



*This article presents general guidelines for Ohio nonprofit organizations as of the date written and should not be construed as legal advice. Always consult an attorney to address your particular situation.*

# Navigating a Nonprofit's Tax Obligations and Exemptions

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As a nonprofit, maintaining 501(c)(3) status is essential to operational success. This status is so important because it grants nonprofits exempt status from certain taxes both at the federal and state level and allows donors to make tax-deductible contributions. During its operations, a nonprofit will encounter many tax questions that must be resolved correctly; otherwise, the nonprofit risks losing this critical 501(c)(3) status. While hundreds of questions may arise during the normal course of a nonprofit's operations, this article focuses on just a few and provides a brief overview of important tax laws that nonprofit organizations should consider.

## Federal Taxes

Generally, section 501(c)(3) of the Internal Revenue Code exempts income received by nonprofit organizations from income tax. This exemption helps nonprofits keep more of the money they generate. However, as discussed below, obtaining and maintaining 501(c)(3) status requires certain actions and there are situations where the tax-exempt status of the nonprofit does not protect its income from being taxed.

### 1. Obtaining and Maintaining 501(c)(3) Status

To become recognized as a 501(c)(3) organization, a nonprofit needs to take certain steps such as filing an application called a Form 1023. The IRS provides helpful guidance for nonprofits seeking 501(c)(3) status online. In addition to the initial application process, the nonprofit should also be aware that there are certain annual filing requirements, such as filing an annual Form 990, that must be made to continue operating as a 501(c)(3) organization.

### 2. Unrelated Business Income Tax

If a nonprofit engages in an activity outside its central purposes, this unrelated activity can complicate the organization's tax-exempt status as applied to income derived from that activity. This complication exists because the Internal Revenue Service ("IRS") might categorize this income as unrelated business income. The IRS will categorize income as unrelated business income if the primary purpose of the activity was to generate income, the activity is done frequently (i.e., the activity is not a one-time event), and the activity is *not* substantially related to furthering the exempt purpose of the organization.



Where an organization's income from unrelated business activities surpasses \$1,000.00, the organization will be required to file Form 990-T and will be subject to the Unrelated Business Income Tax ("UBIT"). If an organization expects its UBIT for the year to be \$500.00 or more, it must pay estimated tax throughout the year. For more information on how to pay estimated taxes, see Form 990-W titled *Estimated Tax on Unrelated Business Taxable Income for Tax-Exempt Organizations*.

As an example, imagine a nonprofit organization that focuses on animal well-being but tries to fundraise by selling apparel bearing the name of the organization year-round in its storefront. The IRS will likely label this apparel income as income from unrelated business activities because the income is derived from activities outside the scope of the nonprofit's activities that directly help animals. Therefore, if the nonprofit earns more than \$1,000.00 from this activity, that income will be subject to the UBIT.

### 3. Employment Taxes

501(c)(3) status does not exempt a nonprofit organization that has employees from the responsibility of Federal Income Tax Withholding and Social Security and Medicare taxes along with certain other federal employment taxes.

## State and Local Taxes

The Ohio Secretary of State does not have the power to label an organization as tax-exempt. Rather, a nonprofit's status depends on its federal status as a tax-exempt organization. Ohio's law governing tax-exempt organizations is different from the federal tax law because Ohio applies different levels of taxation and exemptions.

### 1. Sales and Use Tax Exemption

Just like any other organization, nonprofits that sell goods must obtain a vendor's license prior to engaging in the sale. Therefore, the general rule is that when a sale is made, nonprofits are required to remit sales tax to the state. However, there are certain sales tax exemptions that permit certain sales by nonprofit charitable organizations to bypass sales tax. For example, if a nonprofit only makes sales over the course of six days or less in any calendar year, those sales are generally exempted from sales tax so long as the item sold is not a motor vehicle, titled watercraft, titled outboard motor, off-highway motorcycle, all-purpose vehicle, or personal watercraft.

On the other side of the sale, the general rule is that nonprofits are exempt from paying Ohio sales and use tax on their purchases. In order to obtain this exemption, vendors typically require that the nonprofit provide a sales tax exemption form when making the purchase.

### 2. Real Property Tax Exemption

A nonprofit may also be eligible for a real property tax exemption if the use of the property meets certain criteria discussed in Ohio Revised Code section 5709.12. That is, the property is being used exclusively



for charitable or public purposes and for an activity within the scope of the nonprofit's mission. To become exempt from real property taxes, a nonprofit must file an application for exemption with the Ohio Department of Taxation. If you missed last year's deadline to file an exemption application, you still may have an opportunity to obtain an exemption. Taxpayers can look back three years prior to the year of application and request remission of overpaid property taxes.

### 3. Employment Taxes

Nonprofits should be aware that they are required to comply with Ohio's workers' compensation laws. Further, where a nonprofit has employed four or more individuals in some capacity for 20 calendar weeks, in either the current or preceding calendar year, the nonprofit will be required to comply with Ohio's unemployment tax law. Moreover, a nonprofit is responsible for payroll taxes, including federal and state withholding and Social Security taxes.

### 4. Commercial Activity Tax Exemption

The Commercial Activity Tax ("CAT") is, in simplified terms, Ohio's version of an income tax that taxes an entity's gross receipts as opposed to net income. Nonprofit organizations are exempt from the CAT. Therefore, a qualified nonprofit's income is not subject to federal income tax, nor is it subject to Ohio's CAT.

For more guidance and assistance navigating the tax laws surrounding nonprofit organizations, see the Ohio Secretary of State's guidance for nonprofits or contact a tax advisor.

## Need Legal Advice?

If you are a PBPO client and have questions regarding the content of this article, please contact us at [info@pbpohio.org](mailto:info@pbpohio.org) or (513) 977-0304.

If you are not a client but would like to apply, please contact us at [info@pbpohio.org](mailto:info@pbpohio.org) or (513) 977-0304.

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