UNDERSTANDING
Nonprofit and Tax-Exempt Status

Michigan Society of Association Executives (MSAE)

People often use *'nonprofit'* and *'tax-exempt'* as though they mean the same thing, but they do not. **Nonprofit status** usually refers to how an organization is formed under state law: it is organized for a mission-driven purpose and does not distribute profits to owners or shareholders. In Michigan, for example, the Department of Licensing and Regulatory Affairs says a domestic nonprofit corporation is formed by filing nonprofit Articles of Incorporation. **Tax-exempt status** is a separate federal tax recognition from the Internal Revenue Service that exempts the organization from federal income tax on income related to its exempt purpose. In short, nonprofit status concerns the legal structure, tax-exempt status concerns federal tax treatment.

501(c)(6): The Most Common Classification for Associations

For trade associations, chambers, and many professional societies, the most common federal tax classification is 501(c)(6). The IRS describes these organizations as business leagues and similar groups organized to promote a common business interest and improve business conditions for a line of business, rather than provide particular services to individuals. A 501(c)(6) is generally exempt from federal income tax on income tied to that exempt purpose, and it usually has more latitude than a 501(c)(3) to engage in lobbying related to its mission. However, contributions to a 501(c)(6) are not deductible for donors, though dues or payments may, in some cases, be deductible as ordinary and necessary business expenses, subject to lobbying-disclosure rules and possible proxy tax.

501(c)(3): Charitable and Educational Organizations

Some professional societies, foundations, and affiliated education or research entities are classified as 501(c)(3) organizations. These are organized and operated for charitable, educational, scientific, or similar exempt purposes, and are generally exempt from federal income tax on income related to their exempt purpose. One major difference is that contributions to a qualified 501(c)(3) may be tax-deductible for donors, making philanthropy, scholarships, research support, and educational fundraising much more feasible. In exchange for that benefit, 501(c)(3) organizations face stricter rules: lobbying must remain limited, and political campaign intervention is prohibited.

501(c)(4): Social Welfare Organizations

A less common but sometimes relevant classification is 501(c)(4). This type of organization is tax-exempt and formed primarily to advance social welfare or civic betterment. It is generally exempt from federal income tax on income related to that purpose and typically has more latitude for lobbying and some political activity than a 501(c)(3), so long as political campaign activity does not become its primary activity. Contributions to a 501(c)(4) are generally not charitable deductions. While this classification is less common for traditional associations and professional societies, it may be relevant where the organization's work is more civic or advocacy-centered.

Related Foundations, Subsidiaries, and Partner Entities

Many associations do not operate as a single entity but rather as a family of organizations. An association with a 501(c)(6) classification may also have a related 501(c)(3) foundation or educational organization to handle scholarships, research, public education, or training that is better suited to charitable treatment. Some organizations also use taxable subsidiaries or other related entities for specific activities. The key point is that structure should follow purpose: each entity's classification should reflect what it is actually organized to do, and funds cannot simply move between entities without regard to the legal rules that apply to each.

UBIT: When Tax-Exempt Does Not Mean Tax-Free

Tax-exempt does not mean exempt from every tax. Many associations and professional societies are subject to unrelated business income tax, or UBIT, when they regularly carry on a trade or business that is not substantially related to their exempt purpose. The IRS explains that the activity does not become exempt merely because the income is used to support the mission. Common examples can include selling advertising in magazines, newsletters, journals, or on the organization's website; renting or selling mailing lists; and certain other commercial activities carried out in a businesslike way. Because the rules are fact-specific, associations should not assume that all earned revenue is tax-free simply because the organization itself is tax-exempt.

Whatever the classification, the key is ensuring that the organization's structure, tax status, and activities fit together in a way that supports mission, compliance, and long-term effectiveness.