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The Basics of 501(c)(3), 501(c)(4), and 501(c)(6) Tax-Exempt Status

Section 501 of the IRS Code exempts certain types of organizations from taxation. Section 501(c) describes the different types of organizations that are eligible to tax-exempt status and the requirements they must meet to gain that status.

501(c)(3)

501(c)(3) is the most commonly used section of 501. Often referred to generally as “charitable organizations.”

Who

Organizations that are organized exclusively for charitable, religious, scientific, literary, or educational purposes may be eligible for tax exemption under 501(c)(3).

- Educational purposes include instruction of the public on topics for which there are sufficient facts to permit an individual or the public to form an independent opinion or conclusion. An unsupported opinion is not considered educational.
- Childcare organizations: The term educational purposes includes providing care of children away from their homes if substantially all the care is provided to enable the parents to be gainfully employed and the services are available to the general public.

Purpose and Requirements

To qualify for 501(c)(3) status, an organization must meet several exemption requirements:

- It must be organized and operated exclusively for one or more of the purposes set forth in section 501(c)(3).
 - An organization will be regarded as operated exclusively for one or more of the purposes if it engages primarily in activities that accomplish one or more of the specified exempt purposes. (ie: if not more than an insubstantial part of its activities is not in furtherance of an exempt purpose.)
- It must be organized as a corporation, community chest, fund, foundation, or charitable trust. An individual or partnership will not qualify.
- None of the net earnings of the organization may inure to the benefit of any private shareholder or individual.
- Lobbying cannot be a substantial part of its activities.
- It may not participate at all in campaign activity for or against political candidates.
- Assets of the organization must be permanently dedicated to an exempt purpose. Upon dissolution the assets must be distributed for a charitable purpose.

Articles of Organization:

- Must limit the organization's purpose to one or more of the exempt purposes set forth in IRC section 501(c)(3).
- Must not expressly empower the organization to engage, other than as an insubstantial part of its activities, in activities that are not in furtherance of one or more of these purposes.
- The organization may not participate at all in campaign activity for or against a political candidate.
 - This requirement is met if the purposes stated in the Articles of Organization are limited in some way by reference to section 501(c)(3).
- Should include a provision that the assets will be distributed for an exempt purpose in the event of dissolution of the organization.
 - Including this provision in the Articles of Organization will help the IRS process the application more speedily.

Contributions to a 501(c)(3)

Organizations with 501(c)(3) status are eligible to receive tax-deductible contributions (in accordance with IRC §170).

Benefits

Contributions to 501(c)(3) organizations are tax-deductible.

Drawbacks

The organization may not participate at all in campaign activity for or against a political candidate.

No substantial part of the organization's activities may consist of lobbying.

501(c)(4)

Who

Organizations that are formed and operated only to promote social welfare are eligible for tax exemption. Examples are civic associations and volunteer fire companies. Social welfare is defined as general welfare and the common good.

Purpose and Requirements

To qualify for 501(c)(4) status, an organization must meet several exemption requirements:

- The earnings of the organization may not benefit any private shareholder or individual.
- They must show that the organization will be operated on a nonprofit basis.
- It must be organized exclusively to promote social welfare by submitting evidence that your organization will operate primarily to further the common good and general welfare of the people of the community (such as by bringing about civic betterment and social improvements).
- The organization may not restrict the use of its facilities to certain groups.

- If the organization submits proof that it is exclusively organized to promote social welfare, some political activity related to the social welfare purpose is permitted.

Contributions to a 501(c)(4).

- Contributions to civic leagues or other section 501(c)(4) organizations generally are not deductible as charitable contributions for federal income tax purposes. However, they may be deductible as trade or business expenses, if ordinary and necessary in the conduct of the taxpayer's business.
- Donations to volunteer fire companies are deductible on the donor's federal income tax return, but only if made for exclusively public purposes.

Benefits

A substantial part of their activities may consist of lobbying or political activities, as long as the political activities are germane to the social welfare purpose of the organization.

Drawbacks

Contributions to the organization are *not* tax deductible.

501(c)(6)

Who

Nonprofit business leagues, chambers of commerce, real estate boards, boards of trade, and professional football leagues are eligible for exemption.

- Business league is an association of persons having some common business interest with a purpose to promote that common interest (trade and professional associations)
- Chambers of Commerce are usually composed of the merchants and traders of a city.
- Boards of trade are usually composed of persons in similar lines of business.
- Real Estate Boards are composed of members interested in improving business conditions in the real estate field.

Purpose and Requirements:

To qualify for 501(c)(6) status, an organization must meet several exemption requirements:

- In its application form, the organization must indicate that none of its net earnings will benefit any private shareholder or individual.
- It must be clear that the organization is not organized for profit or to engage in the type of activity normally carried on for profit.
- The organization must be primarily engaged in activities or functions that are the basis for its exemption, and be primarily supported by membership dues and other income from activities substantially related to its exempt purpose.
- The organization must show it is devoted to improvement of business conditions, and show that the conditions of a particular trade or community interest will be advanced.
- The organization may only engage in working for the enactment of laws if it is to advance the common business interest of the organizations members.

Contributions to a 501(c)(6)

Contributions to 501(c)(6) organizations are not deductible as charitable contributions on the donor's federal income tax return. They may be deductible as trade or business expenses if ordinary and necessary in the conduct of the taxpayer's business.

Benefits

Dues and investment income are tax exempt.

There is no express limitation on the lobbying or other political activities of 501(c)(6) organizations. However, actions to influence legislation will affect the ability of members to deduct their dues.

Drawbacks

Contributions to the organization are *not* tax deductible.