

**DESCRIPTION OF PRESENT LAW RELATING TO CHARITABLE
AND OTHER EXEMPT ORGANIZATIONS AND STATISTICAL
INFORMATION REGARDING GROWTH AND OVERSIGHT OF THE
TAX-EXEMPT SECTOR**

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INTRODUCTION

The Senate Finance Committee has scheduled a public hearing for June 22, 2004, titled “Charity Oversight and Reform: Keeping Bad Things from Happening to Good Charities.” This document, prepared by the staff of the Joint Committee on Taxation, presents legal and statistical information regarding tax-exempt organizations, principally organizations described in section 501(c)(3),¹ as well as information about organizations described in sections 501(c)(4), 501(c)(5), and 501(c)(6).²

In general, tax-exempt status is available under the Code to a wide variety of organizations. The Internal Revenue Service (“IRS”) reported over 1.6 million tax-exempt organizations for the 2003 fiscal year (not including churches). For the year 2000, charitable organizations alone held \$2.07 trillion in assets and reported \$939 billion in revenues.³ The list of organizations under section 501(c) alone covers more than 28 types of tax-exempt organizations, including instrumentalities of the Federal government, title holding companies, social clubs, fraternal benefit organizations, benevolent life insurance associations, cemetery companies, credit unions, and veterans’ organizations. Exemptions under other Code provisions also are provided for qualified pension plans, apostolic and religious organizations, farmers’ cooperatives, and political organizations, among others.

Charitable organizations, or those described in section 501(c)(3), form the bulk of the tax-exempt sector. Almost 1.0 million of the 1.6 million tax-exempt organizations reported by the IRS were charities. Other numerous exempt organizations include social welfare organizations (section 501(c)(4)), labor, agricultural, and horticultural organizations (section 501(c)(5)), and trade associations (section 501(c)(6)). The IRS reports about 285,000 of these three types of organizations in 2003.

¹ All section references are to the Internal Revenue Code of 1986, unless otherwise indicated.

² This document may be cited as follows: Joint Committee on Taxation, *Description of Present Law Relating to Charitable and Other Exempt Organizations and Statistical Information Regarding Growth and Oversight of the Tax-Exempt Sector* (JCX-44-04), June 22, 2004. All of the statistical information reported in this document is publicly available from IRS sources or from prior Joint Committee on Taxation staff publications.

³ Paul Arnsberger, “Charities and Other Tax-Exempt Organizations, 2000,” *Statistics of Income Bulletin*, Fall 2003, Volume 23, No. 2, at 122; Melissa Ludlum, “Domestic Private Foundations and Charitable Trusts, 2000,” *Statistics of Income Bulletin*, Fall 2003, Volume 23, No. 2, at 138. The \$2.07 trillion in assets does not include churches, certain other religious organizations, and most organizations with receipts of less than \$25,000. Of the \$2.07 trillion in assets, \$472 billion represents the fair market value of assets held by private foundations. Of the \$939 billion of revenues, \$72.8 billion is attributable to private foundations. The sources of other statistical information used in this Introduction is provided in Part II of this pamphlet.

A significant function of the tax-exempt division of the IRS is to determine whether organizations qualify as charitable, and therefore are exempt from tax and eligible to receive deductible contributions. For the period 1992 to 2003, the IRS issued 637,000 such determinations. The IRS also processes annual information returns (Form 990 series) for the tax-exempt sector (e.g., 572,000 such returns were filed in 2002). IRS administrative and oversight responsibilities have grown in recent years as the tax-exempt sector has grown. Between 1995 and 2003, the number of charitable organizations reported by the IRS grew by 54 percent and the number of all exempt organizations grew by 33 percent. Over the same period, information returns filed by exempt organizations increased by 34 percent; while the number of unrelated business income tax returns filed by exempt organizations decreased by approximately three percent. Tax collections on unrelated business activities have declined over the past several years.

During the period 1993 to 2003, IRS enforcement statistics show declines in examinations. The percentage of tax-exempt organization returns examined by the IRS decreased from 2.5 percent in 1993 to 0.7 percent in 2001, then remained at 0.7 percent during 2002 and 2003. Nonetheless, the most recent statistics show that the recommended aggregate additional tax imposed after examination of exempt organizations more than doubled from 1998 (\$82 million) to 2002 (\$169 million). There is no mandated, periodic procedure for review of whether an organization, once determined by the IRS to be a charitable organization, continues to operate consistent with charitable purposes.

In a 20-year study of exempt organizations from 1975 to 1995, the IRS concluded that the net assets and revenues of exempt organizations filing information returns more than tripled during that period, compared to real growth in gross domestic product (“GDP”) over the same period of 74 percent. Revenues of all section 501(c) organizations more than doubled as a percentage of GDP during this period, increasing to 12 percent of GDP in 1995, with revenues of charities alone comprising nine percent of the 1995 GDP.

The statutory law regulating the tax-exempt sector has changed only incrementally in the past decades, with the last seminal change in 1969, when, in the Tax Reform Act of 1969, Congress responded to widely reported abuses by private foundations and established a separate regime distinguishing private foundations from other charitable organizations and special anti-abuse rules applicable only to private foundations. These rules largely have remained intact. The most significant subsequent change to the tax laws relating to charities was in 1996, when Congress introduced “intermediate sanctions” as an alternative to loss of exemption for public charities engaging in self-dealing transactions with insiders. Many of the recent legislative efforts regarding tax-exempt organizations have involved charitable giving incentives, reporting requirements, and charitable contributions of non-cash property. In recent times, there has not been a comprehensive evaluation of the standards for exemption, procedures for revocation, IRS coordination of oversight with State governments, or the implications of the growth of and increasing complexity of the tax-exempt sector and whether present law rules are sufficiently clear and administrable to take such growth and complexity into account.

I. GENERAL DESCRIPTION OF PRESENT-LAW BENEFITS AND REQUIREMENTS OF FEDERAL INCOME TAX EXEMPTION

A. Eligibility for Exemption and Tax Treatment (including UBIT)

1. Charitable organizations

General description

Charitable organizations, i.e., organizations described in section 501(c)(3), generally are exempt from Federal income tax and are eligible to receive tax deductible contributions.⁴ A charitable organization must operate primarily in pursuance of one or more tax-exempt purposes constituting the basis of its tax exemption.⁵ The Code specifies such purposes as religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster international amateur sports competition, or for the prevention of cruelty to children or animals. In general, an organization is organized and operated for charitable purposes if it provides relief for the poor and distressed or the underprivileged.⁶

In order to qualify as operating primarily for a purpose described in section 501(c)(3), an organization must satisfy the following operational requirements: (1) the net earnings of the organization may not inure to the benefit of any person in a position to influence the activities of the organization; (2) the organization must operate to provide a public benefit, not a private benefit;⁷ (3) the organization may not be operated primarily to conduct an unrelated trade or business;⁸ (4) the organization may not engage in substantial legislative lobbying; and (5) the organization may not participate or intervene in any political campaign.

Section 501(c)(3) organizations are classified either as “public charities” or “private foundations.”⁹ Private foundations are defined under section 509(a) as all organizations

⁴ Certain organizations described elsewhere within section 501, namely cooperative hospital service organizations (sec. 501(e)), cooperative service organizations of operating educational organizations (sec. 501(f)), child care organizations (sec. 501(k)), and charitable risk pools (sec. 501(n)), are treated as charitable organizations described within section 501(c)(3). Such organizations generally are subject to their own organizational and operational requirements specified in the relevant Code provision.

⁵ Treas. Reg. sec. 1.501(c)(3)-1(c)(1).

⁶ Treas. Reg. sec. 1.501(c)(3)-1(d)(2).

⁷ Treas. Reg. sec. 1.501(c)(3)-1(d)(1)(ii).

⁸ Treas. Reg. sec. 1.501(c)(3)-1(e)(1). Conducting a certain level of unrelated trade or business activity will not jeopardize tax-exempt status.

⁹ Sec. 509(a). Private foundations are either private operating foundations or private non-operating foundations. In general, private operating foundations operate their own

described in section 501(c)(3) other than an organization granted public charity status by reason of: (1) being a specified type of organization (i.e., churches, educational institutions, hospitals and certain other medical organizations, certain organizations providing assistance to colleges and universities, or a governmental unit); (2) receiving a substantial part of its support from governmental units or direct or indirect contributions from the general public; or (3) providing support to another section 501(c)(3) entity that is not a private foundation. In contrast to public charities, private foundations generally are funded from a limited number of sources (e.g., an individual, family, or corporation).

Because private foundations receive support from, and typically are controlled by, a small number of supporters, private foundations are subject to a number of anti-abuse rules not applicable to public charities.¹⁰ For example, private foundations are required to make a minimum amount of charitable distributions each year, are prohibited from retaining excess holdings in a business, may not make jeopardizing business investments, and may not make certain expenditures (including expenditures for lobbying, political activities, grants to individuals without prior IRS approval, grants to organizations other than public charities and certain foundations unless special procedures are followed, and noncharitable purposes). Violations result in excise taxes on the foundation and, in the case of jeopardizing business investments and taxable expenditures, the management of the foundation. In addition, both public charities and private foundations generally are prohibited from engaging in certain transactions with disqualified persons. For public charities, an excise tax applies to organization managers and to disqualified persons with respect to an “excess benefit” transaction;¹¹ for private foundations, foundation managers and disqualified persons are subject to an excise tax for acts of self-dealing.¹² As described later, the applicable transactions, the definition of “disqualified person,” and the tax structure relating to the excess benefit and self-dealing rules differ significantly.

Federal income tax treatment

Section 501(c)(3) organizations generally are not subject to Federal income tax on contributions received, on income from activities that are substantially related to the purpose of the organization’s tax exemption, or on investment income. Private foundations, however, are subject to an excise tax on their net investment income.¹³

Section 501(c)(3) organizations are subject to the unrelated business income tax on income derived from a trade or business regularly carried on by the organization that is not

charitable programs in contrast to private non-operating foundations, which generally are grant-making organizations. Most private foundations are non-operating foundations.

¹⁰ Secs. 4940 - 4945.

¹¹ Sec. 4958.

¹² Secs. 4941 - 4945.

¹³ Sec. 4940.

substantially related to the performance of the organization's tax-exempt functions.¹⁴ Certain types of income, however, are specifically exempt from the unrelated business income tax, such as dividends, interest, royalties, and certain rents, unless derived from debt-financed property or from certain 50-percent controlled subsidiaries. Other exemptions from the unrelated business income tax are provided for activities in which substantially all the work is performed by volunteers, for income from the sale of donated goods, and for certain activities carried on for the convenience of members, students, patients, officers, or employees of a charitable organization. In addition, special unrelated business income tax provisions exempt from tax certain activities of trade shows and State fairs, income from bingo games, and income from the distribution of certain low-cost items incidental to the solicitation of charitable contributions. Organizations liable for tax on unrelated business taxable income may be liable for alternative minimum tax determined after taking into account adjustments and tax preference items.

Gross collections of unrelated business income tax have decreased significantly since fiscal year 1997. Gross collections in such fiscal year were \$667 million. Collections increased to \$811 million in fiscal year 1999 but have decreased each year since, to \$386 million in fiscal year 2003.¹⁵

Debt-financed property

For purposes of determining unrelated business income, debt-financed property generally means any property that is held to produce income and with respect to which there is acquisition indebtedness at any time during the taxable year. In general, income of a tax-exempt organization that is produced by debt-financed property is treated as unrelated business income in proportion to the acquisition indebtedness on the income-producing property. Acquisition indebtedness generally means the amount of unpaid indebtedness incurred by an organization to acquire or improve the property and indebtedness that would not have been incurred but for the acquisition or improvement of the property. Acquisition indebtedness does not include, however, (1) certain indebtedness incurred in the performance or exercise of a purpose or function constituting the basis of the organization's exemption, (2) obligations to pay certain types of annuities, (3) an obligation, to the extent it is insured by the Federal Housing Administration, to finance the purchase, rehabilitation, or construction of housing for low and moderate income persons, or (4) indebtedness incurred by qualified organizations (certain educational organizations and pension plans) to acquire or improve real property. Special rules apply in the case of an exempt organization that owns a partnership interest in a partnership that holds debt-financed income-producing property. An exempt organization's share of partnership

¹⁴ Secs. 511 through 514. Tax-exempt corporations are taxed on their unrelated business taxable income at the regular corporate tax rates (sec. 511(a)). Charitable trusts and other tax-exempt trusts generally are subject to tax on their unrelated business taxable income under the rates generally applicable to taxable trusts (sec. 511(b)).

¹⁵ Gross collections of UBIT are from "Summary of Internal Revenue Collections and Refunds, by Type of Tax, Fiscal Years [1997 and 1998 through 2002 and 2003]" available on the IRS website under Tax Stats, Statistics by Topic, Tax Exempts/Employee Plans Statistics, "www.irs.gov/taxstats/".

income that is derived from such debt-financed property generally is taxed as debt-financed income unless an exception provides otherwise.

Treatment of income from controlled entities

Section 512(b)(13) provides special rules regarding income derived by an exempt organization from a controlled subsidiary, and generally treats otherwise excluded rent, royalty, annuity, and interest income as unrelated business income if such income is received from a taxable or tax-exempt subsidiary that is 50 percent controlled by the parent tax-exempt organization. In the case of a stock subsidiary, “control” means ownership by vote or value of more than 50 percent of the stock. In the case of a partnership or other entity, control means ownership of more than 50 percent of the profits, capital or beneficial interests. In addition, present law applies the constructive ownership rules of section 318 for purposes of section 512(b)(13). Thus, a parent exempt organization is deemed to control any subsidiary in which it holds more than 50 percent of the voting power or value, directly (as in the case of a first-tier subsidiary) or indirectly (as in the case of a second-tier subsidiary). Interest, rent, annuity, or royalty payments made by a controlled entity to a tax-exempt organization are includable in the latter organization’s unrelated business income and are subject to the unrelated business income tax to the extent the payment reduces the net unrelated income (or increases any net unrelated loss) of the controlled entity (determined as if the entity were tax exempt).

Deductibility of contributions made to section 501(c)(3) organizations

In general

In computing taxable income, a taxpayer who itemizes deductions generally is allowed to deduct the amount of cash and the fair market value of property contributed to an organization described in section 501(c)(3) or to a Federal, State, or local governmental entity.¹⁶ The amount of the deduction allowable for a taxable year with respect to a charitable contribution of property may be reduced or limited depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.¹⁷ In general, more generous charitable contribution deduction rules apply to gifts made to public charities than to gifts made to private foundations. Within certain limitations, donors also are entitled to deduct their contributions to section 501(c)(3) organizations for Federal estate and gift tax purposes. By contrast, contributions to nongovernmental, non-charitable tax-exempt organizations generally are not deductible by the donor,¹⁸ though such organizations are eligible

¹⁶ The deduction also is allowed for purposes of calculating alternative minimum taxable income.

¹⁷ Secs. 170(b) and (e).

¹⁸ Exceptions to the general rule of non-deductibility include certain gifts made to a veterans’ organization or to a domestic fraternal society. In addition, contributions to certain nonprofit cemetery companies are deductible for Federal income tax purposes, but generally are not deductible for Federal estate and gift tax purposes. Secs. 170(c)(3), 170(c)(4), 170(c)(5), 2055(a)(3), 2055(a)(4), 2106(a)(2)(A)(iii), 2522(a)(3), and 2522(a)(4).

for the exemption from Federal income tax with respect to such donations. Recipients of charitable assistance generally may exclude the assistance from income as a gift.¹⁹

In general, if a donor receives a benefit or quid pro quo in return for a contribution, any charitable contribution deduction is reduced by the amount of the benefit received. For contributions of \$250 or more, no charitable contribution deduction is allowed unless the donee organization provides a contemporaneous written acknowledgement of the contribution that describes and provides a good faith estimate of the value of any goods or services provided by the donee organization in exchange for the contribution.²⁰

Contributions of property

The amount of the deduction for charitable contributions of capital gain property generally equals the fair market value of the contributed property on the date of the contribution. Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of capital gain property are subject to different percentage limitations than other contributions of property.

For certain contributions of property, the deductible amount is reduced from the fair market value of the contributed property by the amount of any gain, generally resulting in a deduction equal to the taxpayer's basis. This rule applies to contributions of: (1) ordinary income property, e.g., property that, at the time of contribution, would not have resulted in long-term capital gain if the property was sold by the taxpayer on the contribution date;²¹ (2) tangible personal property that is used by the donee in a manner unrelated to the donee's exempt (or governmental) purpose; and (3) property to or for the use of a private foundation (other than a foundation defined in section 170(b)(1)(E)).

¹⁹ Sec. 102(a).

²⁰ Sec. 170(f)(8).

²¹ For certain contributions of inventory, C corporations may claim an enhanced deduction equal to the lesser of (1) basis plus one-half of the item's appreciated value (i.e., basis plus one half of fair market value in excess of basis) or (2) two times basis. Sec. 170(e)(3). To be eligible for the enhanced deduction, the contributed property generally must be inventory of the taxpayer, contributed to a charitable organization described in section 501(c)(3) (except for private nonoperating foundations), and the donee must (1) use the property consistent with the donee's exempt purpose and solely for the care of the ill, the needy, or infants, (2) not transfer the property in exchange for money, other property, or services, and (3) provide the taxpayer a written statement that the donee's use of the property will be consistent with such requirements. A similar enhanced deduction is available for contributions of scientific property and equipment (sec. 170(e)(4)) and for contributions of computer technology used for educational purposes made in taxable years beginning before January 1, 2004 (sec. 170(e)(6)).

In general, a charitable contribution deduction is allowed only for contributions of the donor's entire interest in the contributed property, and not for contributions of a partial interest.²² If a taxpayer sells property to a charitable organization for less than the property's fair market value, the amount of any charitable contribution deduction is determined in accordance with the bargain sale rules.²³ If a taxpayer pays more than fair market value for property acquired from a charitable organization, the excess above fair market value may be deductible assuming that the donor intended to make a gift of such excess.

Taxpayers are required to obtain a qualified appraisal for donated property with a value of \$5,000 or more, and to attach an appraisal summary to the tax return.²⁴ In the case of contributions of art valued at \$20,000 or more, taxpayers are required to attach the appraisal to the tax return. Under Treasury regulations, a qualified appraisal means an appraisal document that, among other things: (1) relates to an appraisal that is made not earlier than 60 days prior to the date of contribution of the appraised property and not later than the due date (including extensions) of the return on which a deduction is first claimed under section 170;²⁵ (2) is prepared, signed, and dated by a qualified appraiser; (3) includes (a) a description of the property appraised; (b) the fair market value of such property on the date of contribution and the specific basis for the valuation; (c) a statement that such appraisal was prepared for income tax purposes; (d) the qualifications of the qualified appraiser; and (e) the signature and taxpayer identification number of such appraiser; and (4) does not involve an appraisal fee that violates certain prescribed rules.²⁶

Tax-exempt financing

State and local governments may act as conduits to provide tax-exempt financing for limited activities conducted and paid for by nongovernmental entities or individuals, including for the exempt activities of section 501(c)(3) organizations.²⁷ Accordingly, section 501(c)(3) organizations have access to tax-exempt financing through State and local governments. This

²² Sec. 170(f)(3).

²³ Sec. 1011(b) and Treas. Reg. sec. 1.1011-2.

²⁴ Pub. L. No. 98-369, sec. 155(a)(1) through (6) (1984) (providing that not later than December 31, 1984, the Secretary shall prescribe regulations requiring an individual, a closely held corporation, or a personal service corporation claiming a charitable deduction for property (other than publicly traded securities) to obtain a qualified appraisal of the property contributed and attach an appraisal summary to the taxpayer's return if the claimed value of such property (plus the claimed value of all similar items of property donated to one or more donees) exceeds \$5,000).

²⁵ In the case of a deduction first claimed or reported on an amended return, the deadline is the date on which the amended return is filed.

²⁶ Treas. Reg. sec. 1.170A-13(c)(3).

²⁷ Sec. 145.

generally does not include financing for unrelated business activities of such organizations.²⁸ Tax-exempt organizations other than section 501(c)(3) organizations generally must satisfy requirements generally applicable to nongovernmental entities or individuals in order to obtain tax-exempt financing.

2. Social welfare organizations, labor organizations, and business leagues

General description

Section 501(c)(4) provides tax exemption for civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, and no part of the net earnings of which inures to the benefit of any private shareholder or individual. An organization is operated exclusively for the promotion of social welfare if it is engaged primarily in promoting in some way the common good and general welfare of the people of a community.²⁹ The promotion of social welfare does not include direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office. An organization is not operated primarily for the promotion of social welfare if its primary activity is operating a social club for the benefit, pleasure, or recreation of its members, or is carrying on a business with the general public in a manner similar to organizations that are operated for profit.

Section 501(c)(5) provides tax exemption for certain labor, agricultural, or horticultural organizations. Such organizations must have no net earnings inuring to the benefit of any member, and must have as their objects the betterments of the conditions of those engaged in such pursuits, the improvement of the grade of their products, and the development of a higher degree of efficiency in their respective occupations.³⁰ An organization generally is not exempt under this provision if its principal activity is to receive, hold, invest, disburse, or otherwise manage funds associated with savings or investment plans or programs, including pension or other retirement savings plans or programs.³¹

Section 501(c)(6) provides a tax exemption for business leagues and certain other organizations not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual. A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit.³²

²⁸ Sec. 145(a).

²⁹ Treas. Reg. sec. 1.501(c)(4)-1(a)(2).

³⁰ Treas. Reg. sec. 1.501(c)(5)-1(a).

³¹ Treas. Reg. sec. 1.501(c)(5)-1(b).

³² Treas. Reg. sec. 1.501(c)(6)-1.

Federal income tax treatment

Sections 501(c)(4), 501(c)(5), 501(c)(6), and other 501(c) organizations generally are not subject to Federal income tax on income from activities that are substantially related to the purpose of the organization's tax exemption, or on investment income. However, such organizations are subject to tax on their unrelated business taxable income, and may be liable for alternative minimum tax, determined after taking into account certain adjustments and tax preference items. Special unrelated business taxable income rules apply to certain of these organizations. For example, certain required annual dues of agricultural or horticultural organizations are not treated as unrelated trade or business income by reason of any benefits or privileges to which members of such organization are entitled.³³ Social welfare organizations, labor organizations, agricultural organizations, and horticultural organizations, exempt under section 501(c)(4) or (c)(5), are subject to special rules regarding income from certain activities of fairs and exhibitions, and such organizations and business leagues are subject to special rules regarding income from qualified convention and trade show activities.³⁴

³³ Sec. 512(d).

³⁴ Sec. 513(d).

B. Determinations of Tax-Exempt Status and Annual Reporting Requirements

1. Determinations of tax-exempt status for section 501(c)(3) organizations

Application for tax-exemption

Section 501(c)(3) organizations (with certain exceptions) are required to seek formal recognition of tax-exempt status by filing an application with the IRS (Form 1023). In response to the application, the IRS issues a determination letter or ruling either recognizing the applicant as tax-exempt or not. Certain organizations are not required to apply for recognition of tax-exempt status in order to qualify as tax-exempt under section 501(c)(3) but may do so. These organizations include churches, certain church-related organizations, organizations (other than private foundations) the gross receipts of which in each taxable year are normally not more than \$5,000, organizations (other than private foundations) subordinate to another tax-exempt organization that are covered by a group exemption letter, and for certain purposes only, charitable trusts described in section 4947(a)(1) that were organized before October 9, 1969.

A favorable determination by the IRS on an application for recognition of tax-exempt status (Form 1023) will be retroactive to the date that the section 501(c)(3) organization was created if it files a completed Form 1023 within 15 months from the end of the month it was formed.³⁵ If the organization does not file Form 1023 or files a late application, it will not be treated as tax-exempt under section 501(c)(3) for any period prior to the filing of an application for recognition of tax exemption.³⁶ Contributions to section 501(c)(3) organizations that are subject to the requirement that the organization apply for recognition of tax-exempt status generally are not deductible from income, gift, or estate tax until the organization receives a determination letter from the IRS.³⁷

Information required on Form 1023 includes: (1) a detailed statement of actual and proposed activities; (2) a statement of receipts and expenditures for the current year and the three preceding years (or for the number of years of the organization's existence, if less than four years); (3) a balance sheet for the current year; (4) a description of anticipated receipts and contemplated expenditures; (5) a copy of the articles of incorporation, trust document, or other organizational or enabling document; (6) organization bylaws (if any); and (7) information about

³⁵ Pursuant to Treas. Reg. sec. 301.9100-2(a)(2)(iv), organizations are allowed an automatic 12-month extension as long as the application for recognition of tax exemption is filed within the extended, i.e., 27-month, period. The IRS also may grant an extension beyond the 27-month period if the organization is able to establish that it acted reasonably and in good faith and that granting relief will not prejudice the interests of the government. Treas. Reg. secs. 301.9100-1 and 301.9100-3.

³⁶ Treas. Reg. sec. 1.508-1(a)(1).

³⁷ Sec. 508(d)(2)(B). Contributions made prior to receipt of a favorable determination letter may be deductible prior to the organization's receipt of such favorable determination letter if the organization has timely filed its application to be recognized as tax-exempt. Treas. Reg. secs. 1.508-1(a) and 1.508-2(b)(1)(i)(b).

previously filed Federal income tax and exempt organization returns, if applicable. The IRS currently is revising the Form 1023.

A favorable determination letter issued by the IRS will state that the application for recognition of tax exemption and supporting documents establish that the organization submitting the application meets the requirements of section 501(c)(3) and will classify the organization as either a public charity or a private foundation.

Review of exempt status

An organization that has received a favorable tax-exemption determination from the IRS generally may continue to rely on the determination as long as “there are no substantial changes in the organization’s character, purposes or methods of operation.”³⁸ There is no mandated, periodic procedure to review an organization’s continuing qualification for exemption.

Organizations that are classified as public charities (or as private operating foundations) and not as private nonoperating foundations may cease to satisfy the conditions that entitled the organization to such status. The IRS makes an initial determination of public charity or private foundation status (either a definitive ruling, or an advance ruling generally effective for five years and then reviewed again by the IRS) that is subsequently monitored by the IRS through annual return filings. The IRS periodically announces in the Internal Revenue Bulletin a list of organizations that have failed to establish, or have been unable to maintain, their status as public charities or as private operating foundations, and that become private nonoperating foundations.

If the IRS denies an organization’s application for recognition of exemption under section 501(c)(3), the organization may seek a declaratory judgment regarding its tax status.³⁹ Prior to utilizing the declaratory judgment procedure, the organization must have exhausted all administrative remedies available to it within the IRS.

Revocation (and suspension) of exempt status

A ruling or determination letter concluding that an organization is exempt from tax may be revoked or modified by: (1) notice from the IRS to the organization to which the ruling or determination letter was originally issued; (2) enactment of legislation or ratification of a tax treaty; (3) a decision of the United States Supreme Court; (4) issuance of temporary or final Regulations by the Treasury Department; or (5) issuance of a revenue ruling, a revenue procedure, or other statement in the Internal Revenue Bulletin.⁴⁰ An organization’s tax exemption will not be terminated if it becomes inactive for a time so long as the organization does not cease to be a legal entity under the laws of the State in which it is organized.

³⁸ Treas. Reg. sec. 1.501(a)-1(a)(2).

³⁹ Sec. 7428.

⁴⁰ Rev. Proc. 90-27, 1990-1 C.B. 514; IRS Pub. No. 557, Tax-Exempt Status for Your Organization (May 2003) at 4-5.

The IRS generally issues a letter revoking recognition of an organization's tax-exempt status only after: (1) conducting an examination of the organization; (2) issuing a letter to the organization proposing revocation; and (3) allowing the organization to exhaust the administrative appeal rights that follow the issuance of the proposed revocation letter. In the case of a section 501(c)(3) organization, the revocation letter immediately is subject to judicial review under the declaratory judgment procedures of section 7428. To sustain a revocation of tax-exempt status under section 7428, the IRS must demonstrate that the organization no longer is entitled to exemption.

Upon revocation of tax-exemption or change in the classification of an organization (e.g., from public charity to private foundation status), the IRS publishes an announcement of such revocation or change in the Internal Revenue Bulletin.⁴¹ Contributions made to organizations by donors who are unaware of the revocation or change in status ordinarily will be deductible if made on or before the date of publication of the announcement.

The IRS may suspend the tax-exempt status of an organization for any period during which an organization is designated or identified by U.S. Federal authorities as a terrorist organization or supporter of terrorism.⁴² Such an organization also is ineligible to apply for tax exemption. The period of suspension runs from the date the organization is first designated or identified to the date when all designations or identifications with respect to the organization have been rescinded pursuant to the law or Executive order under which the designation or identification was made. During the period of suspension, no deduction is allowed for any contribution to a terrorist organization.

Conversions from exempt status

Organizations described in section 501(c)(3) may seek to convert to a status as a taxable entity, organized and operated for profit. Conversion transactions must be structured in a manner that is consistent with the organizational requirements of a charitable organization, namely that the organization's assets are dedicated to an exempt purpose. An organization's assets are considered dedicated to an exempt purpose if, for example, upon dissolution, such assets are distributed for one or more exempt purposes, or to the Federal government, or to a State or local government, for a public purpose.⁴³ There are a variety of structures used to effect conversion transactions, including: (1) an asset sale by the nonprofit to a for-profit entity; (2) a merger of the nonprofit with and into a for-profit entity; (3) a formation by the nonprofit of a for-profit subsidiary to conduct the business; (4) a conversion under State corporate law from a nonprofit into a for-profit corporation; and (5) a joint venture model in which a portion of the nonprofit's assets are transferred to a separate nonprofit organization, and the remaining assets are retained

⁴¹ Rev. Proc. 82-39, 1982-2 C.B. 759.

⁴² Sec. 501(p) (enacted by Pub. L. No. 108-121, sec. 108(a), effective for designations made before, on, or after November 11, 2003).

⁴³ Treas. Reg. sec. 1.501(b)(4).

to be used by a successor for-profit entity after the nonprofit's conversion to a for-profit entity.⁴⁴ The regulation or oversight of conversion transactions has varied among the States, both with respect to procedural requirements and the substantive standards under which the transactions are reviewed.

2. Organizations exempt under section 501(c)(4), 501(c)(5), or 501(c)(6)

Organizations described within section 501(c)(4), 501(c)(5), or 501(c)(6) are not required to provide notice to the Secretary that they are requesting recognition of exempt status. Rather, organizations are exempt under these provisions if they satisfy the requirements applicable to such organizations. However, in order to obtain certain benefits such as public recognition of tax-exempt status, exemption from certain State taxes, and nonprofit mailing privileges, such organizations may request a formal recognition of exempt status by filing a Form 1024.

3. Annual reporting requirements

Section 501(c)(3) organizations (as well as other organizations exempt from taxation under section 501(a)) are required to file an annual return, stating specifically the items of gross income, receipts, disbursements, and such other information as the Secretary may prescribe.⁴⁵ The requirement that an exempt organization file an annual information return does not apply to certain exempt organizations, including organizations (other than private foundations) the gross receipts of which in each taxable year normally are not more than \$25,000. Also exempt from the requirement are churches, their integrated auxiliaries, and conventions or associations of churches; the exclusively religious activities of any religious order; certain state institutions whose income is excluded from gross income under section 115; an interchurch organization of local units of a church; certain mission societies; certain church-affiliated elementary and high schools; and certain other organizations, including some that the IRS has relieved from the filing requirement pursuant to its statutory discretionary authority.⁴⁶

Section 501(c)(3) organizations that are classified as public charities must file Form 990 (Return of Organization Exempt From Income Tax)⁴⁷ and an additional form, Schedule A, which requests information specific to section 501(c)(3) organizations. An organization that is required to file an information return, but that has gross receipts of less than \$100,000 during its taxable

⁴⁴ Singer, Lawrence E., *The Conversion Conundrum: The State and Federal Response to Hospitals' Changes in Charitable Status*, 23 American Journal of Law and Medicine 221 (1997).

⁴⁵ Sec. 6033(a). An organization that has not received a determination of its tax-exempt status, but that claims tax-exempt status under section 501(a), is subject to the same annual reporting requirements and exceptions as organizations that have received a tax-exemption determination.

⁴⁶ Sec. 6033(a)(2)(A); Treas. Reg. sec. 1.6033-2(a)(2)(i) and (g)(1).

⁴⁷ Social welfare organizations, labor organizations, agricultural organizations, horticultural organizations, and business leagues are subject to the generally applicable Form 990, Form 990-EZ, and Form 990-T annual filing requirements.

year, and total assets of less than \$250,000 at the end of its taxable year, may file Form 990-EZ. Private foundations are required to file Form 990-PF rather than Form 990.⁴⁸

On the applicable annual information return, organizations are required to report their gross income, information on their finances, functional expenses, compensation, activities, and other information required by the IRS in order to review the organization's activities and operations during the previous taxable year and to review whether the organization continues to meet the statutory requirements for exemption. Examples of the information required by Form 990 include: (1) a statement of program accomplishments; (2) a description of the relationship of the organization's activities to the accomplishment of the organization's exempt purposes; (3) a description of payments to individuals, including compensation to officers and directors, highly paid employees and contractors, grants, and certain insider transactions and loans; and (4) disclosure of certain activities, such as expenses of conferences and conventions, political expenditures, compliance with public inspection requirements, and lobbying activities. The IRS is currently revising Form 990.

A section 501(c)(3) organization that is subject to the unrelated business income tax and that has \$1,000 or more of gross unrelated business taxable income must file Form 990-T. Public charities that make an election under section 501(h) regarding permitted lobbying expenditures and that incur tax for excess lobbying expenditures must file Form 4720. Form 4720 also is required to be filed (by public charities or private foundations, as the case may be) with respect to any taxes owed for self-dealing (sec. 4941), undistributed income (sec. 4942), excess business holdings (sec. 4943), investments that jeopardize charitable purposes (sec. 4944), taxable expenditures (sec. 4945), political expenditures (sec. 4955) and excess benefit transactions (sec. 4958).⁴⁹

⁴⁸ Form 990-PF requires, among other things, reporting of: the foundation's gross income for the year; expenses attributable to such income; disbursements for exempt purposes; total contributions and gifts received and the names of all substantial contributors; names, addresses, and compensation of officers and directors; an itemized statement of securities and other assets held at the close of the year; an itemized statement of all grants made or approved; and information about whether the organization has complied with the restrictions applicable to private foundations (secs. 4941 through 4945).

⁴⁹ Organizations described in section 501(c)(4) (social welfare organizations) are required to provide certain information on their annual returns relating to section 4958 excess benefit taxes and any transactions relating thereto. Sec. 6033(f).

C. Public Availability of Documents, Information Sharing, and State Oversight

1. Disclosure of applications for recognition of tax exemption and annual returns

In general, the IRS and the organization are required to make approved applications for recognition of tax-exempt status (and certain related documents) available for public inspection, except that the Secretary (and the organization) may withhold disclosure of certain information if disclosure would divulge a trade secret, patent, process, style of work, or apparatus of the organization, and the Secretary determines that such disclosure would harm the organization, or the Secretary determines the disclosure would harm national defense.⁵⁰ The IRS is required to make annual information returns (Form 990 or Form 990-PF) available for public inspection, except that the IRS is not authorized to disclose the names and addresses of contributors (other than contributors to a private foundation).⁵¹ A copy of the organization's annual return generally is required to be made publicly available by the organization for inspection. Names and addresses of contributors (other than contributors to a private foundation) are not required to be made available for public inspection by the organization.⁵²

2. Information sharing with State officials

In general, the Secretary of the Treasury is required to share certain information with appropriate State officers regarding charitable organizations and organizations that have applied for tax-exempt status as a charitable organization.⁵³ The Secretary must notify the appropriate State officer of: (1) a refusal to recognize such an organization as an organization described in section 501(c)(3); (2) a revocation of a section 501(c)(3) organization's tax-exempt status; and (3) the mailing of a notice of deficiency for any tax imposed under section 507, chapter 41, or chapter 42.⁵⁴ In addition, at the request of such appropriate State officer, the Secretary is required to make available for inspection and copying, such returns, filed statements, records, reports, and other information relating to the above-described disclosures, as are relevant to any State law determination. An appropriate State officer is the State Attorney General, State tax officer, or any State official charged with overseeing organizations of the type described in section 501(c)(3).

⁵⁰ Sec. 6104(a)(1)(D).

⁵¹ Sec. 6104(b).

⁵² Sec. 6104(d)(3).

⁵³ Sec. 6104(c).

⁵⁴ The applicable taxes include the termination tax on private foundations; taxes on public charities for certain excess lobbying expenses; taxes on a private foundation's net investment income, self-dealing activities, undistributed income, excess business holdings, investments that jeopardize charitable purposes, and taxable expenditures (some of these taxes also apply to certain non-exempt trusts); taxes on the political expenditures and excess benefit transactions of section 501(c)(3) organizations; and certain taxes on black lung benefit trusts and foreign organizations.

3. State oversight of charitable organizations

The regulation and oversight of charitable organizations generally involves both State and Federal authorities. State regulation, often accomplished through the Office of the State Attorney General, is designed to protect charitable donors from diversion and waste of funds and to ensure that the intended charitable beneficiaries receive the intended benefits. In many cases, nonprofit corporation fiduciary principles govern the actions of the organization's directors, trustees, and officers, and charitable trust law governs the use and disposition of the assets of the organization.

Charitable organizations typically are organized as nonprofit corporations or as trusts. State laws generally impose organizational and operational requirements on organizations that are formed under its nonprofit corporation or trust laws, and may impose certain requirements on organizations formed elsewhere that conduct activities within the State. These laws generally address issues such as the organization's purposes and powers, governing instruments (such as articles of organization and bylaws), governance (board composition, requirements for board action, and duties and standards of conduct for board members and officers), and dedication of assets for charitable uses (including a prohibition against the use of assets or income for the benefit of private individuals). The State Attorney General usually is responsible for enforcing the State's nonprofit corporation and trust laws, and often is a party in administrative or judicial proceedings brought to wind up the affairs of a charitable organization. In addition, charities often are required to notify the State Attorney General of certain actions and activities, such as termination, change in use of the charitable assets or in the fundamental nature of the organization, liquidation or distribution of the charitable assets, and certain dissolution, merger, consolidation, and asset transfer transactions. Organizations and trusts subject to State charitable trust laws generally are required to register with the State as a charitable trust, and notify the State Attorney General of any court proceeding involving the charitable trust. A State Attorney General may be authorized to take legal action to ensure that assets held by charitable organizations are used properly.

States also are responsible for regulating, enforcing and supervising other State laws such as charitable trust laws, professional fundraising and charitable solicitation laws, and State tax exemption laws (e.g., income, sales, and property tax exemptions). Charitable organizations frequently are required to register with States within which they conduct activities or solicit charitable contributions, file financial and tax information with the relevant State authorities, disclose to the public certain financial and operational information, and in some cases, obtain and submit to State authorities an independent accountant's review report or a certified audit report with respect to its financial statements.

In addition, certain types of exempt organizations are subject to other Federal and State laws that impose licensing requirements or other operational standards on such organizations. For example, hospitals are subject to State law licensing and certificate of need laws, as well as Federal Medicare and Medicaid laws that subject the hospital and other health care providers to certain requirements with respect to receipt of reimbursement payments from such programs for services provided to patients.

D. Certain Penalties and Taxes Applicable to Tax-Exempt Organizations

1. Cause for revocation of tax-exempt status

Private inurement/private benefit

Section 501(c)(3) provides that no part of a charitable organization's net earnings may inure to the benefit of any private shareholder or individual.⁵⁵ For this purpose, "private shareholder or individual" means persons having a personal and private interest in the activities of the organization.⁵⁶ This generally includes founders, trustees, directors, officers, key employees, and related family and organizations of these persons. There is no de minimis or incidental exception to the private inurement prohibition. Violation of the private inurement prohibition means that an organization does not qualify for exemption from Federal income tax as a charitable organization, and the IRS may seek revocation of the organization's exemption.⁵⁷

An organization cannot qualify as an exempt charitable organization if it violates the private benefit doctrine. This doctrine generally provides that the exempt organization cannot operate to confer a benefit on private parties. The private benefit doctrine differs from the private inurement prohibition in that it is not limited in its application to providing benefits to insiders. In addition, the private benefit doctrine does not prohibit all private benefit. Incidental private benefit will not cause an otherwise exempt organization to fail to qualify or to lose its exempt status. The IRS and the courts generally look to whether the private benefit is incidental in both a quantitative and a qualitative sense.

Organized and operated for a non-exempt purpose

An exempt organization must be operated exclusively for exempt purposes. This requirement may be violated if the organization conducts activities that are similar to those of a commercial enterprise. This applies to activities that are conducted directly by the exempt organization, and to activities of certain affiliates of the organization (e.g., joint ventures in which the exempt organization is a co-venturer). The presence of profit-making activities is not a per se bar to qualification as an exempt organization. For example, exempt organizations are permitted to conduct activities that are not related to their exempt purposes, and pay unrelated business income tax on income derived from such unrelated activities. The IRS and the courts look to the nature of the activity that gives rise to commercial profits, and, in general, to the time and resources expended on the unrelated activity. Generally, however, unrelated trade or business activities may not comprise a substantial portion of the organization's total activities without jeopardizing the exempt status of the organization. An organization may qualify as an

⁵⁵ The private inurement prohibition also applies to organizations described in sections 501(c)(4), 501(c)(5), and 501(c)(6).

⁵⁶ Treas. Reg. sec. 1.501(a)-1(c).

⁵⁷ As an alternative to revocation of tax exemption, the IRS may assert intermediate sanctions to the extent that the inurement results in an "excess benefit transaction," as described below.

exempt entity if it operates a trade or business that is substantially related to the charitable, educational, or other purposes that constitute the basis for its exemption.

Political and lobbying activities

Political activities

Organizations described in section 501(c)(3) and exempt from tax under section 501(a) may not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.⁵⁸ The prohibition on such political activity is absolute. The sanction for a violation of the prohibition is loss of the organization's tax-exempt status.

In general, political activities that are educational are permitted. Educational activities are those that present "a sufficiently full and fair exposition of the pertinent facts," are not biased, and "permit an individual or the public to form an independent opinion or conclusion."⁵⁹ Public charities also generally may provide a forum for debates by candidates, so long as the forum is fair and neutral and all qualified candidates are given equal time for debate.⁶⁰ Voter registration by public charities generally is permitted so long as the activity is conducted in a nonpartisan and fair manner. Other forms of voter education, such as publication of voter guides, also may be permissible if certain guidelines are followed.⁶¹ The prohibition on political activity is not intended to restrict free expression on political matters by persons speaking for themselves as individuals and not as representatives of a charitable organization.

For organizations that engage in prohibited political activity, the Code provides three penalties that may be applied either as alternatives to revocation of tax exemption or in addition to loss of tax-exempt status: an excise tax on political expenditures (section 4955), termination assessment of all taxes due (section 6852(a)(1)), and an injunction against further political expenditures (section 7409).

Lobbying activities

An organization does not qualify for tax-exempt status as a charitable organization described in section 501(c)(3) unless "no substantial part" of its activities constitutes "carrying on propaganda, or otherwise attempting, to influence legislation" (commonly referred to as "lobbying").⁶² Public charities may engage in limited lobbying activities, provided that such activities are not substantial, without losing their tax-exempt status and generally without being

⁵⁸ Sec. 501(c)(3).

⁵⁹ Treas. Reg. sec. 1.501(c)(3)-1(d)(3).

⁶⁰ See Rev. Rul. 86-95, 1986-2 C.B. 73.

⁶¹ Rev. Rul. 78-248, 1978-1 C.B. 154.

⁶² Sec. 501(c)(3).

subject to tax. In contrast, private foundations are subject to the restriction that lobbying activities, even if insubstantial, may result in the foundation being subject to penalty excise taxes.⁶³ For purposes of determining whether lobbying activities are a substantial part of a public charity's overall functions, a public charity may choose between two standards, the "substantial part" test or the "expenditure" test.⁶⁴

The substantial part test derives from the statutory language quoted above and uses a facts and circumstances approach to measure the permissible level of lobbying activities. Because there is no statutory or regulatory guidance clarifying this standard, it is not clear whether the determination is based on the organization's activities, its expenditures, or both. An arithmetical percentage test (e.g., looking only at the percentage of the budget, or employee's time spent on lobbying), while relevant, has been held not determinative. If public charities exceed the substantial part standard, they risk losing their tax exemption. In addition, excise taxes may be imposed if a public charity (other than a church) ceases to qualify for tax-exempt status under section 501(c)(3) due to its substantial lobbying activities.⁶⁵

The expenditure test sets specific dollar limits, calculated as a percentage of a charity's total exempt purpose expenditures, on the amount a charity may spend to influence legislation.⁶⁶ The test establishes two expenditure limits: one restricts the total amount of lobbying expenditures the public charity can make, the other restricts grass roots lobbying expenditures as a subset of total lobbying expenditures. A public charity's total lobbying expenditures for a year are the sum of its expenditures for direct lobbying and its expenditures for grass roots lobbying. The allowable amount of lobbying expenditures that can be made for any tax year is determined under a sliding-scale formula. In no event can the allowable amount of lobbying for a charity electing the expenditure test exceed \$1 million for any year.⁶⁷ A charity wishing to be subject to the expenditure test must affirmatively elect to do so (the "section 501(h) election"); charities that do not file an election (and churches) are subject to the substantial part test.

2. Intermediate sanctions (excess benefit transactions)

In general

The Code imposes excise taxes on excess benefit transactions between disqualified persons and charitable organizations (other than private foundations) or social welfare

⁶³ Sec. 4945(d)(1).

⁶⁴ Secs. 501(c)(3), 501(h), and 4911. Churches and certain church-related entities may not choose the expenditure test. Sec. 501(h)(5).

⁶⁵ Sec. 4912.

⁶⁶ Secs. 501(h) and 4911.

⁶⁷ Sec. 4911(c)(2).

organizations (as described in section 501(c)(4)).⁶⁸ An excess benefit transaction generally is a transaction in which an economic benefit is provided by a charitable or social welfare organization directly or indirectly to or for the use of a disqualified person, if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing such benefit. The tax does not apply to fixed payments made by an organization to a disqualified person pursuant to a binding written contract between the organization and a person who was not a disqualified person immediately before entering into the contract (the “initial contract exception”).⁶⁹ For example, the tax does not apply to a fixed payment compensation agreement between an exempt organization and an individual who is hired by the organization as its chief executive officer, if the individual was not a disqualified person with respect to the organization immediately before the parties executed the agreement.

The excess benefit tax is imposed on the disqualified person and, in certain cases, on the organization’s organization managers, but is not imposed on the exempt organization. An initial tax of 25 percent of the excess benefit amount is imposed on the disqualified person that receives the excess benefit. An additional tax on the disqualified person of 200 percent of the excess benefit applies if the violation is not corrected. A tax of 10 percent of the excess benefit (not to exceed \$10,000 with respect to any excess benefit transaction) is imposed on an organization manager that knowingly participated in the excess benefit transaction, if the manager’s participation was willful and not due to reasonable cause, and if the initial tax was imposed on the disqualified person.⁷⁰ If more than one person is liable for the tax on disqualified persons or on management, all such persons are jointly and severally liable for the tax.⁷¹

Disqualified person

A disqualified person is any person in a position to exercise substantial influence over the affairs of the organization at any time in the five-year period before the excess benefit transaction occurred.⁷² A disqualified person also includes certain family members of such a person, and certain entities that satisfy a control test with respect to such persons. Disqualified person is defined separately for purposes of the self-dealing rules applicable to private foundations.

Persons holding certain powers, responsibilities, or interests are considered to be in a position to exercise substantial influence over the affairs of the organization. These include: (1)

⁶⁸ Sec. 4958. The excess benefit transaction tax is commonly referred to as “intermediate sanctions,” because it imposes penalties generally considered to be less punitive than revocation of the organization’s exempt status.

⁶⁹ Treas. Reg. sec. 53.4958-4(a)(3).

⁷⁰ Sec. 4958(d)(2). Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

⁷¹ Sec. 4958(d)(1).

⁷² Sec. 4958(f)(1)(A); Treas. Reg. sec. 53.4958-3(a).

any individual serving on the governing body of the organization who is entitled to vote on any matter over which the governing body has authority; (2) any person who, regardless of title, has ultimate responsibility for implementing the decisions of the governing body or for supervising the management, administration, or operation of the organization (generally includes a president, chief executive officer, or chief operating officer unless the person demonstrates otherwise); and (3) any person who, regardless of title, has ultimate responsibility for managing the finances of the organization (generally includes a treasurer or chief financial officer unless the person demonstrates otherwise).⁷³

Certain persons are deemed not to have substantial influence over the affairs of the organization. These include employees receiving economic benefits of less than a specified amount in a taxable year and who are not family members of other disqualified persons or a substantial contributor to the organization.⁷⁴

In all other cases, whether a person is a disqualified person depends upon all relevant facts and circumstances. Facts and circumstances tending to show substantial influence over the affairs of the organization include, but are not limited to, whether: (1) the person founded the organization; (2) the person is a substantial contributor to the organization; (3) the person's compensation is primarily based on revenues derived from activities of the organization, or of a particular department or function of the organization, that the person controls; (4) the person has or shares authority to control or determine a substantial portion of the organization's capital expenditures, operating budget, or compensation of employees; (5) the person manages a discrete segment or activity of the organization that represents a substantial portion of the organization's activities, assets, income, or expenses, as compared to the organization as a whole; and (6) the person owns a controlling interest in an entity that is a disqualified person.⁷⁵

Facts and circumstances tending to show that the person does not have substantial influence over the affairs of the organization include, but are not limited to: (1) the person is a contractor whose sole relationship to the organization is providing professional advice (without having decision-making authority) with respect to transactions from which the contractor will not economically benefit either directly or indirectly (aside from customary fees received for the advice rendered); (2) the direct supervisor of the individual is not a disqualified person; (3) the person does not participate in any management decisions affecting the organization as a whole or a discrete segment of activity of the organization that represents a substantial portion of the organization's activities, assets, income or expenses, as compared to the organization as a whole; and (4) any preferential treatment based on the size of the person's contribution is also offered to all other donors making a comparable contribution as part of a solicitation intended to attract a substantial number of contributions.⁷⁶

⁷³ Treas. Reg. sec. 53.4958-3(c).

⁷⁴ Treas. Reg. sec. 53.4958-3(d).

⁷⁵ Treas. Reg. sec. 53.4958-3(e)(2).

⁷⁶ Treas. Reg. sec. 53.4958-3(e)(2).

Rebuttable presumption for certain arrangements

In certain cases, an exempt organization may avail itself of a rebuttable presumption procedure with respect to compensation arrangements and property transfers. Payments under a compensation arrangement are presumed to be reasonable, and a transfer of property, or the right to use property, is presumed to be at fair market value, if: (1) the arrangement or terms of transfer are approved in advance by an authorized body of the organization composed entirely of individuals who do not have a conflict of interest with respect to the arrangement or transfer; (2) the authorized body obtained and relied upon appropriate data as to comparability prior to making its determination; and (3) the authorized body adequately documented the basis for its determination concurrently with making that determination.⁷⁷ If these requirements are satisfied, the IRS may rebut the presumption if it develops sufficient contrary evidence to rebut the probative value of the comparability data relied upon by the authorized body.⁷⁸

3. Self-dealing by private foundations

Excise taxes are imposed on acts of self-dealing between a disqualified person and a private foundation.⁷⁹ Self-dealing transactions are any direct or indirect: (1) sale or exchange, or leasing, of property between a private foundation and a disqualified person, including transfers of property subject to a mortgage or lien that the private foundation assumes or that was put on the property by the disqualified person within 10 years of the transfer; (2) lending of money or other extension of credit between a private foundation and a disqualified person, except for no-interest loans by a disqualified person, the proceeds of which are used exclusively for charitable purposes; (3) the furnishing of goods, services, or facilities between a private foundation and a disqualified person, unless the goods, services, or facilities are (i) functionally related to the foundation's exempt purposes and are provided to or by the foundation on the same basis as provided by the foundation or disqualified person to the general public, (ii) reasonable and necessary to performing exempt purposes and not excessive, or (iii) provided by disqualified person without charge; (4) the transfer to, or use by or for the benefit of, a disqualified person of the income or assets of the private foundation, unless the use or benefit is de minimis; and (5) certain payments of money or property to a government official. Leases provided by a disqualified person without charge to a private foundation, even if the foundation pays for maintenance, are permitted.

In general, a disqualified person includes: (1) substantial contributors; (2) foundation managers (officers, directors, trustees, or individuals having powers or responsibilities similar to those of officers, directors, or trustees); (3) owners of more than 20 percent of a business enterprise that is a substantial contributor; (4) family members of the persons described above; (5) business entities (including corporations, partnerships, trusts, and estates) in which persons

⁷⁷ Treas. Reg. sec. 53.4958-6(a).

⁷⁸ Treas. Reg. sec. 53.4958-6(b).

⁷⁹ Sec. 4941.

described above own more than 35 percent of the voting power (or profits interest or beneficial interest as the case may be); and (6) certain government officials.⁸⁰

An initial tax of five percent of the amount involved with respect to an act of self-dealing is imposed on any disqualified person (other than a foundation manager acting only as such) who participates in the act of self-dealing. If such a tax is imposed, a 2.5 percent tax of the amount involved is imposed on a foundation manager who participated in the act of self-dealing knowing it was such an act (and such participation was not willful and was due to reasonable cause). Such initial taxes may not be abated.⁸¹ Such initial taxes are imposed for each year in the taxable period, which begins on the date the act of self-dealing occurs and ends on the earliest of the date of mailing of a notice of deficiency for the tax, the date on which the tax is assessed, or the date on which correction of the act of self-dealing is completed. A government official (as defined in section 4946(c)) is subject to such initial tax only if the official participates in the act of self-dealing knowing it is such an act. If the act of self-dealing is not corrected, a tax of 200 percent of the amount involved is imposed on the disqualified person and a tax of 50 percent of the amount involved is imposed on a foundation manager who refused to agree to correcting the act of self-dealing. Such additional taxes are subject to abatement.⁸²

4. Certain other excise taxes applicable to private foundations but not to public charities

Tax on failure to distribute income and on net investment income

Private nonoperating foundations are required to pay out a minimum amount each year as qualifying distributions. In general, a qualifying distribution is an amount paid to accomplish one or more of the organization's exempt purposes, including reasonable and necessary administrative expenses.⁸³ Failure to pay out the minimum results in an excise tax of up to 100 percent of the undistributed amount.⁸⁴ A foundation may include as a qualifying distribution the salaries, occupancy expenses, travel costs, and other reasonable and necessary administrative expenses that the foundation incurs in operating a grant program. A qualifying distribution also includes any amount paid to acquire an asset used (or held for use) directly in carrying out one or more of the organization's exempt purposes and certain amounts set-aside for exempt purposes.⁸⁵ Private operating foundations are not subject to the payout requirements.

⁸⁰ Sec. 4946.

⁸¹ Sec. 4962(b).

⁸² Sec. 4961.

⁸³ Sec. 4942(g)(1)(A).

⁸⁴ Sec. 4942(a) and (b). Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

⁸⁵ Sec. 4942(g)(1)(B) and 4942(g)(2). In general, an organization is permitted to adjust the distributable amount in those cases where distributions during the five preceding years have exceeded the payout requirements. Sec. 4942(i).

Private foundations are subject to a two-percent excise tax on their net investment income.⁸⁶ The two-percent rate of tax is reduced to one percent if, in general, a foundation makes a minimum amount of qualifying distributions in a taxable year and certain other requirements are met.⁸⁷ The amount of tax paid on net investment income reduces the amount that a foundation is required to pay out as qualifying distributions.⁸⁸

Tax on excess business holdings

Private foundations are subject to tax on excess business holdings.⁸⁹ In general, a private foundation is permitted to hold 20 percent of the voting stock in a corporation, reduced by the amount of voting stock held by all disqualified persons (as defined in section 4946). If it is established that no disqualified person has effective control of the corporation, a private foundation and disqualified persons together may own up to 35 percent of the voting stock of a corporation. A private foundation shall not be treated as having excess business holdings in any corporation if it owns (together with certain other related private foundations) not more than two percent of the voting stock and not more than two percent in value of all outstanding shares of all classes of stock in that corporation. Similar rules apply with respect to holdings in a partnership (“profits interest” is substituted for “voting stock” and “capital interest” for “nonvoting stock”) and to other unincorporated enterprises (by substituting “beneficial interest” for “voting stock”). Private foundations are not permitted to have holdings in a proprietorship. Foundations generally have a five-year period to dispose of excess business holdings (acquired other than by purchase) without being subject to tax.⁹⁰ This five-year period may be extended an additional five years in limited circumstances.⁹¹

Tax on jeopardizing investments

Private foundations and foundation managers are subject to tax on investments that jeopardize the foundation’s charitable purpose.⁹² In general, an initial tax of five percent of the

⁸⁶ Sec. 4940(a). Taxable private foundations, such as certain charitable trusts, are subject to an excise tax that is calculated somewhat differently from that imposed on tax-exempt private foundations. Secs. 4940(b) and 4947. Exempt operating foundations are exempt from the tax based on net investment income. Sec. 4940(d).

⁸⁷ Sec. 4940(e).

⁸⁸ Sec. 4942(d)(2).

⁸⁹ Sec. 4943. Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

⁹⁰ Sec. 4943(c)(6).

⁹¹ Sec. 4943(c)(7).

⁹² Sec. 4944. Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

amount of the investment applies to the foundation and to foundation managers who participated in the making of the investment knowing that it jeopardized the carrying out of the foundation's exempt purposes. If the investment is not removed from jeopardy (e.g., sold or otherwise disposed of), an additional tax of 25 percent of the amount of the investment is imposed on the foundation and five percent of the amount of the investment on a foundation manager who refused to agree to removing the investment from jeopardy. An investment, the primary purpose of which is to accomplish a charitable purpose and no significant purpose of which is the production of income or the appreciation of property, is not considered a jeopardizing investment.⁹³

Tax on taxable expenditures

Certain expenditures of private foundations are subject to tax.⁹⁴ In general, taxable expenditures are expenses: (1) for lobbying; (2) to influence the outcome of a public election or carry on a voter registration drive (unless certain requirements are met); (3) as a grant to an individual for travel, study, or similar purposes unless made pursuant to procedures approved by the Secretary; (4) as a grant to an organization that is not a public charity or exempt operating foundation unless the foundation exercises expenditure responsibility⁹⁵ with respect to the grant; or (5) for any non-charitable purpose. For each taxable expenditure, a tax is imposed on the foundation of 10 percent of the amount of the expenditure, and an additional tax of 100 percent is imposed on the foundation if the expenditure is not corrected. A tax of 2.5 percent of the expenditure (up to \$5,000) also is imposed on a foundation manager who agrees to making a taxable expenditure knowing that it is a taxable expenditure. An additional tax of 50 percent of the amount of the expenditure (up to \$10,000) is imposed on a foundation manager who refuses to agree to correction of such expenditure.

5. Penalties for violations of annual reporting and public inspection requirements

Information return filing penalties

Exempt organizations other than private foundations generally use Form 990 or Form 990-EZ to file their annual information returns. Private foundations use Form 990-PF. If an exempt organization does not timely and completely file the information return or does not furnish the correct information, it must pay \$20 for each day the failure continues (\$100 a day for large organizations, i.e., ones with gross receipts exceeding one million dollars for the taxable year).⁹⁶ The maximum penalty for each return will not exceed the lesser of \$10,000 (\$50,000 for

⁹³ Sec. 4944(c).

⁹⁴ Sec. 4945. Taxes imposed may be abated if certain conditions are met. Secs. 4961 and 4962.

⁹⁵ In general, expenditure responsibility requires that a foundation make all reasonable efforts and establish reasonable procedures to ensure that the grant is spent solely for the purpose for which it was made, to obtain reports from the grantee on the expenditure of the grant, and to make reports to the Secretary regarding such expenditures. Sec. 4945(h).

⁹⁶ Sec. 6652(c)(1)(A).

a large organization) or five percent of the gross receipts of the organization for the year. The penalty will not be imposed if the organization can show the failure was due to reasonable cause. There also are penalties for willful failures and for filing fraudulent returns and statements.⁹⁷

Filing and payment penalties for returns for which tax is paid

In general, exempt organizations that have gross unrelated business taxable income of at least \$1,000 for the taxable year are required to file Form 990-T.⁹⁸ Such organizations may be subject to penalties for filing late returns or failing to pay tax when due. The penalty for late filing of a Form 990-T is five percent of the unpaid tax for each month or part of a month the return is late, up to a maximum of 25 percent of the unpaid tax.⁹⁹ The minimum penalty for a return that is more than 60 days late is the smaller of the tax due or \$100. The penalty for late payment of taxes is usually one-half of one percent of the unpaid tax for each month the tax is unpaid, not to exceed 25 percent of the unpaid tax. Failure to file and failure to pay penalties will not be imposed if the organization can show the failure was due to reasonable cause. Penalties can be imposed for negligence, substantial understatement of tax, and fraud.¹⁰⁰ There also are penalties for willful failure to file and for filing fraudulent returns and statements.¹⁰¹

The Form 990-PF constitutes a tax return for the excise tax on net investment income, so the penalties imposed by section 6651 for not filing a tax return or paying tax, and the penalties for negligence, substantial understatement of tax, fraud, willful failure to file, and filing fraudulent returns and statements, also apply.

Organizations required to file Form 4720, Return of Certain Excise Taxes on Charities and Other Persons Under Chapters 41 and 42 of the Internal Revenue Code, may be liable for penalties for failure to file or to pay tax.¹⁰² There also are penalties for willful failure to file returns, supply information, or pay tax,¹⁰³ and for filing fraudulent returns and statements.¹⁰⁴

⁹⁷ Secs. 7203, 7206, and 7207.

⁹⁸ Sec. 6012; Treas. Reg. sec. 1.6012-2(e). Organizations liable for the proxy tax on lobbying and political expenditures also are required to file Form 990-T. The proxy tax is treated as an income tax for purposes of applicable filing and payment requirements and penalties. Sec. 6033(e)(2)(C).

⁹⁹ Sec. 6651(a).

¹⁰⁰ Secs. 6662 and 6663.

¹⁰¹ Secs. 7203, 7206, and 7207.

¹⁰² Sec. 6651.

¹⁰³ Sec. 7203.

¹⁰⁴ Secs. 7206 and 7207.

Penalties for failure to satisfy inspection and disclosure requirements

A penalty may be imposed on any person who does not make an organization's annual returns or exemption application materials available for public inspection. The penalty amount is \$20 for each day during which a failure occurs. If more than one person fails to comply, each person is jointly and severally liable for the full amount of the penalty. The maximum penalty that may be imposed on all persons for any one annual return is \$10,000. There is no maximum penalty amount for failing to make the exemption application available for public inspection. Any person who willfully fails to comply with the public inspection requirements is subject to an additional penalty of \$5,000.¹⁰⁵

¹⁰⁵ Sec. 6685.

II. STATISTICAL INFORMATION REGARDING CERTAIN EXEMPT ORGANIZATIONS

A. IRS Master File Information Regarding Types of Exempt Organizations

Overview

The IRS master file contains a list of organizations that have requested recognition as a tax-exempt organization or that have filed annual information returns.¹⁰⁶ The master file generally includes organizations for which an application for exemption has been processed, but also includes organizations for which a formal exemption has not been granted if the organization has filed an annual return.¹⁰⁷ Figure 1, below, shows a breakdown of various types of tax-exempt and other organizations included in the master file for fiscal year 2003.¹⁰⁸ Table 1, below, provides information regarding the IRS master file as it pertains to exempt organizations described within section 501(c), including section 501(c)(3) through 501(c)(6), for 1995 and 1998 through 2003. The master file, and thus Figure 1 and Table 1, generally do not include information about churches, or other organizations not required to file information returns, such as organizations with gross receipts of \$25,000 or less.

¹⁰⁶ The master file, consisting of magnetic tape records, constitutes the basic record source of the IRS for exempt organizations. IRM 25.7.1.1.1.

¹⁰⁷ IRM 25.7.1.1.1(2) and 25.7.1.2.1(1) and Exhibit 25.7.1-2.

¹⁰⁸ The source for Figure 1 is the 2003 column of Table 1. Tax-exempt and other organizations not described in section 501(c) include organizations described in note 2 of Table 1.

Figure 1.--Distribution of Tax-Exempt and Certain Other Organizations Reported in IRS Master File by Type, Fiscal Year 2003

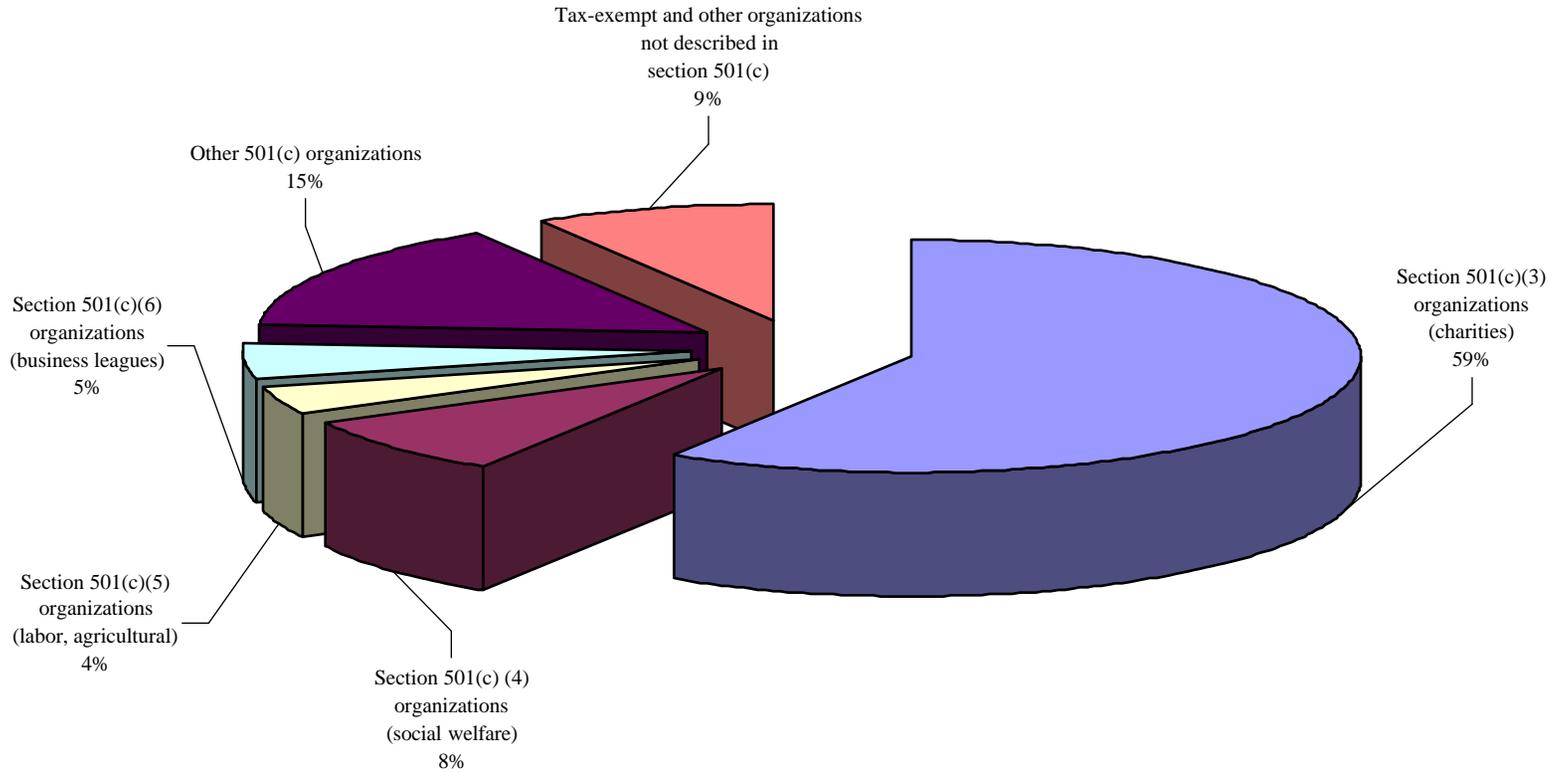


Table 1.— Number of Certain Types of Tax-Exempt Organizations and Other Entities Included in IRS Master Files, 1995 and 1998-2003

Category	1995	1998	1999	2000	2001	2002	2003	Percentage Change (1995-2003)	Annual Percentage Change
Tax-exempt organizations¹	1,235,905	1,376,395	1,428,208	1,473,062	1,567,580	1,580,767	1,640,949	32.8	3.6
Section 501(c) organizations¹	1,164,789	1,271,742	1,312,647	1,354,395	1,399,558	1,440,905	1,501,772	28.9	3.2
Tax-exempt organizations not described in section 501(c)²	71,116	104,653	115,561	118,667	168,022	139,862	139,177	95.7	8.8
Section 501(c)(3) organizations (charities)¹	626,226	733,790	773,934	819,008	865,096	909,574	964,418	54.0	5.5
Section 501(c)(4) organizations (social welfare)	139,451	139,533	138,927	137,037	136,882	137,526	137,831	-1.2	-0.1
Section 501(c)(5) organizations (labor, agricultural)	66,662	64,804	63,716	63,456	62,944	62,246	62,641	-6.0	-0.8
Section 501(c)(6) organizations (business leagues)	75,695	79,864	81,493	82,246	82,706	83,712	84,838	12.1	1.4

Source: Data compiled by the staff of the Joint Committee on Taxation from multiple IRS tables, *Tax-Exempt Organizations and Other Entities Listed on the Exempt Organization Business Master File, by Type of Organization and Internal Revenue Code Section*, prepared by the IRS for various fiscal year reports.

(1) Does not include certain section 501(c)(3) organizations not required to apply for recognition of tax-exemption, such as churches, integrated auxiliaries, subordinate units, and conventions or associations of churches, unless they specifically requested a determination. (2) Comprised almost entirely of nonexempt charitable trusts, which are taxable entities for which the IRS tax-exempt organization function has program responsibility. This information also includes organizations described in sections 501(d), 501(e), 501(f), 501(k), 501(n), 521, 529, and taxable farmers' cooperatives. Nonexempt charitable trusts increased in number from 68,134 in 1995 to 163,423 in 2001, then decreased to 135,690 and 138,999 in 2002 and 2003, respectively.

As Table 1 shows, the number of exempt organizations included in the IRS master file increased by 33 percent from 1995 to 2003. Organizations described in section 501(c)(3) constituted the largest group of exempt organizations, increasing from 51 percent to 59 percent of the total number of exempt organizations reported in the IRS master file from 1995 to 2003. Such organizations grew in number by 54 percent during this period. Social welfare organizations decreased in number by one percent during this period and comprised eight percent of the total number of exempt organizations reported in the IRS master file for 2003. Organizations described in section 501(c)(5) decreased in number by six percent and constituted four percent of the total number reported in 2003.¹⁰⁹ Business leagues increased in number by 12 percent during this period, and comprised five percent of the total number of exempt organizations included in the IRS master file for 2003.

B. Number of Annual Returns Filed by Various Tax-Exempt Organizations

1. Annual returns filed by tax-exempt organizations

The IRS makes public certain information regarding the number of returns filed by type, including those filed by exempt organizations. Table 2 below provides data regarding the number of returns filed by exempt organizations for various years, including 1975, 1985, 1995, and each of 2000 through 2003. As Table 2 shows, Form 990 series returns filed by exempt organizations increased by 60 percent since 1975.¹¹⁰ The largest percentage increase in Form 990 series filings from 1975 to 2003, and from 1995 to 2003, is in Form 990-PF, which increased at a rate more than twice that of other organizations. Form 990-T unrelated business income tax filings were the only return filings that declined, decreasing by approximately three percent from 1995 to 2003.

¹⁰⁹ Exempt organizations not described in section 501(c) almost doubled in number from 1995 to 2003, increasing by 96 percent, and constituted nine percent of the total number of exempt organizations in the IRS 2003 master file. Nonexempt charitable trusts (trusts with certain interests devoted to charitable purposes and which generally file Form 990, 990-EZ, or 990-PF returns in addition to Form 1041) accounted for all of this growth, increasing from 68,134 in 1995 to 138,999 in 2003. Without including such trusts, the number of exempt organizations not described in section 501(c) decreased slightly during this period.

¹¹⁰ See Part I.B.3. of this pamphlet for filing requirements and other information regarding the Form 990 series

Table 2.—Number of Returns Filed by Exempt Organizations

Category	1975	1985	1995	2000	2001	2002	2003 (Projected)	Percentage Change (1975-2003)	Annual Percentage Change	Percentage Change (1995-2003)	Annual Percentage Change
Total of Forms 990, 990-EZ, 990-PF, 990-T, 990-C, 4720, 5227 filed by exempt organizations¹	403,800	454,100	572,600	699,100	724,200	744,400	765,700	89.6	2.3	33.7	3.7
Forms 990-C, 4720, 5227²	7,900	30,400	65,100	114,900	121,700	126,200	131,500	1564.6	10.6	102.0	9.2
Total of Forms 990, 990-EZ, 990-PF, 990-T³	395,900	423,700	507,500	584,200	602,500	618,200	634,200	60.2	1.7	25.0	2.8
Forms 990, 990-EZ	346,600	365,500	406,400	461,700	481,000	495,000	505,600	45.9	1.4	24.4	2.8
Form 990-PF	29,600	32,000	51,300	70,000	73,300	76,900	80,100	170.6	3.6	56.1	5.7
Form 990-T	19,700	26,200	49,800	52,600	48,200	46,400	48,500	146.2	3.3	-2.6	-0.3

Source: Data extracted from “Selected Returns and Forms Filed or To Be Filed by Type During Specified Calendar Years, 1975-2004.

¹ Forms 990 and 990-EZ are for tax-exempt organizations other than private foundations (Form 990-PF). Form 990-T is the income tax return for unrelated trades or businesses conducted by exempt organizations. Form 990-C is for farmers’ cooperatives. Form 4720 is the return used for computing most excise taxes applicable to private foundations. Form 5227 is the form used for split-interest trusts treated as private foundations for certain purposes.

² This category includes the forms used for split-interest charitable trusts, which have significantly increased in number in recent years. See Table 1 above regarding IRS master file information.

³ Year 2000 and 2002 amounts are calculated, and do not reconcile with components due to arithmetic errors or rounding in the source document.

2. Unrelated business income tax returns, Form 990-T, filed by section 501(c)(3), 501(c)(4), 501(c)(5), and 501(c)(6) organizations

As shown in Table 3, during the period 1995 to 1999, the number of unrelated business income tax (Form 990-T) returns filed by exempt organizations increased by 16 percent. Form 990-T filings by charitable organizations and social welfare organizations increased by 17 percent and 14 percent, respectively, while the number of returns filed by labor, agricultural, and horticultural organizations decreased by five percent during this period. The number of Form 990-T returns filed by exempt organizations other than those described in sections 501(c)(3), 501(c)(4), 501(c)(5), and 501(c)(6), increased by 24 percent from 1995 to 1999.¹¹¹ This breakdown is not yet available for 2000 and thereafter.

¹¹¹ The increase in Form 990-T filings by other exempt organizations (an increase of 3,924 returns) was attributable to increased Form 990-T filings by IRAs, which increased from 4,642 returns in 1995 to 8,708 in 1999 (an increase of 4,066 returns).

Table 3.—Number of Forms 990-T filed by Exempt Organizations, including Section 501(c)(3), (c)(4),(c)(5), and (c)(6) Organizations, 1995-1999

Category	1995	1996	1997	1998	1999	Percentage Increase (1995-1999)
All exempt organizations	36,394	40,621	39,302	46,208	42,151	15.8
Section 501(c)(3) organizations	9,903	10,407	10,614	10,898	11,614	17.3
Section 501(c)(4) organizations	1,377	1,364	1,485	1,500	1,574	14.3
Section 501(c)(5) organizations	2,471	2,265	2,610	2,497	2,342	-5.2
Section 501(c)(6) organizations	6,103	6,362	6,315	6,238	6,157	0.9
Other exempt organizations¹	16,540	20,223	18,278	25,075	20,464	23.7

Source: Data compiled by the staff of the Joint Committee on Taxation from various IRS tables contained in the Annual Reports “Unrelated Business Income Tax Returns,” including “Number of Returns, Gross Unrelated Business Income (UBI), Total Deductions, Net Income (Less Deficit), Net Income (Taxable Profit), and Total Tax, by Internal Revenue Code Section Describing Type of Tax-Exempt Organization,” for various tax years.

¹ This includes section 401(a) trusts, section 408(e) individual retirement accounts (IRAs), and other section 501(c) organizations, such as social clubs, fraternal beneficiary organizations, voluntary employees’ beneficiary associations, and (c)(19) veterans’ organizations.

As shown by Table 4, below, the percentage of all section 501(c) organizations that filed a Form 990-T for 1999 was approximately two percent. Approximately one percent of social welfare organizations filed a Form 990-T for 1999, while 1.5 percent of charities filed an unrelated business income tax return for that year. Approximately four percent of labor, agricultural, and horticultural organizations, and approximately eight percent of business leagues and other section 501(c)(6) organizations, filed a Form 990-T for 1999. Taxable year 1999 information is the most recent Form 990-T information available on the IRS’s web site that provides Form 990-T filing information by types of organizations.

Table 4.—Number of Forms 990-T filed by Section 501(c)(3), (c)(4), (c)(5), (c)(6), and Other Section 501(c) Organizations, as a Percentage of Total Number of Such Organizations, 1999

Category	Number of Organizations	Number of Form 990-T Filings	Percentage of Organizations filing 990-T
All section 501(c) organizations	1,428,208	32,703 ¹	2.3
Section 501(c)(3) organizations	773,934	11,614	1.5
Section 501(c)(4) organizations	138,927	1,574	1.1
Section 501(c)(5) organizations	63,716	2,342	3.7
Section 501(c)(6) organizations	81,493	6,157	7.6
Other section 501(c) organizations	370,138	11,016	3.0

Source: Data compiled by the staff of the Joint Committee on Taxation from various IRS tables.

¹ This figure differs from the 42,151 figure in Table 3 because Table 3 includes IRAs and other organizations not described in section 501(c).

C. Data Regarding IRS Examinations of Exempt Organizations

The number of exempt organization returns examined by the IRS declined from 12,589 returns in 1993 to 5,754 returns in 2003. During the period 1993 through 2003, the number of returns examined as a percentage of the number of returns filed declined from 2.5 percent to 0.7 percent. During the period 1996 through 2002, the percentage of exempt entities examined declined from 0.81 percent to 0.37 percent, and the number of examined returns has declined in all categories of exempt organization returns (other than Form 4720), although the decline was not spread proportionately across all categories. As a percentage of total exempt organization returns examined, Forms 990 and 990-EZ increased from 41 percent in 1998 to 59 percent in 2003, and Forms 4720 tripled. As a percentage of total exempt organization returns examined during this period, unrelated business income tax returns decreased from 17 percent in 1998 to 13 percent in 2003. The number of exempt organization returns examined by the IRS increased slightly in 2003.

Table 5.—Examinations of Tax-Exempt Organizations, 1993-2003, and Recommended Additional Tax After Examination, 1998-2003

Fiscal Year	Active Exempt Organizations¹	Total Returns Filed³	Total Returns Examined (Excluding Tax-Exempt Bonds)	Returns Examined as Percentage of Total Returns Filed	Recommended Additional Tax After Examination (thousands of dollars)	Number of Entities Examined as Percentage of All Exempt Entities
1993	1,103,265	505,131	12,589	2.5	N/A ²	N/A ²
1994	1,126,976	510,077	11,765	2.3	N/A ²	N/A ²
1995	1,149,867	535,094	10,450	2.0	N/A ²	N/A ²
1996	1,187,700	564,207	10,952	1.9	N/A ²	0.81
1997	1,235,470	607,042	10,600	1.7	N/A ²	0.83
1998	1,285,663	644,496	10,227	1.6	82,244	0.73
1999	1,316,878	645,626	8,519	1.3	97,625	0.69
2000	N/A ²	712,928	7,435	1.0	338,531	0.54
2001	N/A ²	745,229	5,342	.7	38,462	0.35
2002	N/A ²	783,582	5,278	.7	43,147	0.37
2003	N/A ²	809,223	5,754	.7	169,202	N/A ²

Sources: Joint Committee on Taxation, *Report of Investigation of Allegations Relating to Internal Revenue Service Handling of Tax-Exempt Organization Matters* (JCS-3-00), March 2000, Table 3 at 61 and Table 5 at 109; “Returns of Tax-Exempt Organizations and Employee Plans Examined, and Recommended and Average Additional Tax After Examination, by Type of Examination”; “Examination Coverage (Including EITC) All Taxpayers, By Examination Class, Fiscal Years 1996-2002.”

¹ Number of active tax-exempt organizations does not include churches that have not elected to file with the IRS.

² Not available.

³ Includes Forms 990, 990-EZ, 990-PF, 5227, 1041A, and 1120-POL. Prior to 2003, also includes Form 990-C farmers’ cooperatives returns.

**Table 6.—Returns of Tax-Exempt Organizations Examined,
By Type of Return, 1998-2003**

Fiscal Year	Number of Returns Examined (Excluding Tax-Exempt Bonds)	Number of Forms 990 and 990-EZ Examined	Number of Forms 990-PF, 5227, 1041A, and 1120 Examined	Number of Forms 990-T Examined	Number of Forms 4720 Examined	Other Returns Examined¹
1998	10,227	4,145	350	1,717	50	3,965
1999	8,519	4,170	209	1,198	87	2,855
2000	7,435	3,630	148	1,217	121	2,319
2001	5,342	2,494	132	825	41	1,850
2002	5,278	2,755	119	653	53	1,698
2003	5,754	3,396	145	726	89	1,398

Source: Compiled by the staff of the Joint Committee on Taxation from annual IRS tables, “Returns of Tax-Exempt Organizations, Employee Plans, and Tax-Exempt Bonds Examined, by Type of Return.”

¹ Includes employment and retirement tax returns, Forms 990-C, Forms 1120-POL, Forms 1040 and 1120 of related persons adjusted as a result of the examination of the tax-exempt organization return, and Forms 11-C and 730 (occupational and excise taxes on wagering).

D. Data Regarding Applications for Recognition of Exempt Status

As Table 7 shows, the number of applications for a determination letter received by the IRS increased in each year but two, 1999 and 2001, and increased by 102 percent from 1992 to 2003. The denial rate declined each year from 1.1 percent in 1993 to 0.4 percent in 1997, but fluctuated within a range of 0.5 percent to 0.8 percent from 1998 through 2002. The denial rate increased to 1.3 percent in 2003. The approval rate ranged from a low of 68 percent in 1997 to a high of 81 percent in 2000. The approval rate was 79 percent in 2003.¹¹²

¹¹² These percentage amounts were derived from the number of applications received, approved, and denied for each respective year. The calculations do not reflect the fact that an approval or denial in any particular year might relate to an application that was filed in an earlier year. To the extent final determinations were made in a year later than the year in which the application was received, these figures might need to be adjusted up or down to reflect the lag. These calculations are intended to convey approximate approval and denial rates, as well as general trends, if any, and the staff believes that any adjustments that might be made to take into account determinations occurring in a year subsequent to the receipt of the relevant application would not materially alter the calculated amounts.

Table 7.—Determination Letter Statistics, Fiscal Years 1992-2003

Fiscal Year	Total Applications or Disposals	Applications Approved	Applications Denied	Applications Withdrawn	Applications Closed for Failure to Establish Exemption
1992	45,324	N/A ¹	N/A ¹	N/A ¹	N/A ¹
1993	61,306	46,166	696	1,512	8,864
1994	65,810	49,088	679	1,478	10,198
1995	67,178	50,613	619	1,468	11,442
1996	68,463	48,635	577	1,438	11,319
1997	77,733	52,776	299	1,358	14,000
1998	78,259	56,988	426	1,297	12,494
1999	74,444	58,160	470	1,244	9,186
2000	82,707	67,267	482	N/A ¹	N/A ¹
2001	81,636	65,409	646	N/A ¹	N/A ¹
2002	87,342	70,214	557	N/A ¹	N/A ¹
2003	91,439	72,092	1,192	N/A ¹	N/A ¹

Source: Joint Committee on Taxation, *Report of Investigation of Allegations Relating to Internal Revenue Service Handling of Tax-Exempt Organization Matters* (JCS-3-00), March 2000, at 51, for 1992 through 1999. Fiscal year 2000 and subsequent data were obtained from Table 21, Tax-Exempt Organization and Other Entity Applications or Disposals, by Type of Organization and Internal Revenue Code Section.

¹ Data not available. For 2000 through 2003, the IRS aggregated withdrawn applications, incomplete applications, applications that failed to provide the required information, IRS refusals to rule, applications forwarded to other than the IRS National Office, IRS correction disposals, and other. The aggregate amounts were 14,958; 15,581; 16,571; and 18,155 for 2000, 2001, 2002, and 2003, respectively.

E. Data Regarding Growth of the Nonprofit and Exempt Organization Sector

In general

The IRS conducted a study that analyzed the growth of tax-exempt organizations, including public charities, private foundations, and other section 501(c) organizations, during the period 1975 through 1995.¹¹³ The study reported that during this 20-year period, the real assets and revenues of tax-exempt organizations filing information returns with the IRS more than tripled, compared to real growth in gross domestic product of 74 percent during the same period. The study also reported that the 1995 revenues of all organizations exempt under section 501(c) were estimated at 12 percent of the 1995 gross domestic product, more than double that of the comparable comparison for 1975. The 1995 revenues of public charities alone were estimated at nine percent of 1995 gross domestic product.¹¹⁴

The IRS study concluded that the number of public charities that filed Form 990 returns more than doubled from 1975 to 1995, with total assets and total revenues of public charities increasing by over 312 percent and 380 percent, respectively, during this period. The study reported that the number of private foundations increased by 78 percent from 1974 to 1995, and that private foundation revenues, measured in real terms, more than tripled during this period. The largest decrease in the number of exempt organizations for this period was for the section 501(c)(5) labor, agricultural, and horticultural organizations, which fell by 25 percent. The largest increase in the number of non-charitable organizations occurred in the section 501(c)(6) organizations, which increased by 46 percent. The study concluded that noncharitable exempt organizations represented a smaller proportion of the nonprofit sector in 1995, relative to charitable organizations, than they did in 1975.¹¹⁵

Tables 8 and 9 below provide information regarding the growth in revenues, the excess of revenues over expenses, assets, and net worth, of section 501(c)(3), 501(c)(4), 501(c)(5), and 501(c)(6) organizations from 1975 to 1995.¹¹⁶

¹¹³ Meckstroth, Alicia and Arnsberger, Paul, *A 20-Year Review of the Nonprofit Sector, 1975-1995*, Compendium of Studies of Tax-Exempt Organizations, Volume 3, 1989-1998, Statistics of Income, 25-47. The study relied on data of the Statistics of Income Division of the IRS (SOI) and IRS master file data. The study presents data using constant, 1992-based dollars to adjust for inflation, based on the 1992 chain-type price index for gross domestic product from the United States Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Table 7.1. *Id.* at 37; *see, e.g.*, Figure A at 27, and Table 1 at 47.

¹¹⁴ *Id.* at 25, 27-28.

¹¹⁵ *Id.* at 29, 33, 37, 39.

¹¹⁶ For this purpose, expenses include total expenses as reported for Forms 990 and 990-EZ, including program services, management and general expenses, and fundraising expenses.

Table 8.—Total Revenues and Excess of Revenues Over Expenses of Section 501(c)(3), 501(c)(4), 501(c)(5), and 501(c)(6) Organizations, 1975 and 1995
(amounts are millions of constant 1992 dollars)¹

Category	Total Revenues 1975	Total Revenues 1995	Percentage Increase or Decrease of Revenues	Annual Percentage Change in Revenues	Excess of Revenues Over Expenses 1975	Excess of Revenues Over Expenses 1995	Percentage Increase or Decrease of Excess	Annual Percentage Change in Excess
501(c)(3) public organizations	128,650	617,089	379.7	8.2	6,887	54,629	693.2	10.9
501(c)(4) organizations	34,927	26,589	-23.9	-1.4	-333	1,045	N/A ²	N/A ²
501(c)(5) organizations	11,270	13,135	16.5	0.8	275	1,377	400.7	8.4
501(c)(6) organizations	7,645	19,531	155.5	4.8	-7	1,823	N/A ²	N/A ²
Other 501(c) organizations, excluding private foundations	32,016	129,463	304.4	7.2	1,771	16,023	804.7	11.6
All 501(c) organizations, excluding private foundations	214,508	805,807	275.7	6.8	8,593	74,897	771.6	11.4
Private foundations	7,752	30,037	287.5	7.0	N/A ²	N/A ²	N/A ²	N/A ²

Source: Internal Revenue Service, A 20-Year Review of the Nonprofit Sector, 1975-1995, by Alicia Meckstroth and Paul Arnsberger.

¹ “Constant dollars” means the reported amounts are adjusted for inflation, in this case based on the 1992 chain-type price index for gross domestic product from the United States Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Table 7.1.

² Not available.

**Table 9.—Total Assets and Total Net Worth of Section 501(c)(3), 501(c)(4), 501(c)(5),
and 501(c)(6) Organizations, 1975 and 1995**
(amounts are millions of constant 1992 dollars)¹

Category	Total Assets 1975	Total Assets 1995	Percentage Increase or Decrease of Assets	Annual Percentage Change in Assets	Total Net Worth 1975	Total Net Worth 1995	Percentage Increase or Decrease of Net Worth	Annual Percentage Change in Net Worth
501(c)(3) public organizations	257,802	1,063,328	312.5	7.3	171,474	586,693	242.1	6.3
501(c)(4) organizations	30,238	43,086	42.5	1.8	8,509	12,869	51.2	2.1
501(c)(5) organizations	9,627	18,908	96.4	3.4	8,397	16,023	90.8	3.3
501(c)(6) organizations	8,241	25,985	215.3	5.9	4,598	13,172	186.5	5.4
Other 501(c) organizations, excluding private foundations	112,924	374,052	231.2	6.2	45,918	230,051	401.0	8.4
All 501(c) organizations, excluding private foundations	418,832	1,525,359	264.2	6.7	238,896	858,808	259.5	6.6
Private foundations	60,618	245,010	304.2	7.2	N/A ²	N/A ²	N/A ²	N/A

Source: Internal Revenue Service, A 20-Year Review of the Nonprofit Sector, 1975-1995, by Alicia Meckstroth and Paul Arnsberger.

¹ “Constant dollars” means the amounts are adjusted for inflation, in this case based on the 1992 chain-type price index for gross domestic product from the United States Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business*, Table 7.1.

² Not available.

Largest nonoperating private foundations

The IRS recently studied the 100 largest nonoperating private foundations, as determined by the 1997 fair market value of total assets. The IRS study included a panel of the 78 private foundations (of the 100 largest) that were present in all of the IRS Statistics of Income samples for each of the years 1985 through 1997. Table 10, below, reports data from the study with respect to the panel's 78 foundations. The study shows that the assets, investment income, expenses and charitable distributions of the 78 foundations increased substantially during this period. The study found that between 1985 and 1997, asset holdings for the largest 100 nonoperating private foundations operated throughout this period more than tripled, increasing from \$37.6 billion to \$120.6 billion.¹¹⁷ The study also reported that the largest 100 foundations reported approximately one-third of the charitable contributions paid and the fair market value of assets held by private foundations, even though they comprised less than one percent of the total number of private foundations.

¹¹⁷ Large Nonoperating Private Foundations Panel Study, 1985-1997, Compendium of Studies of Tax-Exempt Organizations 1989-1998, Volume 3, Statistics of Income, 471.

**Table 10.—Selected Asset, Income, and Charitable Expenditure Data of 78
of the Largest Nonoperating Private Foundations, 1985 and 1997**
(amounts are millions of constant 1996 dollars)¹

Category	1985	1997	Percentage Increase	Annual Percentage Change
Total assets	51,047	118,292	131.7	7.3
Total net investment assets²	44,950	103,708	130.7	7.2
Total net investment income	5,511	10,105	83.4	5.2
Charitable contribution, gift, and grant expenses	2,088	4,439	112.6	6.5
Other expenses for charitable purposes	190	485	155.3	8.1
Section 4942 distributable amount	2,186	5,077	132.3	7.3
Section 4942 qualifying distributions	2,409	5,113	112.2	6.5

Source: Internal Revenue Service, Large Nonoperating Private Foundations Panel Study, 1985-1997, by Melissa Whitten.

¹ “Constant dollars” means the amounts are adjusted for inflation, in this case based on the 1996 chain-type price index from the National Income and Product Accounts, per the Council of Economic Advisors, *Economic Report of the President*, Table B-7, January 2001.

² Comprises noncharitable-use assets as reported on Form 990-PF, Part X, line 5, relating to determination of the foundation’s minimum annual distribution requirements.

Projected growth

As shown in Table 11, the IRS projects that total primary return filings will increase by eight percent from 2002 to 2010.¹¹⁸ Corporate and partnership sector filings are projected to

¹¹⁸ Total primary returns includes individual income tax returns, individual estimated tax payment vouchers, estate and trust income tax returns, partnership returns, corporation income tax returns, estate tax and gift tax returns, employment tax returns, exempt organization returns, and excise tax returns. Individual, estate and trust income, estate tax and gift tax, employment tax returns, and excise tax returns are included in the total primary return totals, though not listed separately.

grow by 21 percent and 35 percent, respectively, during this period. The IRS projects that total exempt organization filings will grow by 19 percent by 2010, and that unrelated business income tax return (Form 990-T) filings will grow by 11 percent by 2010. Electronic return filings are projected to constitute 14 percent of the Form 990 and 990-EZ filings by 2010, and nine percent of total exempt organization return filings, compared to 14 percent and 17 percent, respectively, of corporation and partnership returns.

Table 11.—Projected Growth in Number of Returns of Exempt Organizations, Actual 2002 and Projected 2010 (numbers of returns in thousands)

Category	Actual Number of Returns 2002	Projected Number of Returns 2010	Projected Percentage Increase	Projected Number of Electronic Returns 2010
Form 990 and Form 990-EZ	495	569	15	81
Form 990-PF	77	102	32	N/A
Form 990-T	46	51	11	N/A
Other exempt organization returns¹	126	163	29	N/A
Total exempt organization returns	744	885	19	81
Partnership Returns	2,272	3,068	35	528
Corporation Income Tax Returns	5,728	6,942	21	958
Total Primary Returns	208,533	225,738	8	N/A

Source: Internal Revenue Service, Data Release, Projections of Returns That Will Be Filed in Calendar Years 2004-2010, by Terry Manzi (Fall 2003).

¹ Consists mostly of Form 5227, Split-Interest Trust Information Return.