Internal Revenue Service

Tax Exempt and
Government Entities

Exempt Organizations

Compliance Guide for 501(c)(3) Tax-Exempt Organizations

Why keep records?

What records should be kept?

How long should you keep records?

What federal tax reports and returns must be filed?

What disclosures must a 501(c)(3) organization make?

Federal tax law provides tax benefits to nonprofit organizations recognized as exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code (IRC). It requires that most tax-exempt organizations must comply with federal tax law to maintain that status and avoid penalties.

This IRS Publication 4221 presents general compliance guidelines for recordkeeping, reporting, and disclosure requirements that apply to organizations that have tax-exempt status from federal income tax under section 501(c)(3) of the IRC. Content includes references to the statute, Treasury regulations, and other IRS publications and IRS forms with instructions. Publication 4221 is neither comprehensive nor intended to address every situation.

To learn more about compliance rules and procedures that apply to organizations exempt from federal income tax under section 501(c)(3) of the IRC, see Publication 557, Tax-Exempt Status for Your Organization. For assistance on 501(c)(3) compliance, you may also want to consult a tax adviser.

Why keep records?

In general, an organization must keep books and records to show that it complies with tax rules. The organization must be able to document the sources of receipts and expenditures reported on Form 990, *Return of Organization Exempt From Income Tax.* See **Prepare Annual Returns and Tax Returns**. If an organization does not keep required records, it may be unable to show that it qualifies for exemption. Thus, the organization may lose its tax-exempt status. In addition, an organization may be unable to complete its returns accurately and may be subject to penalties. See **FILING PENALTIES FOR 990 SERIES** on page 10. A good recordkeeping system will also enable an organization to monitor the progress of programs and aid in the preparation of financial statements and returns.

Monitor Programs

Records can show whether programs are improving, which programs are successful, and what changes an organization may need to make. Good records management may be a contributing factor to the success of a program.

Prepare Financial Statements

It is important to maintain revenue and expense statements and balance sheets to prepare accurate financial statements. These statements can help an organization when working with banks, creditors, and contributors and funding organizations.

Prepare Annual Returns and Tax Returns

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. Also, books and records of exempt organizations must be available for inspection by the IRS. If the IRS examines an organization's returns, the organization may be asked to explain items reported. A complete set of records will speed up the examination.

Identify Sources of Receipts

Organizations may receive money or property from many sources. Records 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 Schedule A of Form 990 noted in section **What federal tax reports and returns must be filed?** Organizations that check box 10, 11, or 12, Part IV, of Schedule A, must keep records that show how much support they receive from specific contributors.

Comply with Racial Nondiscrimination Requirements (Private Schools)

Private schools must keep records that show that they have complied with requirements relating to racial nondiscrimination. For more information, see Part V, Schedule A, of Form 990, *Supplementary Information – Organization Exempt Under Section 501(c)(3).*

Record Deductible Expenses for UBIT Purposes

An organization may overlook deductible expenses when it prepares its unrelated business income tax (UBIT) return (Form 990-T, *Exempt Organization Income Tax Return)* unless it records the expenses when they occur.

What records should be kept?

Except in a few cases, the law does not require a special kind of record. An organization can choose any recordkeeping system, suited to its activities, that clearly shows the organization's income and expenses. The type of activities an organization conducts affects the type of records necessary to keep for federal tax purposes. An organization should set up a recordkeeping system using an accounting method that clearly shows its income for the tax year. See **Accounting Timeframe Periods and Methods** on page 8. If an organization has more than one program, the organization should keep a complete and separate set of records for each program.

A recordkeeping system should generally include a summary of transactions. This summary is ordinarily written in an organization's books (for example, accounting journals and ledgers). The books must show gross receipts and functional expenses, as well as deductions and credits. For most small organizations, the checkbook is the main source

for entries in the books. In addition, an organization must keep documentation that supports entries in the books.

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 in books and the entries on tax and information returns. Organizations should keep them in an orderly fashion and in a safe place. For instance, organize them by year and type of receipt or expense.

GROSS RECEIPTS

Gross receipts are the amounts received from all sources. An organization must keep supporting documents that show the amounts and sources of its gross receipts. Documents that show gross receipts include: cash register tapes, bank deposit slips, receipt books, invoices, credit card charge slips, and Form 1099-MISC, *Miscellaneous Income*.

PURCHASES, INCLUDING ACCOUNTING FOR INVENTORY

Purchases are items bought, including any items resold to customers. If an organization produces items, it must account for any items resold to customers. Thus, for example, it must account for the cost of all raw materials or parts purchased for manufacturing into finished products. Supporting documents should show the amount paid, and that the amount was for purchases. Documents for purchases include: canceled checks, cash register tape receipts, credit card sales slips, and invoices. These records will help an organization determine the value of its inventory at the end of the year. See Publication 538, *Accounting Periods and Methods*, for general information on methods for valuing inventory.

EXPENSES

Expenses are the costs an organization incurs (other than purchases) to carry on its program. Supporting documents should show the amount paid and the purpose of the expense. Documents for expenses include: canceled checks, cash register tapes, account statements, credit card sales slips, invoices, and petty-cash slips for small cash payments.

EMPLOYMENT TAXES

Organizations that have employees must keep specific employment tax records. See Publication 15, *Circular E, Employer's Tax Guide*, for details.

ASSETS

Assets are the property, such as investments, buildings and furniture that an organization owns and uses in its activities. An organization must keep records to verify certain information about its assets. Records should show:

- when and how the asset was acquired
- whether any debt was used to acquire the asset
- purchase price
- cost of any improvements
- deductions taken for depreciation, if any
- deductions taken for casualty losses, if any, such as losses resulting from fires or storms
- how the asset was used
- when and how the asset was disposed of
- selling price
- expenses of sale

Documents that may show the above information include: purchase and sales invoices, real estate closing statements, canceled checks, and financing documents. If an organization does not have canceled checks, it may be able to show payment with certain financial account statements prepared by financial institutions. These include account statements prepared for the financial institution by a third party. Account statements must be highly legible. The following defines acceptable account statements.

IF payment is by:	**THEN** statement must show:
check	check number, amount, payee's name, and date the check amount was posted to the account by the financial institution
electronic funds transfer	amount transferred, payee's name, and date the transfer was posted to the account by the financial institution
credit card	amount charged, payee's name, and transaction date

How long should you keep records?

Exempt organizations must keep records as long as they may be needed to administer provisions of the Internal Revenue Code. Generally, this means you must keep records that support an item of income or deduction on a return until the period of limitations for that return runs out. The period of limitations is the period of time in which an organization can amend its return to claim a credit or refund, or the IRS can assess additional tax. The most common limitations period is three years after the date the return is due or filed, whichever is later.

Records and Timeframe Periods

Timeframes for keeping records vary depending on the types of records and returns.

Permanent Records – Some records should be kept permanently. These include the application for recognition of exempt status, the determination letter recognizing exempt status, and organizing documents, such as articles of incorporation and by-laws, with amendments.

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.

Records 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.

Accounting Timeframe Periods and Methods

Organizations must keep books, report, and file returns based on an annual accounting period called a tax year.

Accounting Periods – A tax year is usually 12 consecutive months. There are two kinds of tax years.

calendar tax year -This is a period of 12 consecutive months beginning January 1 and ending December 31.

fiscal tax year -This is a period of 12 consecutive months ending on the last day of any month except December.

Accounting Methods – An accounting method is a set of rules used to determine when and how income and expenses are reported. An organization chooses an accounting method when it files its first annual return. There are two basic accounting methods:

cash method - Under the cash method, an organization reports income in the tax year received. It usually deducts expenses in the year paid.

accrual method - Under an accrual method, an organization generally records income in the tax year earned, even though it may receive payment in a later year. It records expenses in the tax year incurred, whether or not it pays the expenses that year.

For more information about accounting periods and methods, see Publication 538 and the instructions to Forms 990 (*Return of Organization Exempt From Income Tax)*, 990-EZ (*Short Form Return of Organization Exempt From Income Tax)*, and 990-PF (*Return of Private Foundation)*.

What federal tax reports and returns must be filed?

Most tax-exempt organizations must file an annual tax-exempt organization return in the Form 990 series. Section 501(c)(3) organizations also generally file Schedule A and Schedule B, *Schedule of Contributors*, of Form 990. In addition, exempt organizations must file returns and reports generally filed by other taxpayers, such as employment tax returns.

Form 990 Series

Most 501(c)(3) organizations must file an annual return detailing their income, expenditures, and activities. All private foundations and most nonexempt charitable trusts must file Form 990-PF, *Return of Private Foundation*. Unless excepted from the annual return requirement, other 501(c)(3) organizations file Form 990, *Return of Organization Exempt From Income Tax*, or Form 990-EZ, *Short Form Return of Organization Exempt From Income Tax*. An organization may file Form 990-EZ if its gross receipts are less than $100,000 during the year, and its total assets are less than $250,000 at the end of the year. Otherwise, it must file Form 990.

Form 990 Filing Exceptions

Organizations not required to file Form 990 or Form 990-EZ are:

- churches and certain church-affiliated organizations
- certain organizations affiliated with governmental units
- organizations (other than private foundations) whose annual gross receipts are normally less than $25,000 (from sources within the U.S., for foreign organizations)
- organizations covered by a group return

See the instructions to Forms 990 and 990-EZ for complete details on filing exceptions.

Schedules A and B

Section 501(c)(3) organizations that file Form 990 or 990-EZ must file Schedule A of that return. Schedule A reports information about: compensation of officers, directors, key employees, and independent contractors; the basis for the organization's public charity classification; lobbying expenditures; and certain other activities, as noted on Schedule A instructions. Private schools must fill out a special questionnaire. Organizations must also file Schedule B if they report contributions over a certain amount on Form 990, Form 990-EZ, or Form 990-PF. See the instructions to Schedule B for complete information.

NOTE: FILING PENALTIES FOR 990 SERIES

If a return is not filed, the IRS may assess penalties on the organization of $20 per day until it is filed. This penalty also applies when filer fails to include required information or to show correct information. The penalty for a return may not exceed the lesser of $10,000 or 5 percent of the organization's gross receipts (more for organizations whose gross receipts exceed $1 million). The IRS may impose penalties on organization managers who do not comply with a written demand that the information be filed.

Form 990-T

In addition to filing Form 990, 990-EZ, or 990-PF, an exempt organization must file Form 990-T, *Exempt Organization Business Income Tax Return*, if the organization has $1,000 or more of gross receipts from an unrelated trade or business during the year. The organization must pay quarterly estimated tax on unrelated business income, if the organization expects its tax for the year to be $500 or more. Form 990-W, *Estimated Tax on Unrelated Business*

Taxable Income for Tax-Exempt Organizations, is a worksheet to determine the amount of estimated tax payments required. An organization may be subject to interest and penalty charges if it files a late return, fails to pay tax when due, or fails to pay estimated tax, if required. See Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*, Form 990-T instructions, and Form 990-W instructions for further information.

Employment Tax Returns

Like other employers, 501(c)(3) organizations that pay wages to employees must withhold, deposit, and pay employment tax, including federal income tax withholding and Social Security and Medicare (FICA) taxes. Section 501(c)(3) organizations do not pay federal unemployment (FUTA) taxes. Any person that fails to withhold and pay employment tax may be subject to penalties.

Exempt organizations do not generally have to withhold or pay employment tax on payments to independent contractors, but they may have information reporting requirements. If an organization incorrectly classifies an employee as an independent contractor, it may be held liable for employment tax for that worker. For help in determining if workers are employees or independent contractors, see Publication 15-A, *Employer's Supplemental Tax Guide*. See Publication 557 for details on employment tax exemptions for 501(c)(3) organizations generally and Publication 1828, *Tax Guide for Churches and Religious Organizations*, for employment tax exemptions for churches and church-controlled organizations.

What disclosures must a 501(c)(3) organization make?

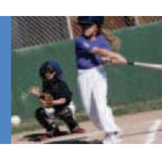
There are a number of disclosure requirements for 501(c)(3) organizations as noted below. Detailed information on federal tax law disclosure requirements for 501(c)(3) tax-exempt organizations can be found in Publication 557, on the IRS Web site at *www.irs.gov*, and in the final regulations (Treasury Decision 8818 published in the Internal Revenue Bulletin 1999-17 (April 26, 1999)).

NOTE: PENALTIES

Penalties apply to organizations that do not comply with disclosure requirements, and to persons responsible for the failure to comply.

Public Inspection of Annual Returns and Exemption Applications

A 501(c)(3) organization must make certain documents available for public inspection and copying upon request and without charge (except a reasonable charge for copying). The organization must disclose its exemption application (Form 1023) along with all supporting documents and a copy of the exemption ruling letter issued by the IRS. The IRS makes these documents available for public inspection and copying. Private foundation returns filed on or after March 13, 2000, are also subject to these disclosure rules.



Annual Information Return – An organization 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 disclose Schedule B of Form 990 or Form 990-T *and* does not need to identify its contributors. Returns need to be available for disclosure for only three years after the due date or filing date of the return, whichever is later.

Exemption Application – An organization must disclose its exemption application (Form 1023) 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
- the exemption ruling letter issued by the IRS

Certain information may be withheld from public inspection. Organizations may place reasonable restrictions on the time, place, and manner of in-person inspection and copying. Organizations may charge a reasonable fee for providing copies. For details on public inspection rules and procedures for 501(c)(3) organizations, see Publication 557 and the instructions to Forms 990 and 1023.

Sale of Free Government Information

If an exempt organization 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

There are two general rules that organizations need to be aware of to meet substantiation and disclosure requirements for federal income tax return reporting purposes:

- a donor must obtain a *written acknowledgement* from a charity for any single contribution of $250 or more before the donor can claim a charitable contribution on his or her federal income tax return.
- a charitable organization must provide a *written disclosure* to a donor who makes a payment in excess of $75 partly as a contribution and partly for goods and services provided by the organization.

See Publication 1771, *Charitable Contributions—Substantiation and Disclosure Requirements*, for details on the federal tax law for organizations such as charities and churches that receive tax-deductible charitable contributions and for taxpayers who make contributions.

IRS assistance and information

The IRS offers help through assistors and with reading material that is accessible either online, via mail, by telephone, and at IRS walk-in offices in many areas across the country. IRS forms and publications can be downloaded from the Internet and ordered by telephone.

Specialized Assistance for Tax-Exempt Organizations

Get help with questions about applying for tax exemption, annual filing requirements, and information about exempt organizations through the IRS Exempt Organizations (EO) division:

EO Web site	**www.irs.gov/eo**
EO customer service	**(877) 829-5500**
EO customer service mailing address	**Internal Revenue Service TE/GE Customer Account Services P.O. Box 2508 Cincinnati, OH 45201**

General IRS Assistance

Get materials on the latest tax laws, assistance with forms and publications, and filing information through the following IRS resources:

IRS Web site	**www.irs.gov**
federal tax questions	**(800) 829-1040**
small business federal tax questions	**(800) 829-4933**
order IRS forms and publications	**(800) 829-3676**
IRS Tax Fax	**(703) 368-9694** Dial from a fax machine, and follow voice prompts to get forms faxed back to you.

Tax Publications for Exempt Organizations

Get publications via the Internet and free through the IRS at (800) 829-3676:

Pub 15, *Circular E, Employer's Tax Guide*

Pub 15-A, *Employer's Supplemental Tax Guide*

Pub 463, *Travel, Entertainment, Gift, and Car Expenses*

Pub 538, *Accounting Periods and Methods*

Pub 557, *Tax-Exempt Status for Your Organization*

Pub 578, *Tax Information for Private Foundations and Foundation Managers*

Pub 583, *Starting a Business and Keeping Records*

Pub 598, *Tax on Unrelated Business Income of Exempt Organizations*

Pub 1771, *Charitable Contributions – Substantiation and Disclosure Requirements*

Pub 1828, *Tax Guide for Churches and Religious Organizations*

Forms for Exempt Organizations

Get forms via the Internet or through your fax machine (see IRS Tax Fax, page 16):

Form 990, *Return of Organization Exempt From Income Tax*

Form 990-EZ, *Short Form Return of Organization Exempt From Income Tax*

Form 990-PF, *Return of Private Foundation or Section 4947(a)(1) Nonexempt Charitable Trust Treated as a Private Foundation*

Schedule A, of Form 990 or 990-EZ, *Supplementary Information – Organization Exempt Under Section 501(c)(3)*

Schedule B, of Form 990, 990-EZ, or 990-PF, *Schedule of Contributors*

Form 990-T, *Exempt Organization Business Income Tax Return*

Form 990-W, *Estimated Tax on Unrelated Business Taxable Income for Exempt Organizations*

Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*

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