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WHAT IT TAKES TO BE A PUBLIC CHARITY AND TO STAY ONE

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What makes a charity a charity?

Organizational Test:

The organizing documents (Articles, trust document, etc):

- limit the purposes of the organization to one or more exempt purposes, and
- do not expressly empower the organization to engage (except as an insubstantial portion of its activities) in activities which in themselves are not in furtherance of one or more of the exempt purposes.

Reg § 1.501(c)(3)-1(b)(1)(i)(a) and (b)



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What makes a charity a charity continued

Operational Test:

An organization is regarded as operated exclusively for an exempt purpose if it:

- engages primarily in activities that accomplish one or more exempt purposes,
- has no part of its net earnings inure to the benefit of private shareholders or individuals, and
- is not an “action” organization.

Reg § 1.501(c)(3)-1(c)(1), (2) and (3)



What makes a charity a public charity?

There are 3 main ways to become and stay a public charity:

1. It can be one of several specified types of organization. Churches, educational organizations, hospitals and medical research organizations are a few of the most common.
2. It can be an organization that receives most of its funding from either:
 1. The general public [§ 509(a)(1)/§ 170(b)(1)(A)(vi)]
 2. Program service fees from activities related to its mission without being overly dependent on investment income [§ 509(a)(2)]
3. A charitable organization that exists to support another public charity. [IRC §509(a)(3)]



Operating in Accordance with the Exempt Purpose

What did the organization tell the IRS that it was going to do when it filed its Form 1023?

So, what if things are going well and the Board decides to start a new, related but different, program?

- The IRS must be informed of new or substantially altered programs.
- The IRS must be informed of the cancellation of any programs and/or of significant changes in how the organization conducts its programs.

Beware of “mission creep”. Some organizations keep tweaking their programs until they find that what they are doing today is very different from what they were doing a few years before.



Activities not related to the exempt purpose

Yes, we are talking about the dreaded Unrelated Business Taxable Income (UBTI).

But don't organizations get income that is not related to their mission that is not UBTI?

Yes, certain types of income are exempted from being treated as unrelated business income.

Some of the more common ones are:

- Investment and passive income such as royalties [IRC §512(b)(1) and (2)]
- Sale of articles/services that are the product of the exempt activity, [Reg. §513-1(d)(4)(ii)]
- Rental of real property that is not incumbered by debt, [IRC §512(b)(3)]
- Activities which lessen the burdens of government,
- A business where virtually all the merchandise has been donated, [IRC §5013(a)(3)]
- A business where 85% or more of the work is performed without compensation. [IRC §5013(a)(1)]
- An activity carried on by a 501(c)(3) entity primarily for the convenience of its members, students, patients, officers or employees. [IRC §513(a)(2)]



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