How to obtain and maintain tax-exempt status

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Private Inurement and Private Benefit

- Private Inurement
  - For a 501(c)(3) to obtain and maintain tax exempt status, **no part** of its net earnings may inure in whole or in part to the benefit of any private shareholder or individual.
  - The concept of private inurement generally refers to benefits conferred upon insiders, such as officers, directors or founders / creators through the use or distribution of the organization's funds.
  - The inurement prohibition dates to the 1909 Payne-Aldrich Tariff Act of 1909.
  - The Code prohibits all private inurement, no matter how small. Courts can be very strict in this regard.
  - The IRS's remedy is to revoke tax-exempt status.

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Private Inurement Examples

- Donor makes a "loan" to a museum to fund the purchase of automated ticket kiosks. Rather than the loan principal being repaid on a certain date and the accrual of interest at market rates at least annually, the "loan" is structured to be repaid by paying to Donor a percentage of ticket sales for a set period.
- This would likely be considered private inurement as the "loan" would not likely be considered debt for tax purposes. The museum would be paying to donor what amounts to a dividend, and this results in private inurement.

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Private Inurement Examples

- Founder creates new 501(c)(3) focusing on animal welfare. Founder is employed by the 501(c)(3) full-time (40 hours a week). The 501(c)(3)'s board consists of three members, the Founder, the Founder's spouse and one independent director. The 501(c)(3) pays Founder a salary that is double the national average for similar organizations in similar markets. All three board members approve the salary.
- Likely private inurement.
- Would it make a difference if the Founder worked 80 hours a week? If the salary was approved by a board comprised of non-conflicted directors?

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Private Inurement Examples

- A director makes a loan to a 501(c)(3) that calls for 10% interest (at a time when market intertest rates are 5%).
- Non-market terms on loans, leases, licenses or other payments likely considered private inurement. Especially when they benefit an insider.

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Private Inurement Examples

- 501(c)(3) owns a parcel of real estate that it does not use and has no plans on using. It has a FMV of $500,000 but the 501(c)(3) sells the land to the founder of the 501(c)(3) who has not been employed by or active with the organization for many years for a sales price of $450,000.
- This is private inurement.
- Would it be different if the purchaser was instead the executive director of the 501(c)(3) and both parties report the transaction as a sale of the land for $450,000 and a $50,000 bonus, taxed as compensation to the executive director? Query whether it would be more prudent to simply sell the land for the market value and use $50,000 of the proceeds to pay the bonus.

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Title search: How to Obtain and Maintain Tax-exempt Status

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