

Understanding Nonprofit and Tax Exempt Organizations

CAROLINA ACADEMIC PRESS UNDERSTANDING SERIES

- Understanding Administrative Law,
Seventh Edition**
Kristen E. Hickman
- Understanding Alternative Dispute Resolution**
Kristen M. Blankley and Maureen A. Weston
- Understanding Animal Law**
Adam Karp
- Understanding Antitrust and Its Economic
Implications, Seventh Edition**
E. Thomas Sullivan and Jeffrey L. Harrison
- Understanding Bankruptcy, Fourth Edition**
Jeffrey Ferriell and Edward J. Janger
- Understanding California Community
Property Law, Second Edition**
Jo Carrillo
- Understanding Capital Punishment Law,
Fourth Edition**
Linda E. Carter, Ellen S. Kreitzberg,
and Scott W. Howe
- Understanding Civil Procedure, Sixth Edition**
Gene R. Shreve, Peter Raven-Hansen,
and Charles Gardner Geyh
- Understanding Civil Procedure:
The California Edition**
Walter W. Heiser, Gene R. Shreve,
Peter Raven-Hansen, and Charles Geyh
- Understanding Civil Rights Litigation,
Second Edition**
Howard M. Wasserman
- Understanding Conflict of Laws,
Fourth Edition**
William M. Richman, William L. Reynolds,
and Chris A. Whytock
- Understanding Constitutional Law,
Fifth Edition**
William D. Araiza
- Understanding Contracts, Fourth Edition**
Jeffrey Ferriell
- Understanding Copyright Law, Seventh
Edition**
Marshall A. Leaffer
- Understanding Corporate Law,
Fifth Edition**
Arthur R. Pinto and Douglas M. Branson
- Understanding Corporate Taxation,
Fourth Edition**
Leandra Lederman and Michelle Kwon
- Understanding Criminal Law, Ninth Edition**
Joshua Dressler
- Understanding Criminal Procedure:
Vol. 1: Investigation, Eighth Edition**
Joshua Dressler, Alan C. Michaels,
and Ric Simmons
- Understanding Criminal Procedure:
Vol. 2: Adjudication, Fourth Edition**
Joshua Dressler and Alan C. Michaels
- Understanding Disability Law, Third Edition**
Mark C. Weber
- Understanding Election Law
and Voting Rights**
Michael R. Dimino, Bradley A. Smith,
and Michael E. Solimine
- Understanding Employee Benefits Law ,
Second Edition**
Kathryn L. Moore
- Understanding Employment
Discrimination Law, Third Edition**
Thomas R. Haggard and Bruce N. Cameron
- Understanding Employment Law,
Third Edition**
Paul M. Secunda, Richard A. Bales, and
Jeffrey M. Hirsch
- Understanding Environmental Law,
Third Edition**
Philip Weinberg and Kevin A. Reilly
- Understanding Estate and Gift Taxation,
Second Edition**
Brant J. Hellwig and Robert T. Danforth
- Understanding Evidence, Fifth Edition**
Paul C. Giannelli
- Understanding Family Law, Fourth Edition**
John Gregory, Peter N. Swisher,
and Robin Wilson
- Understanding Federal and
California Evidence**
Paul C. Giannelli
- Understanding Federal Courts and
Jurisdiction, Second Edition**
Linda Mullenix, Martin H. Redish,
and Georgene Vairo
- Understanding Federal Income Taxation,
Sixth Edition**
J. Martin Burke and Michael K. Friel

- Understanding The First Amendment, Seventh Edition**
Russell L. Weaver
- Understanding Immigration Law, Third Edition**
Kevin R. Johnson, Raquel Aldana, Bill Ong Hing, Leticia M. Saucedo, and Enid Trucios-Haynes
- Understanding Insurance Law, Sixth Edition**
Robert H. Jerry, II and Douglas Richmond
- Understanding Intellectual Property Law, Fourth Edition**
Tyler T. Ochoa, Shubha Ghosh, and Mary LaFrance
- Understanding International Business and Financial Transactions, Fourth Edition**
Jerold A. Friedland
- Understanding International Criminal Law, Third Edition**
Ellen S. Podgor and Roger S. Clark
- Understanding International Law, Third Edition**
Stephen C. McCaffrey
- Understanding Jewish Law, Second Edition**
Steven H. Resnicoff
- Understanding Juvenile Law, Fifth Edition**
Martin Gardner
- Understanding Labor Law, Fifth Edition**
Douglas E. Ray, Calvin William Sharpe, and Robert N. Strassfeld
- Understanding the Law of Terrorism, Second Edition**
Erik Luna and Wayne McCormack
- Understanding the Law of Zoning and Land Use Controls, Third Edition**
Barlow Burke
- Understanding Lawyers' Ethics, Fifth Edition**
Monroe H. Freedman and Abbe Smith
- Understanding Local Government, Second Edition**
Sandra Stevenson
- Understanding Modern Real Estate Transactions, Fourth Edition**
Alex M. Johnson, Jr.
- Understanding Negotiable Instruments and Payment Systems, Second Edition**
William H. Lawrence
- Understanding Nonprofit and Tax Exempt Organizations, Third Edition**
Nicholas P. Cafardi and Jaclyn Fabean Cherry
- Understanding Partnership and LLC Taxation, Fourth Edition**
Jerold A. Friedland
- Understanding Patent Law, Third Edition**
Amy L. Landers
- Understanding Products Liability Law, Second Edition**
Bruce L. Ottley, Rogelio A. Lasso, and Terrence F. Kiely
- Understanding Property Law, Fourth Edition**
John G. Sprankling
- Understanding Remedies, Fourth Edition**
James M. Fischer
- Understanding Sales and Leases of Goods, Third Edition**
William H. Henning, William H. Lawrence, and Henry Deeb Gabriel
- Understanding Secured Transactions, Fifth Edition**
William H. Lawrence, William H. Henning, and R. Wilson Freyermuth
- Understanding Securities Law, Seventh Edition**
Marc I. Steinberg
- Understanding Taxation of Business Entities, Second Edition**
Walter D. Schwidetzky and Fred B. Brown
- Understanding Torts, Sixth Edition**
John L. Diamond, Lawrence C. Levine, and Anita Bernstein
- Understanding Trade Secret Law**
John G. Sprankling and Thomas G. Sprankling
- Understanding Trademark Law, Fourth Edition**
Mary LaFrance
- Understanding Trusts and Estates, Sixth Edition**
Roger W. Andersen and Susan Gary
- Understanding White Collar Crime, Fourth Edition**
J. Kelly Strader

Understanding Nonprofit and Tax Exempt Organizations

THIRD EDITION

Nicholas P. Cafardi

DEAN EMERITUS
DUQUESNE UNIVERSITY SCHOOL OF LAW

Jaclyn Fabean Cherry

PROFESSOR OF LAW
UNIVERSITY OF SOUTH CAROLINA SCHOOL OF LAW



CAROLINA ACADEMIC PRESS

Durham, North Carolina

Copyright © 2022
Carolina Academic Press, LLC
All Rights Reserved

Library of Congress Cataloging-in-Publication Data

Names: Cafardi, Nicholas P., author. | Cherry, Jaclyn Fabean, author.
Title: Understanding nonprofit and tax exempt organizations / by Nicholas
P. Cafardi, Jaclyn Fabean Cherry.
Description: Third edition. | Durham, North Carolina : Carolina Academic
Press, LLC, [2022] | Series: Understanding series | Includes
bibliographical references and index.
Identifiers: LCCN 2021059235 (print) | LCCN 2021059236 (ebook) | ISBN
9781531020125 (paperback) | ISBN 9781531020132 (ebook)
Subjects: LCSH: Nonprofit organizations--Taxation--Law and
legislation--United States. | Charitable uses, trusts, and
foundations--Taxation--United States. | Nonprofit organizations--Law and
legislation--United States. | Charitable uses, trusts, and
foundations--United States.
Classification: LCC KF6449 .C345 2022 (print) | LCC KF6449 (ebook) | DDC
343.7306/6--dc23/eng/20220131
LC record available at <https://lcn.loc.gov/2021059235>
LC ebook record available at <https://lcn.loc.gov/2021059236>

Carolina Academic Press
700 Kent Street
Durham, NC 27701
(919) 489-7486
www.cap-press.com

Printed in the United States of America

To Kathleen, Christopher, Nicholas, Amy, Alicia, Shane and Alaina — NPC

To Joe, Nick, Mary, Trilby and Fitz — JFC

Contents

Preface	xix
Chapter 1 · Introduction to Tax Exempt Organizations	3
§ 1.01 Introduction	3
§ 1.02 Categories of Organizations in Third Sector	4
[A] Nonprofit Organizations	5
[B] Tax Exempt Organizations	5
[C] Charitable Organizations	7
[D] Private Foundations	9
§ 1.03 Conclusion	10
Chapter 2 · Structuring a Nonprofit Organization	13
§ 2.01 Introduction	13
§ 2.02 Rationales	13
[A] Historical	13
[B] Contract Failure	13
[C] Government's Inability to Respond	14
[D] Societal and Political Innovation	15
[E] Protection of Freedom	15
[F] Creation of Cultural Goods	15
[G] Social and Ethnic Associations	16
§ 2.03 Structure Choices	16
[A] Unincorporated Associations	17
[B] Charitable Trusts	18
[C] Nonprofit Corporations	19
[1] Historical Development	19
[2] Defining Nonprofit Corporations	19
[3] Formalities of a Nonprofit Corporation	20
[4] Model Nonprofit Corporation Act	21
[5] Formation	22
[a] Filing Articles of Incorporation	22
[b] Drafting Bylaws	23
[6] Purpose and Powers	23
[a] Conforming to State Public Policy	23
[b] Conforming to State Non-Commercial Purposes	25
[c] Conforming to State Definitions of Charity	26
§ 2.04 Tax Exempt Status	27
§ 2.05 States' Role in Choice of Structure	28
Chapter 3 · Governance of Nonprofit Organizations	31
§ 3.01 Introduction to Governance	31
[A] Unincorporated Association Governance	31

[B] Trust Governance	31
[C] Nonprofit Corporation Governance	32
§ 3.02 Managing the Nonprofit	33
§ 3.03 Fiduciary Duties	33
[A] Duty of Care	34
[1] Relying on Information	34
[2] Business Judgment Rule	35
[3] Trust Standard	36
[4] Corporate Standard	36
[B] Duty of Loyalty	37
[1] Generally	37
[2] Conflicts of Interest	37
[3] Corporate Opportunity Doctrine	37
[4] Applying the Duty of Loyalty	38
[C] Duty of Obedience	39
§ 3.04 Enforcement	41
Chapter 4 · Dissolving a Nonprofit Organization	43
§ 4.01 Introduction	43
§ 4.02 Disposition of Assets	44
[A] Public Benefit versus Mutual Benefit	44
[B] Charitable Trusts	46
§ 4.03 Conversions of Nonprofit Organizations	48
[A] Health Maintenance Organizations	48
[B] Hospitals	49
[C] Blue Cross	49
[D] Structure	49
§ 4.04 Other Restructuring	50
§ 4.05 Antitrust and Nonprofits	51
[A] Generally	51
[B] Health Care Organizations	52
[C] Educational Organizations	54
[D] Damages and Liability	56
Chapter 5 · Rationales for Tax Exemption	57
§ 5.01 Introduction	57
§ 5.02 Public Benefit Theory	57
§ 5.03 Relieving the Burdens of Government Theory	59
§ 5.04 Pluralism Theory	59
§ 5.05 Subsidy Theory	61
§ 5.06 Income Measurement Theory	61
§ 5.07 Capital Subsidy Theory	62
§ 5.08 Donative Theory	63
§ 5.09 Rationales for Trade Associations, Social Clubs, and Fraternal Benefit Organizations	64
[A] Labor and Trade Associations	64
[B] Social Clubs and Fraternal Benefit Organizations	65
§ 5.10 Additional Theories	65
[A] Historical Theory	65
[B] Double Taxation or Immorality Theory	66
[C] Lobbying Theory	66

[D] The Failure Theories: Market, Government, Contract	66
§ 5.11 Additional Benefits of Federal Tax Exemption	67
[A] Tax Deductible Gifts	67
[B] State and Local Income Tax Exemption	68
[C] Property Tax Exemption	68
Chapter 6 · IRS Tests for Tax Exemption	69
§ 6.01 Introduction	69
§ 6.02 Organizational Test	69
§ 6.03 Operational Test	71
[A] Primary Purpose	72
[B] Commercial Activities	73
[C] Private Benefit	74
§ 6.04 Private Inurement Test	75
[A] Overlap of Control and Benefit	75
[B] How Inurement Occurs	77
[C] Improper Valuation	78
[D] Private Inurement versus Private Benefit	79
§ 6.05 Excess Benefit Transactions and Intermediate Sanctions	80
§ 6.06 Political Activities Test	82
[A] Limitations on Lobbying	83
[1] Defining Legislation	83
[2] Defining Substantial Part	84
[3] Section 501(h) Election	85
[B] Restrictions on Electioneering	88
[C] Section 4955 Excise Taxes	92
[D] Section 527(f) Tax on Political Activity	93
[E] Additional Regulations of Political Activity	93
[F] Constitutional Issues	95
Chapter 7 · Court Imposed Limits on Tax Exempt Organizations	97
§ 7.01 Introduction	97
§ 7.02 Illegality and Public Policy Doctrines	97
[A] Illegality Doctrine	98
[B] Public Policy Doctrine	99
§ 7.03 The Commerciality Doctrine	101
[A] Origins of the Doctrine	101
[B] Applying the Doctrine	103
[C] For-Profit Comparison Standard	105
[D] Publishing Houses	105
[E] More Recent Looks at “Commerciality”	108
Chapter 8 · Religious Organizations and Churches	111
§ 8.01 Introduction	111
§ 8.02 Religious Organizations	111
[A] Defining Religion	111
[B] Applying the Operational Test	113
[C] Communal Living	114
§ 8.03 Churches	115
[A] Defining Churches	115

[B] Churches versus Religious Associations	116
[1] Fourteen-Point Test	116
[2] Associational Test	118
[C] Qualifying as a Church for IRS Purposes	120
[D] Benefits of Church Status for IRS Purposes	122
§ 8.04 Conventions or Associations of Churches	123
§ 8.05 Group Ruling	123
§ 8.06 Integrated Auxiliaries of Churches	124
§ 8.07 Apostolic Organizations	125
§ 8.08 Churches and Political Activity	126
§ 8.09 Church Audit Procedures Act	129
§ 8.10 Special Issues for Churches	131
[A] Legal Structure	131
[B] Liability in Church Organizations	131
[1] Church Practices	131
[2] Parent and Subordinate Liability	132
[C] Church Property Issues	133
§ 8.11 Constitutional Considerations	135
Chapter 9 · Educational Organizations	137
§ 9.01 Introduction	137
§ 9.02 Formal versus Informal Educational Organizations	139
[A] Formal Educational Organizations	139
[1] Introduction	139
[2] Guidelines and Recordkeeping Requirements	140
[3] Applying Tests for Tax Exemption	142
[4] Private Schools	143
[B] Informal Educational Organizations	145
§ 9.03 Funding	148
[A] New Funding Sources	148
[B] Investment Vehicles	150
§ 9.04 Rights of Students	150
[A] Suspension	150
[B] Privacy	151
Chapter 10 · Healthcare Organizations	153
§ 10.01 Introduction to Hospitals	153
[A] Indigent Care and Charity Standard	153
[B] Community Benefit Standard	154
§ 10.02 Multi-Corporate Form	157
§ 10.03 Integral Part Test	157
§ 10.04 Hospital Conversions and Private Inurement	160
§ 10.05 Hospital Joint Ventures	162
[A] Hospital-Physician Joint Ventures	162
[B] Physician Recruitment and Acquisition of Physician Practices	163
[C] Integrated Delivery Systems	164
[D] Hospital-Hospital Joint Ventures	165
[E] Shared Services Organizations	168
§ 10.06 Homes for the Aged	170
§ 10.07 Health Maintenance Organizations	172
§ 10.08 Medical Research Organizations	174

Chapter 11 · Arts Organizations	177
§ 11.01 Introduction	177
§ 11.02 Scope of Arts Organizations	178
[A] Art Schools	178
[B] Music	179
[C] Galleries	179
[D] Museums	180
[E] Theaters	181
[F] Performing Arts Groups	183
§ 11.03 Cultural Arts Districts	184
Chapter 12 · Other IRC Section 501(c)(3) Organizations	185
§ 12.01 Introduction	185
§ 12.02 Other Tax Exempt Categories	185
§ 12.03 Relief of Poor and Distressed or Underprivileged	186
[A] Relief of the Poor	186
[B] Public Interest Law Firms	188
§ 12.04 Lessening Government’s Burden	189
§ 12.05 Promotion of Social Welfare	190
§ 12.06 Scientific Organizations	191
§ 12.07 Testing for Public Safety	193
§ 12.08 Literary Organizations	194
§ 12.09 National and International Amateur Sports Organizations	195
§ 12.10 Prevention of Cruelty to Children and Animals	196
§ 12.11 Protection of Environment	196
§ 12.12 Economic and Community Development and Low Income Housing	197
Chapter 13 · IRC Section 501(c)(4): Social Welfare Organizations	201
§ 13.01 Introduction	201
§ 13.02 Applying Tests for Tax Exemption	203
§ 13.03 Defining Social Welfare	203
§ 13.04 Community Benefit	205
[A] Generally	205
[B] Homeowners’ Associations	206
[1] Generally	206
[2] IRC Section 528	209
§ 13.05 Relationship between Section 501(c)(4) and Section 501(c)(3)	210
§ 13.06 Section 501(c)(4) and Federal Election Campaign Act	212
§ 13.07 Local Associations of Employees	213
§ 13.08 Credit Counseling Groups	214
Chapter 14 · Other Tax Exempt Organizations	217
§ 14.01 Introduction	217
§ 14.02 Rationales	217
§ 14.03 Section 501(c)(2) Organizations: Title Holding Companies	218
§ 14.04 Section 501(c)(5) Organizations: Labor, Agriculture and Horticulture Organizations	218
[A] Generally	218
[B] Labor Organizations	219
[1] Savings Plans	221
[2] Pension Plans	221

[3] Political Activities	223
[C] Agricultural Organizations	224
[D] Horticultural Organizations	225
§ 14.05 Section 501(c)(6) Organizations: Business Leagues and Trade Associations	226
[A] Requirement Not to Conduct a Business for Profit	227
[B] Line of Business Requirement	228
[C] Membership	228
[D] Membership Services	229
[E] Trade Shows	229
[F] Political Activities	230
[G] Antitrust Regulations	231
§ 14.06 Section 501(c)(7) Organizations: Social Clubs	232
[A] Organizational and Operational Requirements	232
[B] Taxation	234
[C] Rights of Association and Anti-Discrimination Requirements	235
§ 14.07 Section 501(c)(8) Organizations: Fraternal Benefit Associations	236
[A] Organizational and Operational Requirements	236
[B] Taxation	237
[C] Discrimination	237
§ 14.08 Section 501(c)(10) Organizations: Domestic Fraternal Organizations	238
§ 14.09 Section 501(c)(19) Organizations: Veterans Organizations	238
§ 14.10 Section 501(m) Organizations: Commercial Type Insurers	239
§ 14.11 Other Mutual Benefit Organizations	240
§ 14.12 Issues Involving Voluntary Membership Associations	240
[A] Membership as a Contractual Right	240
[B] Membership as a Property Right	241
[C] Court Examination of Membership Decisions	241
[D] Voluntary Associations and Freedom of Association	242
[E] Exercising State-Like Powers	243
[F] Judicial Intervention into Church Disputes	244
Chapter 15 · IRC Section 527: Political Organizations	245
§ 15.01 Introduction	245
§ 15.02 Defining a Political Organization	246
§ 15.03 Organizational and Operational Tests	246
§ 15.04 Determining Taxation	248
§ 15.05 Newsletter Funds	248
§ 15.06 Segregated Funds	249
§ 15.07 The Section 527(f) Tax	250
§ 15.08 Filing and Reporting Requirements	251
§ 15.09 Recent Litigation	252
Chapter 16 · Unrelated Business Income Tax	255
§ 16.01 Introduction	255
§ 16.02 Defining Unrelated Business Income	257
[A] Trade or Business	257
[B] Fragmentation Rule	259
[C] Regularly Carried On	260
[D] Substantially Unrelated	262
§ 16.03 Siloing	265

§ 16.04 Tax Impact of Unrelated Business Income	265
§ 16.05 Passive Income Modifications	266
[A] Mailing Lists	267
[B] Affinity Cards	268
[C] Rental Income	269
[D] Capital Gains or Losses	270
[E] Research Income	270
[F] Revenue from Controlled Organizations	270
[G] A Special Exception	271
[H] Commercial Insurance Activity	271
[I] Membership Dues	271
§ 16.06 Partnership Income	272
§ 16.07 Debt-Financed Income	273
§ 16.08 Additional Exceptions	277
[A] Businesses Operated by Volunteer Labor	277
[B] Convenience Businesses	278
[C] Businesses Selling Donated Merchandise	278
[D] Qualified Public Entertainment Activities	279
[E] Qualified Convention and Trade Show Activities	279
[F] Hospital Cooperative Services	279
[G] Bingo	279
[H] Distribution of Low-Cost Articles	280
[I] Qualified Sponsorship Payments	280
§ 16.09 Special Situation for Social Clubs	282
§ 16.10 Filing Requirements	285
Chapter 17 · Charitable Contributions	287
§ 17.01 Introduction	287
§ 17.02 Policy Considerations	289
§ 17.03 Defining Charitable Gift	290
[A] Overview	290
[B] Dual Payments	290
[C] Charitable Contributions of Property	291
[D] Determining Gifts Qualified for Deduction	292
[E] Determining When a Gift Has Been Made	293
[F] Determining Validity of Gifts	293
§ 17.04 Deduction Limitations for Taxpayers	296
§ 17.05 Form and Timing	297
[A] Un-reimbursed Expenses	298
[B] Contributions by Check	299
[C] Contributions of Stock	299
[D] Pledge as Payment	299
[E] Corporate Donations	299
§ 17.06 Substantiation and Disclosure Requirements	299
§ 17.07 Contributions of Property	301
[A] Types of Property Donated	301
[1] Capital Gain Property	301
[2] Ordinary Income Property	302
[3] Tangible Personal Property	302
[4] Bargain Sales	303

[5] Partial Interests (Not in Trust)	303
[6] Qualified Conservation Contributions	304
[B] Valuation and Appraisals	304
§ 17.08 Charitable Contribution Vehicles	305
[A] Donor Advised Funds	305
[B] Community Foundations	307
[C] Pooled Common Funds	307
[D] Planned Giving	307
[1] Charitable Remainder Trusts	308
[2] Charitable Lead Trust	308
[3] Remainder Interests	308
[4] Charitable Gift Annuities	308
[E] Estate Tax Exclusions	309
§ 17.09 Disaster Relief and International Giving	309
[A] Disaster Relief	309
[B] International Giving	310
[1] Global Terrorism	311
[2] Gifts to Corporations Operating in Foreign Countries	312
[3] Private Foundation Grants to Foreign Grantees	313
Chapter 18 · Fundraising	315
§ 18.01 Introduction	315
§ 18.02 State Involvement	315
§ 18.03 Constitutional Restrictions	317
§ 18.04 Internet Solicitation	320
§ 18.05 Proposals for Reform	320
Chapter 19 · Private Foundations	321
§ 19.01 Introduction	321
§ 19.02 Defining Private Foundations	322
§ 19.03 Avoiding Private Foundation Status	323
§ 19.04 Rules for Private Foundations	324
[A] The Federal Excise Tax — IRC Section 4940	324
[B] Tax on Self-Dealing — IRC Section 4941	325
[C] Tax on Failure to Distribute Income — IRC Section 4942	330
[D] Tax on Excess Business Holdings — IRC Section 4943	331
[E] Tax on Jeopardizing Investments — IRC Section 4944	333
[F] Tax on Taxable Expenditures — IRC Section 4945	335
[1] Carrying on Propaganda or Attempting to Influence Legislation	335
[2] Influencing Elections and Carrying on Voter Registration Drives	336
[3] Travel and Study Grants to Individuals	336
[4] Grants to Organizations	337
[5] Expenditures for Non-Charitable Purposes	338
§ 19.05 Four Categories of Non-Private Foundations (Public Charities)	339
[A] Section 509(a)(1): Traditional Public Charities	339
[1] Sections 509(a)(1) and 170(b)(1)(A)(i) Organizations	339
[2] Sections 509(a)(1) and 170(b)(1)(A)(ii) Organizations	339
[3] Sections 509(a)(1) and 170(b)(1)(A)(iii) Organizations	339
[4] Sections 509(a)(1) and 170(b)(1)(A)(iv) Organizations	340
[5] Sections 509(a)(1) and 170(b)(1)(A)(v) Organizations	340

[6] Sections 509(a)(1) and 170(b)(1)(A)(vi) Organizations	340
[a] Introduction	340
[b] Tests for Public Support	341
[i] Generally	341
[ii] Determining Amount of Public Support and One-Third Mechanical Test	341
[iii] Ten Percent Facts and Circumstances Test	342
[c] Exception for Organizations Dependent Primarily on Related Activities (Exempt Function) Income	343
[d] Exception for Unusual Grants	344
[e] Normally and Relevant Taxable Period	344
[f] Substantial and Material Changes	345
[g] Community Trusts	345
[i] Generally	345
[ii] Single Entity Test	346
[iii] Component Part Test	347
[B] Section 509(a)(2): Gross Receipt or Service Provider Organizations	348
[C] Section 509(a)(3): Supporting Organizations	350
[1] Relationships	350
[2] Responsiveness Test	352
[3] Integral Parts Test	354
[4] Functionally and Non-Functionally Integrated Type III Supporting Organizations	356
[5] Other Pension Protection Act Restrictions on Section 509(a)(3) Supporting Organizations	356
[D] Section 509(a)(4): Public Safety Testing Organizations	357
§ 19.06 Private Operating Foundations	357
§ 19.07 Terminating a Private Foundation	359
§ 19.08 Private Foundation Forms	360
Chapter 20 · Securing and Maintaining Tax Exempt Status	363
§ 20.01 Introduction	363
§ 20.02 Applying for Tax Exempt Status	363
[A] Organizations Exempt From Filing Form 1023	365
[B] Form 1023	365
[C] Schedules and Attachments	366
[D] Form 1023-EZ	367
[E] Submitting Forms 1023 and 1023EZ	368
[F] Form 1024	369
§ 20.03 Determining Tax Exempt Status	370
[A] Date of Exemption	370
[B] Advance Ruling	370
[C] Determination Letter	371
[D] The Appeals Process	372
[E] Section 7428 Declaratory Judgment Provisions	373
[F] Group Rulings	373
§ 20.04 Maintaining Tax Exempt Status	374
[A] Reporting Requirements	375
[1] Form 990-N, Electronic Notice (e-Postcard)	375

[2] Form 990EZ	375
[3] Form 990	376
[4] Form 990PF	376
[5] Public Availability of Form 990s and Form 990T (Unrelated Business Income)	376
[B] Automatic Revocation of Tax Exempt Status	378
[C] Loss of Tax Exempt Status for Cause Stated	379
Appendix	383
Table of Cases	395
Table of Statutes	405
Index	419

Preface

The first edition of *Understanding Nonprofit and Tax Exempt Organizations* was written in 2006 primarily for our law students (and those in other law schools) taking a course in nonprofit, tax-exempt organizations. That text and its revision in 2012 (as does this 2022 revision) deals with the rules, regulations and limitations imposed on tax exempt organizations by the courts, the Internal Revenue Code (IRC) and the Treasury Regulations (Regulations); the charitable contribution and fundraising issues affecting tax exempt organizations; the unrelated business income tax, excise taxes and intermediate sanctions imposed on tax exempt organizations; and the rules regarding private foundations. This new Third Edition includes a more detailed chapter on churches and religious organizations, reflects recent changes in the law overall for charitable nonprofit organizations, especially those made by the 2017 Tax Cut and Jobs Act in the areas of unrelated business income and executive compensation and sets out new IRS online filing and reporting requirements put in place during the pandemic.

We have learned over the years that our handbook for our students was also being used by practitioners as a quick and effective guide to nonprofit, tax exempt organizations. That was high praise indeed, and we are happy to be serving not just a law school audience but also an audience of our peers.

One audience for our work that we did not expect was that it came to be used as a college level textbook, primarily in undergraduate and graduate schools of business, to study the topic of nonprofit, tax exempt organizations. We are gratified by that audience and we hope, with this third edition, to be able to continue to serve that purpose as well.

Understanding Nonprofit and Tax Exempt Organizations is a guide for the law student, practitioner and others who are looking to understand the law governing the nonprofit, tax exempt sector. The Third Edition of *Understanding Nonprofit and Tax Exempt Organizations* begins with an introduction to nonprofit organizations by discussing the relevant law in general, as nonprofits are governed by state law. Next, tax exempt organizations are discussed, by first giving the reader the background on where such organizations fit in the nonprofit sector; why the organizations are given preferential tax treatment; what form these organizations take; and how such organizations are governed and dissolved. We do not spend time on “Best Practices” but there are now many resources that can be used to supplement an organization’s governance and decision-making. Diversity and inclusion policies and statements within Bylaws have become an important part of an organization’s strategic plans.

The Third Edition also provides detailed explanations of the various rules, regulations and tests organizations must follow to obtain or retain their tax exempt status as well as the consequences for their failure to comply with these requirements. It also looks at the court created commerciality and public policy doctrines for tax exempt organizations and how they have redefined the rules for tax exempt organizations.

The tax exempt sector is populated by numerous types of organizations. This text explores the major types of tax exempt organizations. Highlighted are the primary categories of IRC Section 501(c)(3) organizations: religious organizations, educational organizations, healthcare organizations and arts organizations. Also covered are all the other types of organizations mentioned in IRC Section 501(c)(3): general charitable, scientific, public safety testing, literary, organizations that foster amateur sports and organizations for the prevention of cruelty to children or animals. After explaining Section 501(c)(3) organizations in a comprehensive manner, the text turns to other areas of major tax exempt activity: Section 501(c)(4) social welfare organizations, Section 501(c)(5) labor organizations, Section 501(c)(6) trade associations, Section 501(c)(7) social clubs and Section 501(c)(8) fraternal benefit organizations. There is also a chapter on that very strange type of tax exempt organization, the Section 527 political organization.

Finally, our text ends with chapters on charitable solicitation, fundraising, the unrelated business income tax and that most complicated of tax exempt organizations, the private foundation. The final chapter is a guide to the IRS procedures for obtaining and maintaining tax exempt status, with appropriate reference to the online IRS forms necessary to perform these functions. We believe that all of these topics together provide a reasonably complete overview of the nonprofit tax exempt sector.

Case law, the Internal Revenue Code (IRC) and Regulations are used as a basis to discuss and explain the issues relevant to tax exempt organizations. When the IRC and Regulations are cited, together with IRS explanations of the same, the language we use is usually a paraphrase or a direct quote; however, for the ease of reading, quotation marks are most often omitted to avoid a sea of inverted commas. Also, unless otherwise stated, the statutory and regulatory cites are from the current (as of the date of publication) version of these documents.

While it is important to remember that Revenue Rulings, Revenue Procedures, General Counsel Memoranda, Technical Advice Memoranda and Private Letter Rulings are not legal precedents and may not be used as such, they are used by us in this book to illustrate what has been the IRS's position on the issues that we deal with. We have also cited to the newly published ALI Restatement of the Law of Charitable Nonprofit Organizations as a resource often used by courts, but not as legal precedent.

Dean Cafardi would like to thank Joel Fishman, Ph.D., M.L.S. Associate Director for Lawyer Services, Emeritus, Duquesne University Center for Legal Information/Allegheny County Law Library, Pittsburgh, PA 15219, for his help with the footnotes.

Professor Cherry would like to thank Zachary Polo, J.D. 2021, University of South Carolina School of Law and Marilyn Orcutt, Juris Doctorate Candidate — Class of 2022, University of South Carolina School of Law for their excellent research assistance.