can't be operated (by its employees) - or its income or assets used in such a way - that someone receives a substantial private benefit well beyond what would be considered reasonable compensation for work.
  - b. **Inurement:** The concept of inurement takes the notion of private benefit a bit further.
    - i. The organization can't conduct activities that will provide anyone with a substantial private benefit.
    - ii. When it comes to "insiders" of the organization, absolutely none of the income or assets can accrue to their benefit. (An "insider" is a person who has a



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personal and private interest in the activities of the organization. Examples of typical insiders are officers, directors and key employees.)

1. Examples: (a) Some examples include paying dividends or unreasonable compensation to insiders, (b) transferring property to insiders for less than fair market value. (c) granting money or scholarships to the organizations insiders (Board Members).
- iii. Any amount of inurement is grounds for loss of tax-exempt status - and the insider involved may be subject to excise tax. But, if the activities of an organization privately benefit someone who is not an insider, that benefit must be substantial in order to jeopardize the organization's tax-exempt status.
- iv. Prohibited inurement or private benefit doesn't include reasonable payments for services, other payments that further tax-exempt purposes, or payments for the fair market value of real or personal property.

#### **Charitable Solicitation:**

Each state has laws regulating fundraising - as well as how you go about soliciting donations. These include:

1. Requiring that you register your organization,
2. Special rules when fundraising activities involve paid solicitors and fundraisers counsel.
3. specific procedures for filing financial reports.

*\*Each state is different, so be sure to check with each state you'll be fundraising in to confirm their requirements.*

#### **Governance Tips:**

1. An organization is more likely to operate effectively and consistently with tax law requirements if it can clearly articulate its purpose, selects a knowledgeable and committed governing body and management team, and adopts sound management practices.
2. The IRS requests information about an organization's governance on the application for tax exemption - and again annually on the information return most organizations must file.
3. Your organization shouldn't engage in activities that substantially benefit the private interest of any individual or organization, nor allow any income or assets to accrue for the benefit of insiders.
4. Find out more about charitable solicitation rules for your state and implementing good governance practices.

This information comes directly from the IRS website, <https://www.stayexempt.irs.gov/home/resource-library/virtual-small-mid-size-tax-exempt-organization-workshop>



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Lifecycle page - <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/LifeCycle-of-a-Public-Charity> Publication 4221-PC

Compliance Guide for 501(c)(3) Public Charities <http://www.irs.gov/pub/irs-pdf/p4221pc.pdf> Publication 557

Tax-Exempt Status for Your Organization [http://www.irs.gov/file\\_source/pub/irs-pdf/p557.pdf](http://www.irs.gov/file_source/pub/irs-pdf/p557.pdf) Which Form 990 am I required to file annually? <https://www.irs.gov/charities-non-profits/form-990-series-which-forms-do-exemptorganizations-file-filing-phase-in> Form 990

Overview course <https://www.stayexempt.irs.gov/home/existing-organizations/form-990-overview>

NOTES:

Churches and certain church-affiliated organizations don't have an annual filing requirement, but they may have other filing requirements, such as employment tax returns.

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*The Council for Military Spouse Clubs is a Section 501(c)(3) tax-exempt charitable organization under the Internal Revenue Code and is a registered nonprofit corporation in Colorado.*