

§ 1.2 TAX-EXEMPT ORGANIZATIONS

For the most part in this book, the term *tax-exempt organization* refers to a nonprofit organization that is exempt from (excused from paying) the federal income tax. There are, of course, other federal taxes (such as excise and employment taxes), and there are categories of exemptions from them. At the state level, there are exemptions associated with income, sales, use, excise, and property taxes.

Nonetheless, there is no category of nonprofit organization that is not subject to some form of federal tax. The income tax that is potentially applicable to nearly all tax-exempt organizations is the tax on unrelated business income. n12 Exempt entities can be taxed for engaging in political activities; n13 public charities are subject to tax in the case of substantial efforts to influence legislation n14 or participation in political campaign activities; n15 and some exempt organizations, such as social clubs, are taxable on their investment income. n16 Associations and like organizations can be subject to a proxy tax when engaged in attempts to influence legislation or engage in political activities. n17 Private foundations can be caught up in a variety of excise taxes. n18

n12 See Part Five.

n13 See § 17.5.

n14 See § 20.5.

n15 See § 21.4.

n16 See § 14.3.

n17 See §§ 20.7, 21.7.

n18 See § 11.3.

There is no entitlement in a nonprofit organization to tax exemption; there is no entity that has some inherent right to exempt status. The existence of tax exemption and the determination of entities that have it are essentially the whim of the legislature involved. There is no constitutional law principle mandating tax exemption. n19

n19 Nonetheless, see *supra* note 1.

An illustration of this point is the grant by Congress of tax-exempt status to certain mutual organizations -- albeit with the stricture that to qualify for the exemption, an organization must be organized before September 1, 1957. n20 Prior to that date, exemption was available for all savings and loan associations. This exemption was repealed because Congress determined that the purpose of the exemption, which was to afford savings institutions that did not have capital stock the benefit of exemption so that a surplus could be accumulated to provide the depositors with greater security, was no longer appropriate, because the savings and loan industry had developed to the point where the ratio of capital account to total deposits was comparable to nonexempt commercial banks. A challenge to this law by an otherwise qualified organization formed in 1962 failed, with the U.S. Supreme Court holding that Congress did not act in an arbitrary and unconstitutional manner in declining to extend the exemption beyond the particular year. n21

n20 IRC § 501(c)(14)(B).

n21 *Maryland Sav.-Share Ins. Corp. v. United States*, 400 U.S. 4 (1970).

There are other illustrations of this point. For years, organizations like Blue Cross and Blue Shield entities were tax-exempt; n22 Congress, however, determined that these organizations had evolved to be essentially no different from commercial health insurance providers and thus generally legislated this exemption out of existence. n23 (Later, Congress realized that it had gone too far in this regard and restored exemption for some providers of insurance that function as charitable risk pools. n24) Congress allowed the exempt status for group legal services organizations n25 to expire without ceremony in 1992; it also created a category of exemption for state-sponsored workers' compensation reinsurance organizations, with the stipulation that they be established before June 1, 1996. n26 Indeed, in 1982, Congress established exemption for a certain type of veterans' organization, with one of the criteria being that the entity be established before 1880. n27

n22 By reason of IRC § 501(c)(4).

n23 See § 22.1.

n24 See § 10.6.

n25 See § 16.6.

n26 See § 18.5.

n27 See § 18.10(b).

There is a main list of tax-exempt organizations, n28 to or from which Congress periodically adds or deletes categories of organizations. Occasionally, Congress extends the list of organizations that are exempt as charitable entities. n29 Otherwise, it may create a new provision describing the particular exemption criteria. n30

n28 IRC § 501(c).

n29 IRC §§ 501(e), 501(f), 501(k), 501(m), 501(n).

n30 IRC §§ 521, 526-529.

A compendium of tax law containing an analysis of the law of tax-exempt organizations proclaims that exempt status is the "most prized of all tax concessions sanctioned by Congress." n31 That bit of hyperbole, intending to confer momentum and stature to the exempt organizations field, is in fact a considerable overstatement. For example, in the case of some charitable organizations, the eligibility to receive tax-deductible contributions is a far more prized attribute than tax exemption. From an economic viewpoint, there are several tax expenditures that are worth more (in terms of revenue losses to the federal fisc) than the charitable contribution deduction or the federal tax exemption for nonprofit organizations. n32