

Revenue Notice # 94-22

Tax Exempt Entities - Grounds for Revocation of 501(c)(3) Status Under Minnesota Law

The 1994 Legislature enacted a new law dealing with tax-exempt organizations which states:

The commissioner [of revenue] may examine or investigate an entity claiming exemption under this section [Minnesota Statutes 290.05] and subpart F of the Internal Revenue Code. The commissioner may revoke the exemption under this section for violations of federal law that would permit the commissioner of internal revenue or the secretary of the treasury to revoke the exemption under federal law, regardless of whether such action has been taken under federal law.

This new law clarifies that the Minnesota Department of Revenue can revoke 501(c)(3) status for Minnesota tax purposes, using the same exact guidelines as the Internal Revenue Service can use to revoke 501(c)(3) status for federal purposes under the Internal Revenue Code. The purpose of this notice is to provide guidance on some of the types of activities which might cause the Department to take such action.

Ways to lose 501(c)(3) status

1. Failure to engage primarily in activities which accomplish one or more exempt purposes.

The exempt purpose requirement is satisfied if the organization is operated exclusively for religious, charitable, scientific, testing for public safety, literary, or education purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals.

The presence of a single nonexempt purpose which is substantial in nature will destroy the exemption. While the presence of profit making activities is often an indication of a non exempt purpose, the presence of profit making activities alone is not a bar to qualification of an organization as exempt if the activities further or accomplish an exempt purpose. However, there is no clear test for making the determination: the presence of a nonexempt purpose requires a case by case analysis for determining whether that purpose is 'substantial.'

2. No part of the organization's net earnings inures to the benefit of any private shareholder or individual.

An organization may lose its 501(c)(3) status if it is organized and operated for the benefit of private interests such as designated individuals, the creator or family of the creator, shareholders of the organization, or persons having a personal and private interest in the activities of the organization. Essentially this means that a private shareholder or individual who has the ability to control or influence the organization so as to cause the benefit cannot receive the organization's funds except as reasonable compensation for goods or services.

3. Substantial effort to influence legislation.

No substantial part of the activities of an exempt organization may constitute carrying on propaganda, or otherwise attempting, to influence legislation. An organization is attempting to influence legislation if it contacts, or urges the public to contact, members of a legislative body for the purpose of proposing,

supporting, or opposing legislation, or advocates the adoption or rejection of legislation. While many tax exempt organizations engage in efforts to influence legislation, their tax exempt status is not at risk unless those activities are 'substantial.'

4. Any direct or indirect political campaigning.

An organization can lose its tax exempt status if it directly or indirectly intervenes or participates in any political campaign on behalf of, or in opposition to, any candidate for federal, state or local public office. The campaign activity does not have to be substantial: any amount of campaign activity could result in loss of 501(c)(3) status. Campaign activity includes, but is not limited to, publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to any candidate. Certain non-partisan 'voter education' activities, such as sponsoring candidate debates, compiling and distributing voting records or positions of candidates, if done on a broad range of issues do not constitute prohibited political campaigning. Employees of 501(c)(3) organizations, may, however, engage in political campaigning, as long as they are not using 501(c)(3) approved time or resources to do it.

Result of loss of exempt status

For churches, the result of the loss of 501(c)(3) status is that donations to the organization are no longer deductible to the contributor. For other 501(c)(3) organizations, the effect of loss of 501(c)(3) status is the total loss of tax exempt status. The loss of 501(c)(3) status would also seriously jeopardize, and in most instances be grounds for revocation of sales tax or property tax exemptions to which the organization might otherwise be entitled.

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