

American Jurisprudence Summary
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§ 7900—Exempt Organizations

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§ 7900. Exempt Organizations and Taxable Activities.

The Code exempts from income tax many types of organizations including religious, charitable, and educational organizations. Exemption depends on the facts of each case and is generally determined on application and may be revoked. The conditions for exemption vary. Some organizations are exempt only if they don't engage in certain prohibited transactions or don't unreasonably accumulate income. In addition, the unrelated business income of some otherwise exempt organizations is taxable. And business organizations all of whose profits are paid to exempt organizations are generally fully taxable.

§ 7901. Scope of tax exemption. So-called tax-exempt organizations consist of a long list of organizations specified in the Code traditionally regarded as not organized for private profit. In general, these organizations are exempt from income tax.¹

But some of them are exempt only if they refrain from engaging in certain prohibited transactions and from unreasonably accumulating income, and others are exempt if they just refrain from prohibited transactions.²

Also, some exempt organizations are nevertheless taxed on their unrelated business income.³

Exemption is denied to communist-controlled organizations.⁴

✓ *observation:* The fact that an organization is exempt from income tax doesn't relieve it from the obligation to withhold income tax from its employee's wages.

1. Code Sec. 501(a).
2. Code Secs. 503 and 504.
3. Code Sec. 511(a)(2).
4. Regs. § 1.501(c)-1.

§ 7902. Organizations exempt if they don't engage in prohibited transactions and don't accumulate income. The religious, charitable, and educational organization group is perhaps the most important category of exempt organizations. With certain exceptions, such organizations are exempt only if they refrain from engaging in prohibited transactions and also refrain from improper accumulation, use or investment of income. These restrictions apply to corporations, community chests, funds, or foundations, organized and operated for any of the following purposes:

- ... Religious
- ... Charitable
- ... Educational
- ... Literary

- ... Scientific
- ... Testing for public safety
- ... Prevention of cruelty to children or animals.¹

But neither the prohibited transaction rule nor the rule against improper accumulation, use, or investment of income applies to the following:

- ... Religious organizations other than trusts
- ... Educational organizations with regular faculty, curriculum, and enrolled student body in attendance at a regular place.

... Organizations normally receiving, from the U.S. or the general public, a substantial portion of their support (other than income from their exempt activities).

... Organizations operated, supervised, controlled, or principally supported by an exempt religious organization that isn't a trust.

... Organizations the principal purpose of which is to provide medical or hospital care, medical education, or medical or agricultural research.² This doesn't include an organization engaged primarily in making contributions to tax-exempt hospitals but not itself providing medical or hospital care.³

1. Code Sec. 501(c)(3).
2. Code Secs. 501(b) and 504(a).
3. Rev. Rul. 54-137, CB 1954-1, 289; *Samuel Friedland Foundation v. U.S.*, 144 F. Supp. 74.

§ 7903. Other organizations exempt if they don't engage in prohibited transactions. Two categories of employee trusts are exempt only if they don't engage in prohibited transactions, namely:¹

- ... Employees' supplemental unemployment benefit trusts.²
 - ... Qualified employee pension, profit sharing, or stock bonus trusts.³
- This rule is subject to certain exceptions of limited application with respect to employee trusts.⁴