Tax-Exempt Status: How It Can Be Lost And Found Again

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Filing requirements of small nonprofit organizations, including fraternity and sorority chapters, changed significantly with the passage of the Pension Protection Act of 2006. In addition to requiring all nonprofit organizations to file a return with the IRS regardless of its level of gross receipts, perhaps the most consequential change to come with the Pension Protection Act is the requirement that the tax-exempt status of any organization be revoked if that organization fails to file a proper Form 990, 990-EZ, or 990-N for three consecutive years. In May of 2010, the automatic revocation of exempt status began when the tax-exempt status of approximately 275,000 organizations was revoked, including numerous fraternity and sorority chapters (Guidestar Publications, 2011).

Understandably, the revocation of a fraternity or sorority chapter's tax-exempt status can come as quite a surprise to its undergraduate leaders, if they are aware of their current status at all. Given the infrequent nature of IRS filing requirements as a part of chapter operations, this is an aspect that is easy for both chapter officers and advisors to overlook. Nevertheless, meeting these requirements is important and can have very real consequences for the future operations of fraternity and sorority chapters. The aim of this article is to outline how a chapter can lose its tax-exempt status, the process a chapter should use to reapply for that status, and how advisors can assist in ensuring chapters continue to meet these relatively new IRS filing requirements.

What are the consequences of losing tax-exempt status?

It is important that chapters understand what "tax-exempt" means in relation to their operations. Fraternities and sororities are typically classified by the IRS as 501(c)7 social clubs. The 501(c)7 classification exempts these organizations and their subordinate units (chapters) from paying federal income taxes on business related income. It is also important to understand the difference between 501(c)7 organizations and 501(c)3 organizations.

In comparison to a 501(c)7, an organization classified as a 501(c)3 is exempt from paying federal income tax on business related income, but donations to a 501(c)3 are typically tax deductible for the donor. Donations to 501(c)7 organizations, though, are generally *not* tax deductible for the donor. There are additional, more specific, differences, but this basic distinction is the most applicable to fraternity and sorority chapters.

If a 501(c)7 organization, such as a fraternity or sorority chapter, has its tax-exempt status revoked, it may be required to begin paying federal income taxes, which could have a significant impact on its operations. For chapters, paying federal income taxes, and possibly applicable state income taxes, would likely result in less dollars for member development, recruitment, educational programs, and philanthropic giving. The other "option" available to local chapters would most likely include significant increases in local member dues, which would have its own impacts on a chapter's operations.

How does a chapter lose its tax exempt status?

As the new filing requirements were implemented, the IRS also adjusted the filing threshold for the new Form 990-N, to include organizations whose gross receipts are normally less than or equal to $50,000. Most fraternity and sorority chapters meet this threshold, requiring them to file the 990-N annually. However, regardless of which 990 a chapter is required to file, they are all subject to Section 6033(j) of the Internal Revenue Code, which "automatically revokes the exemption of any organization that fails to satisfy its filing requirement for three consecutive years" (Social Clubs, 2012).

The filing requirements are one of the centerpieces of confusion for a lot of chapters. To help alleviate some of the potential confusion, there are two points that are important to remember:

- Chapters are required to file a 990 form *annually*.
- If a chapter files a 990 only once in a three year period, it may avoid having its tax-exempt status revoked, but until a 990 is filed for each of the previous missing years, the chapter is delinquent in its filing requirements and may be subject to penalties and other ramifications.

How does a chapter get its tax-exempt status reinstated?
If a nonprofit organization loses its tax-exempt status, it can apply to have its exemption reinstated. For fraternity and sorority chapters under the 501(c)7 classification, this means filing IRS Form 1024 (Application for Recognition of Exemption) and paying a user fee.

It is likely a chapter that has lost its tax-exempt status will be subject to paying federal income tax for the time between the revocation of its exemption and the reinstatement of its exempt status. Therefore, the chapter may choose to request its reinstatement be retroactive to the date of revocation. Such a request can be made as a part of its reinstatement application and is described on the IRS website (www.irs.gov).

The IRS also advises writing "Automatically Revoked" at the top of the reinstatement application, as well as the envelope, to ensure that your application goes to a specialist trained to handle these applications.

Ultimately, any chapter applying for reinstatement of its tax-exempt status would be well served to consult a tax professional, such as a Certified Public Accountant (CPA). The expertise of a tax professional can help to ensure the reinstatement application and supporting documentation is completed and filed properly.

How can advisors assist a chapter in reapplying for tax-exempt status?
The most important thing advisors can do to assist chapters regarding their filing requirements is to help them avoid a scenario where the chapter is facing revocation of its tax-exempt status. The consistent turnover of chapter officers can create an environment in which it is easy to overlook the filing requirements if left to officer transitions. Advisors provide a continuity that can help to ensure that important but infrequent aspects of chapter operations, such as IRS filing requirements, do not get lost in the grind of day-to-day operations.

If a chapter does lose its tax-exempt status, an advisor can play an important role in helping the chapter understand what it needs to do to apply for reinstatement. Moreover, an advisor can provide an important balance. It is likely that many chapter officers will not understand the potential consequences of losing the tax-exempt status, so advisors can play an important role in keeping the chapter focused on addressing the issue promptly.

The IRS website offers a litany of information and resources relevant to 501(c)7 organizations, including fraternities and sororities, and advisors should take time to review these resources and familiarize themselves with the information available (www.irs.gov/Charties-&-Non-Profits/Other-Non-Profits).

References

Guidestar Publications. 2011. In *How Automatic Revocations Could Affect You.* Retrieved from http://www.guidestar.org/rxg/news/publications/revocations-april-2011-report.aspx

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