

LUTHER COLLEGE

POLICIES AND PROCEDURES

Department: Administrative Services
Subject: Maintenance of Tax-Exempt Status Policy
Date Issued: May 7, 2009
Date Revised:
Approved By: Reviewed by Cabinet, Approved by President
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I. Policy/Procedure

This policy outlines the guidelines and procedures necessary to maintain the tax-exempt status as a 501(c)(3) public charity. The vice president for finance and administration will annually review this policy with the cabinet to insure compliance.

II. Purpose

To ensure that Luther College maintains its tax-exempt status and meets its ongoing compliance responsibilities.

III. Scope

This policy applies to all officers, directors, trustees, and employees.

IV. Terms and Definitions

- Inurement - inurement occurs when a transaction or exchange occurs whereby an individual with a personal interest in the exempt organization activities acquires economic gain through the use of funds or assets of that exempt organization.
- Insider – a person who has a personal or private interest in the activities of the organization such as an officer, director, or a key employee.
- Public Charity – a charity that is deemed to receive the major part of its support from the public (rather than from a small group of individuals). Luther College has been designated as a public charity under Section 509(a)(1) with a description as “an educational organization such as a school or college”.
- Tax-exempt status - refers to Federal IRS designation as an organization exempt from paying Federal income tax on its business related operations. Luther College has been granted exemption from paying Federal income tax under the provisions of Section 501(c)(3) of the Internal Revenue Code of 1954.

V. Procedures and Guidelines

- A. A 501(c)(3) public charity that does not restrict its participation in certain activities and does not absolutely refrain from others, risks failing the operational test and jeopardizing its tax-exempt status. The following summarizes the limitations on the activities of public charities.
 - Private Benefit and Inurement
 - A public charity is prohibited from allowing more than an insubstantial accrual of private benefit to individuals or organizations. This restriction is to ensure that a tax-exempt organization serves as a public interest, not a private one. If a private benefit is more than incidental, it could jeopardize the organization’s tax-exempt status. No part of an organization’s net earnings may inure to the benefit of a private shareholder or individual.

This means that an organization is prohibited from allowing its income or assets to accrue to insiders. An example of prohibited inurement would include payment of unreasonable compensation to an insider. Any amount of inurement may be grounds for loss of tax exempt status.

- Political Campaign Intervention
 - Public charities are absolutely prohibited from directly or indirectly participating in, or intervening in, any political campaign on behalf of (or in opposition to) a candidate for public office. Contributions to political campaign funds or public statements of position made on behalf of the organization in favor or in opposition to any candidate for office clearly violate the prohibition against political campaign activity. Violation of this prohibition may result in revocation of tax-exempt status and/or imposition of certain excise taxes.
- Legislative Activities
 - A public charity is not permitted to engage in substantial legislative activity (commonly referred to as lobbying). An organization will be regarded as attempting to influence legislation: if it contacts, or urges the public to contact, members or employees of a legislative body for purposes of proposing, supporting or opposing legislation; or if the organization advocates the adoption or rejection of legislation. If lobbying activities are substantial, a 501(c)(3) organization may fail the operational test and risk losing its tax-exempt status and/ or be liable for excise taxes. Substantiality is measured by either the substantial part test or the expenditure test.

B. While 501(c)(3) public charities are exempt from federal income tax, most of the organizations have information reporting obligations under the Code to ensure that they continue to be recognized as tax-exempt. In addition, they may also be liable for employment taxes, unrelated business income tax, excise taxes, and certain local state and local income taxes.

- Form 990, *Return of Organization Exempt from Income Tax and Form 990-EZ*
 - Public charities generally file Form 990, *Return of Organization Exempt from Income Tax*, Form 990-EZ, *Short Form Return of Organization Exempt from Income Tax*, or Form 990-N, *Electronic Notice (e-Postcard) for Tax-Exempt Organizations not Required To File Form 990 or 990-EZ*.
 - Public charities that file Form 990 or Form 990-EZ must file Schedules A thru R of that return as required from information provided in Form 990 or 990-EZ.
 - If a public charity believes it provided an unreasonable benefit to a person who is in a position to exercise substantial influence over the organization's affairs, it must report the transaction on Form 990 or Form 990-EZ. Excess benefit transactions are governed by section 4958 of the Code. Additional information can be found in the Form 990 and Form 990-EZ instructions.
- Form 990-T, *Exempt Organization Business Income Tax Return*
 - Even if a public charity is not required to file a Form 990 or Form 990-EZ, it must file a Form 990-T, *Exempt Organization Business Income Tax Return*, if it has \$1,000 or more of gross receipts from an unrelated trade or business during the year.
- Employment Tax Returns
 - Like other employers, all public charities that pay wages to employees must withhold, deposit, and pay employment tax, including federal income tax withholding and Social Security and Medicare (FICA) taxes. To know how much income tax to withhold, a public charity should have a Form W-4, *Employee's Withholding Allowance Certificate*, on file for each employee. Employment taxes are reported on Form 941, *Employer's Quarterly Federal Tax Return*.

C. In general, a public charity must maintain books to show that it complies with tax rules. The charity must be able to document the sources of receipts and expenditures reported on Form 990, *Return of Organization Exempt From Income Tax*, or Form 990-EZ, *Short Form Return of Organization Exempt From Income Tax*, and Form 990-T, *Exempt Organization Business Income Tax Return*. If an organization does not keep required records, it may not be able to show that it qualifies for tax-

exempt status or is a public charity. Thus, the organization may lose its tax-exempt status or be classified as a private foundation rather than a public charity.

- Evaluate Charitable Programs
 - A charity can use records to evaluate the success of its charitable program and determine whether the organization is achieving desired results. Good records can also help a charity identify problem areas and determine what changes it may need to make to improve performance.
 - Monitor Budgetary Results
 - Without proper financial records, it is difficult for a charity to assess whether the charity has been successful in adhering to budgetary guidelines. The ability to monitor income and expenses and ensure that the organization is operating within its budget is crucial to successful stewardship of a public charity.
 - Prepare Financial Statements
 - It is important to maintain sufficient financial information in order to prepare accurate and timely annual financial statements. A charity may need these statements when it is working with banks, creditors, contributors, and funding organizations. Some states require charities to make audited financial statements publicly available.
 - Prepare Annual Information and Tax Returns
- D. Records must support income, expenses, and credits reported on Form 990 series and other tax returns. Generally, these are the same records used to monitor programs and prepare financial statements. Books and records of public charities must be available for inspection by the IRS. If the IRS examines a public charity's returns, the organization must have records to explain items reported. Having a complete set of records will speed up the examination.
- Identify Sources of Receipts
 - Public charities may receive money or property from many sources. With thorough recordkeeping, a charity can identify the sources of receipts. Organizations need this information to separate program from non-program receipts, taxable from non-taxable income, and to complete Schedules A thru R of Form 990.
 - Substantiate Revenues, Expenses and Deductions for Unrelated Business Income Tax (UBIT) Purposes.
 - A public charity may need records to substantiate the amount, if any, of unrelated business taxable income. An organization must appropriately track the financial revenues and expenses subject to UBIT reporting in order to prepare its unrelated business income tax return, Form 990-T, *Exempt Organization Income Tax Return*.
 - Comply with Grant-Making Procedures (Grants to Individuals)
 - A public charity that makes grants to individuals must keep adequate records and case histories to demonstrate that grants to individuals serve its charitable purposes. Case histories on grants to individuals should show names, addresses, purposes of grants, manner of selection, and relationship (if any) that the recipient has with any members, officers, trustees, or donors of the organization.
 - Comply with Racial Nondiscrimination Requirements (Private Schools)
 - Private schools must keep records that show that they have complied with requirements relating to racial nondiscrimination, including annual publication of a racially nondiscriminatory policy through newspaper or broadcast media to the general community served.
 - Accounting Periods and Methods
 - Public charities must keep their financial records based on an annual accounting period called a tax year in order to comply with annual reporting requirements.
 - Supporting Documents
 - Organization transactions such as contributions, purchases, sales, and payroll will generate supporting documents. These documents — grant applications and awards, sales slips, paid bills, invoices, receipts, deposit slips, and canceled checks — contain information to be recorded in accounting records. It is important to keep these documents because they support

the entries into books and the entries on tax and information returns. Public charities should keep supporting documents organized by year and type of receipt or expense. Also, keep records in a safe place.

- E. Public charities must keep records for federal tax purposes for as long as they may be needed to document evidence of compliance with provisions of the code. Generally, this means the organization must keep records that support an item of income or deduction on a return until the statute of limitations for the return runs. The statute of limitations has run when the organization can no longer amend its return and the IRS can no longer assess additional tax. Generally, the statute of limitations runs three years after the date the return is due or filed, whichever is later. An organization may be required to retain records longer for other legal purposes, including state or local tax purposes.
- Record Retention Periods
 - Record retention periods vary depending on the types of records and returns.
 - Permanent Records – Some records should be kept permanently. These include the application for recognition of tax-exempt status, the determination letter recognizing tax-exempt status, the organizing documents, such as articles of incorporation and by-laws, with amendments, as well as board minutes.
 - Employment Tax Records – If an organization has employees, it must keep employment tax records for at least four years after the date the tax becomes due or is paid, whichever is later.
 - Record for Non-Tax Purposes – When records are no longer needed for tax purposes, an organization should keep them until they are no longer needed for non-tax purposes. For example, a grantor, insurance company, creditor, or state agency may require that records be kept longer than the IRS requires.
- F. There are a number of disclosure requirements for public charities.
- Public Inspection of Annual Returns and Exemption Applications
 - A public charity must make the following documents available for public inspection and copying upon request and without charge (except for a reasonable charge for copying). The IRS makes these documents available for public inspection and copying.
 - Exemption Application – A public charity must disclose its exemption application, Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, along with each of the following documents: all documents submitted with Form 1023; all documents the IRS requires the organization to submit in support of its application; and the exemption ruling letter issued by the IRS.
 - Annual Information Return – A public charity must disclose its annual information return (Form 990 series) with schedules, attachments, and supporting documents filed with the IRS. However, the organization does not have to identify its contributors on Schedule B of Form 990. Certain information may be withheld from public inspection. Returns need to be available for disclosure for only three years after the due date or the filing date of the return.
 - Form 990-T – For returns filed after August 17, 2006, a public charity must make its Form 990-T available for public inspection.
 - Sale of Free Government Information
 - If a public charity offers to sell goods or services that are available free from the federal government, the organization must disclose that fact in a conspicuous and easily recognized format. An organization that intentionally disregards this requirement is subject to a penalty.
 - Charitable Contributions – Substantiation And Disclosure
 - A public charity should be aware of the substantiation and disclosure rules imposed on donors of charitable contributions and the disclosure rules imposed on charities that receive certain quid pro quo contributions.

VI. Confidentiality and Record

All records related to this policy will be maintained by the appropriate offices.