



## Chapter 2

# Federal Law

---

### CHAPTER OUTLINE

1. Charitable purpose & assets
  2. Private benefit
  3. Lobbying
    - A. Lobbying limits
    - B. Education
  4. Political campaigns
  5. Public documentation
    - A. Annual filing
    - B. Public disclosure
  6. Legal Checklist: Federal Law
- Chapter 2 Summary: Federal Law
- 

### INTRODUCTION

If you want to take your car on big highways and drive farther, more rules apply. This is also true for nonprofit organizations who want their revenue to be exempt from federal income tax and want to be eligible to receive tax-deductible contributions. For organizations applying to the IRS for tax-exemption and those who have received 501(c)(3) tax-exempt status, understanding the associated federal laws and tax rules is essential.

Board members need to be aware of and comply with federal tax rules outlined for 501(c)(3) organizations. If federal laws and rules are not followed, an organization may face legal or financial penalties including having its tax-exempt status revoked. *If your nonprofit does not have tax-exemption as a 501(c)(3) organization, it will not have to comply with the following federal tax rules.*



## 1. CHARITABLE PURPOSE & ASSETS

When considering an organization's charitable purpose and assets, there are three items to make certain the nonprofit meets. These items are outlined below as: purpose, dissolution, and income unrelated to purpose.

- **Purpose:** A 501(c)(3) organization must be organized and operated exclusively for one or more charitable purposes. These purposes must meet the definition of charitable purposes under federal tax law.
- **Dissolution:** The Articles of Incorporation must provide that, upon dissolution of the 501(c)(3) organization, all assets must go to another 501(c)(3) organization or a government entity for a public purpose.
- **Income unrelated to purpose:** 501(c)(3) organizations may have a limited amount of unrelated business income (income unrelated to its charitable purpose), but the organization must report the income and pay taxes on said income. If there is too much unrelated business income, or the unrelated income is not reported, it can jeopardize the nonprofit's tax-exempt status. There are legal tests to determine if income is unrelated business income and if there is too much unrelated business income. If unrelated income is an issue, the organization should consult an attorney.

### Definition of "Charitable"

The term "charitable" is used in the Internal Revenue Code section 501(c)(3) in its generally accepted legal sense. That includes relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of government; promotion of social welfare.

## 2. PRIVATE BENEFIT

Tax-exempt organizations are created to serve a public good, not the people creating or governing the organization. No officer, director, or other insider can therefore receive any benefit for which they have not appropriately paid. Loans to board members are not permitted. In general, a board needs to pay close attention to compensation, purchases and sales, or other financial transactions with insiders. Transactions with insiders cannot exceed fair market value.

The IRS can impose financial penalties on insiders that violate rules around private benefit, as well as on directors who approve such dealings. The organization may have its tax-exempt status revoked.

## 3. LOBBYING

Lobbying is any attempt to influence legislation by (1) expressing a position on specific legislation to a legislator or their staff, or (2) encouraging members of the general public to contact their legislators with

a position on a specific legislation (like a “call to action”). Contrary to what many people think, tax-exempt organizations may engage in lobbying if the lobbying is not a substantial part of the organization’s activities. All tax-exempt organizations may engage in education.

### **A. Lobbying limits**

- **The “substantial part” test:** Known as the “substantial part test,” these rules require that “no substantial part of a charity’s activities consist of carrying on propaganda or otherwise attempting to influence legislation.” “Substantial” has never been clearly defined. However, it is clear that the definition of lobbying under the “substantial part test” is not related to an expenditure of money alone. For example, activities conducted by volunteers to influence legislation may be considered lobbying. Organizations that choose not to elect into Section 501(h) of the tax code (see next bullet point) are still subject to section 501(c)(3) and the rules developed in common law.
- **501(h) expenditure test:** Under this standard, the amount of lobbying is measured as an expenditure of money. It sets forth specific dollar limits, calculated as a percentage of the organization’s total exempt purpose expenditures. Those 501(c)(3) organizations that choose the Section 501(h) election must apply an “expenditure test.” Section 501(h) and its related regulations also provide helpful definitions of lobbying and several exemptions.

### **B. Education**

To be clear, 501(c)(3) organizations may engage in education without limitation. A nonprofit may educate anyone anytime about the people the organization serves, the impact of policies on these people, and what ideas the organization has to help their community. An organization may tell the stories of clients or speak up when a better solution is possible. An organization may invite a policymaker into their facility to see their work in action. Nonprofits play an important role in the education of their community, including policymakers, about their work and the issues related to their success.

## **4. POLITICAL CAMPAIGNS**

A 501(c)(3) organization is not allowed to favor or oppose a candidate for public office. A candidate includes a declared candidate, an incumbent until they state that they will not seek re-election, and a person subject to speculation. A 501(c)(3) organization may not make endorsements. Also, a 501(c)(3) organization may not use its resources for a campaign for public office. It is important to prevent any campaign activity by an employee, volunteer, or board member from being attributed to the organization.

## 5. PUBLIC DOCUMENTATION

Making public key information about tax-exempt organizations through annual Form 990 filing and public disclosure about organizational activities can highlight how a nonprofit is operated, how it is compliant with applicable tax laws, and how it is governed and managed.

### A. Annual filing

Each year tax-exempt organizations must file an IRS Form 990, or one of its variations, by the 15<sup>th</sup> day of the 5<sup>th</sup> month after the organization's accounting period ends (i.e., for a calendar-year filer, submit the Form 990 by May 15<sup>th</sup>). There are several Form 990 formats available depending on your nonprofit's annual gross receipts and assets.

There are financial penalties for filing the Form 990 late. If an organization fails to file a Form 990 for three consecutive years, its tax-exempt status will be automatically revoked.

Nonprofit Association of Washington's *Finance Unlocked for Nonprofits* guide has an entire chapter on the Form 990, which includes a quick review section, a short worksheet, and questions to help you get more acquainted with your organizations Form 990.



### B. Public disclosure

It is considered to be in the public's best interest that tax-exempt organizations make public key information about their activities. Specifically, a tax-exempt organization must make available for public inspection its:

- Application for tax exemption, which is either Form 1023 or Form 1024 depending on the organization.
- Annual return, which includes Form 990 and its variations for the prior three years.

It is **not** required to disclose the name and address of any contributor.

## 6. LEGAL CHECKLIST: FEDERAL LAW

If YES, date sent or reviewed	NO	ITEM
<b>KEEPING CURRENT WITH IRS – MAINTAINING TAX-EXEMPT STATUS</b>		
		<p>Our organization files a version of the IRS Form 990 every year.</p> <ul style="list-style-type: none"> <li><input type="checkbox"/> Our organization does not normally receive more than \$50,000 in annual gross receipts and files a Form 990-N (e-Postcard).</li> <li><input type="checkbox"/> Our organization normally receives more than \$50,000 in gross receipts each year and files annual Form 990 or 990-EZ with the IRS.</li> </ul>
		Our organization understands its 501(c)(3) determination letter from the IRS, and its status as either a “public charity” or a “private foundation.”
		Our organization’s Board of Directors regularly reviews the organization’s financial statements, and reviews and approves the annual IRS Form 990.
		If our organization receives funds from regularly conducted business activities that are unrelated to its exempt purpose, the organization correctly accounts for those funds and understands how to report and pay taxes on this unrelated business income.
<b>KEEPING CURRENT WITH IRS</b>		
		Our organization has notified the IRS of any material changes to our exempt purposes or activities, or amendments to our Articles of Incorporation or Bylaws since we applied for 501(c)(3) status.
<b>CONFLICT OF INTEREST</b>		
		Our organization has a written Conflict of Interest Policy and follows that policy.
		Any transactions our organization undertakes with its insiders, known as “disqualified persons,” is approved by the board or an independent committee, no members of which have a personal or financial interest in the transaction.
		The setting of our executive director’s salary is based on appropriate comparability data.
		Transactions are concurrently documented by the board or committee which states the basis for its approval in writing.
<b>OTHER POLICIES</b>		
		Our organization has considered adopting a written Whistleblower Policy and if adopted, follows that policy.
		Our organization has considered adopting a written Document Retention Policy and if adopted, follows that policy.
<b>ADVOCACY</b>		
		Our organization does not endorse candidates for political office and does not participate in any political campaign for or against a candidate for any public office.
		Our lobbying activities, if any, are an insubstantial part of our organization’s overall activities. If we are participating in any lobbying activities, we have considered the two ways that nonprofits can document their lobbying activities.



1. Federal tax law provides tax benefits to 501(c)(3) organizations because they provide a benefit to society in some way. In return, these organizations must further one or more “charitable purposes” and provide assurance that the organization’s assets will remain charitable.
2. Individuals or organizations may not benefit personally from the activities of a tax-exempt organization.
3. 501(c)(3) organizations are limited in their advocacy activities. Lobbying conducted by 501(c)(3) organizations cannot be a “substantial part” of their activities. There is an important difference between education and lobbying.
4. 501(c)(3) organizations may not participate in or intervene in the campaign of a candidate for public office.
5. Tax-exempt organizations may not operate in the dark. Tax-exempt organizations must make some documents available for public inspection and must file annual informational tax returns. Organizations must also provide donors with appropriate donation receipts.



**Here are some questions to think about:**

- Is there an individual or organization who is receiving a private benefit from your nonprofit? Does your nonprofit have a Conflict of Interest Policy? If yes, is the policy followed?
- How does your organization currently educate the community, including policymakers, about your work and issues related to achieving your nonprofit’s mission?
- If you are not already, would your nonprofit benefit from engaging in lobbying activities?

**Reflections**




**Next steps:**

- Advocacy can be a powerful tool to advance your mission. Learn more about nonprofit advocacy by exploring Nonprofit Association of Washington’s [Build a Movement!](#) resources. Bolder Advocacy has materials for [Lobbying Under the Insubstantial Part Test](#).