

What Does it Mean to Be a 501(c)(3) Organization?

What is a 501(c)(3) organization?

A 501(c)(3) organization is an organization that has applied for, and IRS has granted, status as tax exempt charitable organization under Internal Revenue Code Section 501(c)(3).

In order to qualify as a 501(c)(3) tax exempt charitable organization, an organization must be organized and operated for selected charitable purposes, such as religious, educational, scientific, or literary activities.

Note: there are other types of tax exempt organizations under different sections of the Internal Revenue Code, for example - 501(c)(7) Social Clubs, 501(c)(14) Credit Unions. Each type of tax exempt organization has its own regulatory and reporting requirements under the Internal Revenue Code.

What does 501(c)(3) status mean for Lehigh's operations?

Generally,

- 1) With some exceptions, we are exempt from federal income tax
- 2) We are eligible to receive tax deductible contributions
- 3) We must operate for public, not private, benefit
- 4) We must comply with restrictions on lobbying activities
- 5) We are subject to different information and tax reporting requirements than for-profit organizations

See below for additional detail on these Internal Revenue Service rules.

*** We are always subject to audit by the IRS on our compliance with these restrictions***

1) Exemption from Federal Income Tax

Generally, the activities we conduct as part of our exempt purpose (primarily education and research) are exempt from federal income tax. We must pay corporate income tax on any income we receive as a result of an unrelated trade or business.

Unrelated trade or business income as defined by the IRS:

- Income from a trade or business
- Regularly carried on
- Not substantially related to the performance of our tax-exempt functions

If unrelated activity were to become a significant portion of our operations, we could jeopardize our tax exempt status.

Examples of what is unrelated business income at Lehigh **(TAXABLE)**:

- Advertising Revenue (but not corporate sponsorships)
- Stabler Arena external events (ex. – car show)
- Commercial testing services in research centers
- Conference Services external rentals when services are provided

Examples of what is not unrelated business income **(NOT TAXABLE)**:

- Revenue resulting from activities with substantial causal relationship to our exempt purpose
- Convenience businesses (laundry, food service for students, etc)
- Research (but not commercial testing)
- Corporate Sponsorships (but not advertising)
- Passive Income (interest and dividends, real estate rentals without services, etc)
- Royalties

2) Eligible to Receive Tax Deductible Contributions

- Donor must have “detached and disinterested generosity”
- Cannot have a return benefit to the donor (but can specify what portion of a payment is a tax-deductible donation)
- Donor must relinquish control of the funds
- Gifts with substantial restrictions on use of donation may cause deduction to be disallowed (donor can support a specific area of the University, but can't donate to support a specific student).
- There are reporting and acknowledgement rules depending on the amount and nature of the gift – therefore it is very important to work with the Advancement Office when gifts are received

3) Prohibition against Private Benefit / Excess Benefit

None of the income or assets of the University may be diverted from its exempt purpose in order to unduly benefit a private enterprise or person, particularly those who have some close relationship to the organization ("disqualified person").

Transactions with must be reasonable, negotiated on an arms-length basis. All reimbursements must meet IRS "accountable plan" rules.

Types of transactions to consider:

- Sale, exchange, leasing or property
- Lending of money
- Furnishing of goods, services or facilities
- Payment of compensation or reimbursement of expenses (Is it reasonable compared to market rates? Is it a disguised attempt to distribute profits?)
- Transfer of income or assets of the University

4) Lobbying Restrictions

The University is limited in the nature and scope of its lobbying activity.

Definition of Lobbying: attempt to influence legislation (but not executive branch or administrative agency regulations).

There is an absolute prohibition on participation on political campaigns. Participation in political campaigns can result in revocation of our tax exemption.

5) Subject to different tax reporting requirements

The University is required to file IRS Information Return on Form 990. The information in the 990 is based on our fiscal year and includes financial statement information as well as certain other disclosures.

The University also files IRS Form 990-T which is a return related to net unrelated business income.

Forms 990 and 990-T are subject to public inspection. There are regulations requiring a prompt response time upon receipt of an inspection request. Therefore, it is important to notify the Controller's Office immediately when requests are received.

Due to these rigorous IRS reporting requirements, it is very important to advise the Controller's Office of any new revenue-generating activities, and record all revenue in the appropriate index and account code.