

Basics of not-for-profit and tax-exempt law



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The following article was adapted from telephone presentations I gave to AAMA state societies and local chapters. Although not all not-for-profit (NFP) and tax-exempt entities are corporations, the following article will address only NFP and tax-exempt entities that are incorporated.

What is the difference between not-for-profit and for-profit corporations?

A primary difference is that not-for-profit (NFP) corporations do not have stockholders. This is because the law does not give NFP corporations the authority to issue shares of stock. Not-for-profit corporations must use their resources to further their tax-exempt purposes, not to provide economic benefit to any individual or other legal entity.

In contrast, for-profit corporations are authorized by law to issue shares of stock. The stockholders may be paid dividends from the profits of the corporation. They also benefit from any increase in the value of the stock.

What are the typical governance documents of an NFP corporation?

The primary governance documents of an NFP corporation are its articles of incorporation and its bylaws. The articles of incorporation are typically given greater legal weight than the bylaws. Consequently, if the bylaws contain language inconsistent with the articles of incorporation, the provisions of the articles will usually prevail over the language of the bylaws.

An NFP corporation may also have secondary governance documents, such as standing rules, policies, and procedures. The language of the articles of incorporation

and the bylaws prevail over the provisions of these secondary documents.

What must an NFP do in order to incorporate?

Not-for-profit incorporation is granted by a state executive-branch agency, such as the offices of the secretary of state, attorney general, or department of revenue. An entity must be organized and must operate in accordance with its state's NFP act in order to incorporate. For example, the NFP must have a purpose permitted by the relevant NFP statute. The NFP's purpose is usually specified in its articles of incorporation, its bylaws, or both. Also, the primary governance documents must specify that, if the NFP corporation is dissolved, any remaining assets (after debts and obligations have been paid) must not be given to any individual members or leaders of the NFP corporation. Rather, remaining assets must be distributed to an entity such as another NFP corporation.

The NFP must complete the form for NFP incorporation; include its articles of incorporation, bylaws, and the required fee; and submit these documents to the appropriate state agency. If everything is deemed to be in order, the NFP will be sent a certificate of incorporation. Most states require a short and simple annual report (along with a small fee) to be submitted by each NFP corporation.

How does an NFP corporation obtain an income tax exemption?

First, individuals and for-profit corporations are not the only entities required to pay federal income tax. Some limited liability companies, partnerships, estates, trusts, and NFP corporations are required to file federal returns and pay federal income tax.

Although state law governs the incorporation of NFPs, federal law sets forth the requirements for income tax exemptions. For an NFP corporation to obtain an income tax exemption, it must fall into one of the tax-exempt categories established by the United States Congress in the Internal Revenue Code. The NFP corporation must then complete and submit the appropriate form for tax exemption, with the necessary documentation and the required fee, to the Internal Revenue Service (IRS). An NFP corporation granted income tax exemption will receive an exemption letter from the IRS.

What are examples of tax-exempt categories in the Internal Revenue Code?

The Internal Revenue Code has two tax-exempt categories that are of particular interest to NFP associations. The first category is found in section 501(c)(6) of the Internal Revenue Code. This section authorizes income tax exemptions for professional societies, business leagues, and

trade associations. The second category is found in section 501(c)(3) of the Internal Revenue Code. This section includes charitable, philanthropic, scientific, religious, and educational entities.

Most professional societies, such as the American Association of Medical Assistants® (AAMA), are NFP corporations exempt under section 501(c)(6) of the Internal Revenue Code. Many associations have established an affiliated 501(c)(3) entity. An example is the AAMA Endowment (AAMAE).

The AAMAE is an NFP that is separately incorporated and is exempt from income tax under section 501(c)(3) of the Internal Revenue Code. The AAMAE houses the Medical Assisting Education Review Board (MAERB) and its activities as an accreditation-recommending committee on accreditation of the Commission on Accreditation of Allied Health Education Programs (CAAHEP). The Medical Assisting Education Review Fund includes the Ivy Reade Relkin Surveyor Training Fund, whose purpose is to provide financial assistance for individuals to attend surveyor training workshops held by MAERB. These individuals become accreditation site surveyors of medical assisting programs seeking initial or continuing accreditation by CAAHEP. The AAMAE also houses the Maxine Williams Scholarship Fund, whose purpose is to provide scholarships to worthy medical assisting students in CAAHEP-accredited medical assisting programs.

Is an NFP association exempt from paying sales tax on its purchases?

This question has been a source of much confusion in the NFP and association worlds. The primary reason is that 501(c)(6) associations are treated differently from 501(c)(3) entities in regard to paying sales tax on items purchased to carry out their tax-exempt purposes.

All states do not have a sales tax. States that have a sales tax require the seller of goods to charge the buyer the required sales tax and remit that amount to the state

State laws do not exempt 501(c)(6) entities (including professional associations) from paying sales tax on items they purchase for consumption by attendees at a state annual meeting or education conference. However, some state sales tax laws exempt 501(c)(3) entities—or a subset of 501(c)(3) entities—from paying sales tax on items they buy for consumption by attendees at fund-raising or charitable events.

department of revenue. This applies to all buyers unless a buyer has been granted an exemption.

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Eligible 501(c)(3) entities can submit their certificate of NFP incorporation from the state and their 501(c)(3) tax exemption letter from the IRS to the state department of revenue. The department, in turn, will issue the 501(c)(3) entity a letter verifying its exemption from sales tax. The 501(c)(3) entity may show a copy of its sales tax exemption letter to a vendor. The vendor is then not permitted to charge the 501(c)(3) entity sales tax on purchases related to its tax-exempt purpose.

Are association dues and amounts paid for continuing education deductible by the members?

Dues and continuing education costs paid by members are deductible as professional expenses in calculating federal income tax. Membership dues and continuing education costs are not deductible as charitable expenses.

Are contributions to 501(c)(3) bodies, such as scholarship funds established by an association, deductible for income tax purposes?

Donations to a 501(c)(3) association foundation are deductible as charitable contributions. Such donations are not deductible as professional expenses. ♦

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