



TAX ISSUES FOR EDUCATIONAL ORGANIZATIONS

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WHAT IS A TAX-EXEMPT ORGANIZATION?

Congress decided that the work carried on by some organizations was so important that it wanted them to keep their funds to carry out their work, rather than paying part of it to the federal government as income taxes.



Congress established several categories of organizations which are exempt from federal income taxes. Today, those categories are usually referred to by the sections of the Internal Revenue Code which grant them tax- exempt status. The more common ones are:

- Section 501(c)(3) organizations - charitable, educational and religious organizations
- Section 501(c)(4) organizations - social welfare organizations
- Section 501(c)(5) organizations - agricultural organizations
- Section 501(c)(6) organizations - trade associations, professional societies, and chambers of commerce



ARE TAX-EXEMPT ORGANIZATIONS EXEMPT FROM ALL TAXES?

Tax-exempt status means that an organization does not pay corporate federal income tax on income from activities that are substantially related to the purposes for which the organization was given exempt status.



The organization does pay that tax on other types of income, which is called "unrelated business income."

The reason for this split-level taxing system is to be fair to tax-paying businesses.



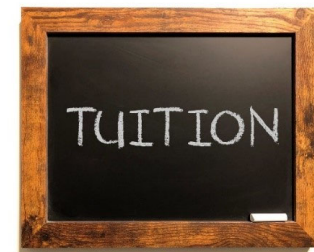
WHEN IS INCOME TAX FREE?

An activity will not be subject to the tax on unrelated business income if it is "substantially related" to the exempt function of the organization.



IS TUITION AND REGISTRATION TAX-FREE?

If the entity's purpose is educational the activity is related to the entity's exempt function of education. It contributes importantly to the achievement of that exempt function.



How is taxable income computed for a 501(c)(3) entity compared to a 501(c)(6) entity?

They are treated the same. Tuition or fees for classroom activities will not be taxable.



What are the main differences between a 501(c)(3) and a 501(c)(6) entity?

- a. 501(c)(3)'s are subject to more scrutiny



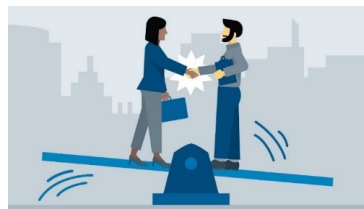
- b. 501(c)(3) organizations may give their donors charitable contribution deductions. 501(c)(6) organizations may give their donors a business expense deduction.



- c. Government entities sometimes prefer to give grants to 501(c)(3) organizations.



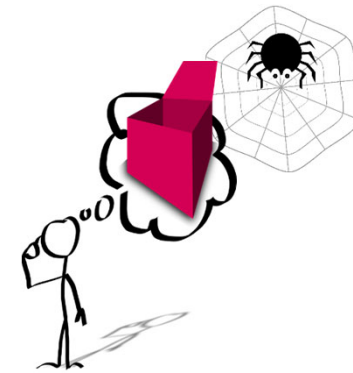
d. Public benefit vs. Mutual benefit



- e. 501(c)(3)'s cannot limit participation to members of a related 501(c)(6)

nonprofit

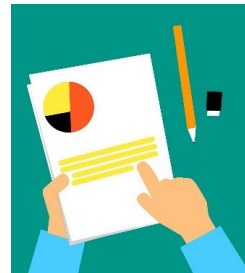
f. Cash is trapped in a 501(c)(3)



- g. Permitted payments from 501(c)(3) to 501(c)(6)'s are limited



h. 501(c)(3)'s must register with states as charities and file extra reports



Questions?

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