

Classification of Tax-Exempt Organizations

ORGANIZATIONS QUALIFYING FOR EXEMPTION from federal income tax are granted exemption under the Internal Revenue Code (IRC), Section 501(a).

The qualification process starts by completing one of these forms:

- Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the IRS Code, for 501(c)(3) organizations
- Form 1024, Application for Recognition of Exemption, for all other not-for-profit organizations

Tax-exempt status applications are open for public inspection and must be retained for this purpose permanently. This issue is discussed in detail in Chapter 6, "Disclosure of Information."

Essential IRS Classifications

Of the many types of tax-exempt organizations, six are particularly important to not-for-profit professionals. They are listed in Exhibit 1.1 by type, advantages, and disadvantages. Exhibit 1.2 lists other 501(c) organizations, and Exhibit 1.3 lists other important IRS classifications of organizations.

EXHIBIT 1.1

IRS Classifications and Types of Tax-Exempt Organizations**IRS Classification: 501(c)(3) (Public Charities)***Qualifying Entities or Organizations*

- Religious
- Charitable
- Scientific
- Educational
- Public safety testing
- Literary
- National or international amateur sports
- Organizations formed to prevent cruelty to children or animals

Advantages

- Contributions are deductible by the donors.
- Postal rates are favorable.
- Organizations are exempt from the Federal Unemployment Tax Act (FUTA).
- State sales tax and other local tax exemptions are possible if allowable under state law.
- Foundations often require 501(c)(3) status before issuing grants.
- Exemption from Federal Insurance Contributions Act (FICA) tax election is available to clergy.

Disadvantages

- Insubstantial amounts can be spent on lobbying to influence legislation.
- There is absolute prohibition from lobbying in election campaigns.
- Earnings cannot inure to individuals.

IRS Classification: 501(c)(3) (Private Foundations)

501(c)(3) organizations are further classified as either public charities or private foundations. This distinction is decided when completing Form 1023, the application for exemption. The major differences for private foundations are as follows:

Disadvantages

- More reporting requirements on Form 990-PF
- Limitations on deductions for charitable contributions
- IRS-imposed operating restrictions

IRS Classification: 501(c)(4)

- Social welfare organizations
- Local associations of employees for charitable purposes

EXHIBIT 1.1 (Continued)*Advantage*

- Lobbying activities are unrestricted.

Disadvantages

- Charitable contributions are not deductible by donors.
- There are no exemptions for FUTA, FICA, or state and local taxes.
- Earnings cannot inure to individuals.
- Foundations cannot participate in political activities.
- Postal rates are less favorable.

IRS Classification: 501(c)(5)

- Labor
- Agriculture
- Horticulture
- Unions

Advantage

- There is no restriction on lobbying activities, including participation in political activities, which is not available to 501(c)(3) and 501(c)(4) organizations.

Note: Under the Hatch Act, unions of federal government employees may not engage in political activities. See Section 527 (political action committees).

Disadvantages

- Charitable contributions are not deductible by donors.
- No exemptions are available for FUTA, FICA, or state and local taxes.
- Earnings cannot inure to individuals.
- Postal rates are less favorable.

IRS Classification: 501(c)(6)

- Business leagues
- Trade associations
- Professional associations
- Chambers of commerce
- Boards of trade
- Real estate boards
- Professional football leagues not organized for profit

Advantages

- There are no restrictions on engaging in lobbying or political activities.
- Contributions may be deductible as business expenses.

EXHIBIT 1.1 (Continued)*Disadvantages*

- Charitable contributions are not deductible by the donors.
- There are no exemptions for FUTA, FICA, or state and local taxes.
- Postal rates are less favorable.

IRS Classification: 501(c)(7)

- Social clubs

Advantages

- Advantages are essentially the same as for 501(c)(6) organizations.

Disadvantages

- Disadvantages are essentially the same as for 501(c)(6) organizations, with the exception that there are strict limits on revenues from nonmembers; nonmember activity could result in conversion to a taxable entity.

IRS Classification: 501(c)(19)

- Armed forces organizations (at least 75 percent of the members must be present or past members of the armed forces).

Advantages

- Advantages are essentially the same as for 501(c)(6) organizations, except that contributions are deductible as charitable contributions by the donors.

Disadvantages

- Disadvantages are essentially the same as for 501(c)(6) organizations.

EXHIBIT 1.2

Other 501(c) Classifications

IRS Classification	Qualifying Entities or Organizations
501(c)(1)	Organizations organized by an act of Congress
501(c)(2)	Title-holding corporations for other 501(c) organizations
501(c)(8)	Fraternal organizations producing life, sickness, accident, or other benefits to members or dependents
501(c)(9)	Employee beneficiary organizations providing life, sickness, accident, or other benefits to members, dependents, or beneficiaries
501(c)(10)	Fraternal societies devoted to religious, charitable, educational, scientific, or literary purposes, excluding life, sickness, and accident benefits
501(c)(11)	Local teacher retirement fund associations
501(c)(12)	Local ditch, irrigation, telephone, and life insurance associations
501(c)(13)	Cemetery, burial, and cremation organizations
501(c)(14)	Credit unions without capital stock
501(c)(15)	Insurance companies other than life or marine with receipts under \$150,000
501(c)(16)	Farmers cooperative associations
501(c)(17)	Supplemental unemployment benefits trusts
501(c)(18)	Pension plans funded by employees and organized before June 25, 1959
501(c)(20)	Legal services plans
501(c)(21)	Black Lung Acts benefits
501(c)(22)	Employment Retirement Income Security Act of 1974 benefits
501(c)(23)	Organizations of past or present members of the armed forces
501(c)(24)	Employee Retirement Income Security Act of 1974 trust described in Section 4049
501(c)(25)	Other title-holding trusts or corporations

EXHIBIT 1.3

Other Important IRS Classifications

IRS Classification	Qualifying Entities or Organizations
Section 527	Political organizations
Section 528	Homeowners' associations
Section 501(d)	Religious and apostolic organizations
Section 501(e)	Cooperative hospital service organizations
Section 501(k)	Child care organizations

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Private Foundations

There are two types of 501(c)(3) organizations: publicly supported organizations and private foundations.

Typically, private foundations are associated with large corporations and wealthy families that don't find it necessary to solicit the public for support.

There are several rules that affect private foundations, the most important of which are as follows:

- Private foundations are prohibited from lobbying.
- There is significantly more paperwork and reporting involved.
- There is an excise tax on net investment income.

Private foundations file Form 990-PF.

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