Guide to the Internal Revenue Service Decision-Making Process under Section 501(c)(3) for Journalism and Publishing Non-Profit Organizations

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http://www.citmedialaw.org/irs
ABOUT THE DIGITAL MEDIA LAW PROJECT:

The Digital Media Law Project (“DMLP”) works to ensure that individuals and organizations involved in online journalism and digital media have access to the legal resources, education, tools, and representation that they need to thrive. The DMLP began operations as the “Citizen Media Law Project” in May 2007, focusing its work on providing legal resources for citizen journalism. The project changed its name in 2012 to reflect the broader range of independent digital media ventures that it has grown to serve, including citizen media as well as professional journalists and content creators operating outside of the traditional publishing industry.

The DMLP carries out its mission through its five core initiatives: (1) maintaining a detailed legal guide on media and business law topics for non-lawyers; (2) compiling a searchable database of complaints and other legal threats directed at online publishers; (3) engaging in research and responsive activity to address breaking issues in digital media law; (4) facilitating access for online publishers to legal representation through its nationwide attorney referral service, the Online Media Legal Network; and (5) publishing regular blog entries on current issues in media law, technology law and journalism.

The DMLP is based at the Berkman Center for Internet & Society at Harvard University.

ABOUT THE BERKMAN CENTER FOR INTERNET & SOCIETY:

The Berkman Center for Internet & Society is a research center founded at Harvard Law School in 1997. Now a University-wide Center, it serves as the locus for a network of Harvard and other faculty, students, fellows, lawyers, entrepreneurs, and others working to identify and engage with the challenges and opportunities presented by the Internet. The Center is devoted to research and teaching on issues at the intersection of emerging technologies, law, public policy, industry, and education, and to the development of dynamic approaches and rigorous scholarship that can affect and support the public interest.

The Berkman Center has been at the forefront of efforts to study and facilitate online expression, including, among other initiatives: publishing Media Re:public, a series of papers exploring the potential and the challenges of the emerging networked digital media environment; launching Global Voices Online, a non-profit organization that aggregates and disseminates the views expressed in blogs throughout the world; and hosting the Blogging, Journalism, and Credibility Conference, which brought together professional journalists, bloggers, news executives, media scholars, and lawyers to study the emerging media environment on the Internet.

The Berkman Center also has been at the forefront of studying the Internet’s impact on democracy and how we can use Internet technologies to enhance economic and educational opportunities, to improve the way that we teach and learn, and to make information accessible to citizens around the world.
Introduction

In order to avoid the difficulty that for-profit news organizations can face with capitalization and profitability, many startup news outlets have elected to form as non-profit corporations. The business plan for such organizations normally depends on obtaining tax-exempt status under Section 501(c)(3) of the Internal Revenue Code, so that they can avoid payment of corporate tax and receive tax-deductible donations from foundations and individuals (among other significant benefits).

The Internal Revenue Service (“IRS”) is the United States government agency charged with determining whether applicants qualify for an exemption from taxation at the federal level (for more information on exemptions from state taxes, see p. 4, inset). The IRS applies the Internal Revenue Code as it is written by the U.S. Congress; although the IRS is granted substantial discretion to interpret the law, it is not empowered to deviate from the language of the law. In that regard, it is important to understand that Section 501(c)(3) contains no tax exemptions that are specifically intended to benefit journalism organizations. Put another way, the fact that an organization is intended to benefit the public by sharing newsworthy information is not by itself sufficient to obtain Section 501(c)(3) status. Rather, the IRS applies a complex set of federal laws, agency regulations and internal guidelines to determine whether an applicant meets the statutory definition of a tax-exempt organization.

Confusion about the IRS’s processes and standards has led to criticism of the IRS as being arbitrary in its decision-making process and adverse to the journalism industry. But while there have been controversial decisions by the IRS in particular cases, it is critical to understand that the IRS’s primary duty with respect to these applications is to protect the public fisc by ensuring that only organizations that meet criteria enacted by the United States Congress are granted a 501(c)(3) exemption. Although the IRS has some discretion in applying these criteria, it does not have the authority to recognize broad new categories of tax-exempt organizations, such as news outlets.

Until and unless there is action in Congress to facilitate tax exemptions for journalism non-profits, news organizations seeking 501(c)(3) status must learn how to structure their operations to meet the existing standards applied by the IRS. To that end, this guide is intended to provide practical information regarding the standards that the IRS applies in determining whether to grant federal tax-exempt status to a non-profit organization under Section 501(c)(3).

Note: To assist the reader, a chart that maps out the structure of the IRS’s analysis is attached to this guide as an appendix. This chart lays out the questions that the IRS might ask, from its most general lines of inquiry down to more specific considerations.

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What Rules Does the IRS Follow?

In order to understand how the IRS determines eligibility for tax exemptions under Section 501(c)(3), it is necessary to understand where the standards that the IRS applies come from. Section 501(c)(3) itself is part of a federal statute, Section 501 of Title 26 of the United States Code, and states that the following organizations are exempt from income taxation:

Corporations ... organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation ..., and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.\(^2\)

The eight purposes set forth in the statute (religious, charitable, scientific, public safety testing, literary, educational, amateur sports, and prevention of cruelty to children and animals) define the range of tax-exempt organizations under Section 501(c)(3).\(^3\) However, Section 501(c)(3) is just the starting point; these purposes have specific legal definitions, and the IRS is not free to interpret them as it sees fit. Instead, there is a complex body of law and guidance on the topic developed over the course of more than fifty years, including the following:

<table>
<thead>
<tr>
<th>SOURCE OF AUTHORITY</th>
<th>DESCRIPTION</th>
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<tbody>
<tr>
<td>Rulings by U.S. Federal Courts</td>
<td>Judges in the United States federal court system can be called upon to interpret Section 501(c)(3) and applicable regulations in the course of reviewing IRS decisions on applications for tax exemption under the statute. These rulings are normally binding on the IRS.</td>
</tr>
<tr>
<td>Rulings by the U.S. Tax Court</td>
<td>The United States Tax Court is a special court created by Congress pursuant to Article I of the U.S. Constitution to hear certain cases relating to tax issues. The decisions of the Tax Court can be appealed to the United States Courts of Appeals in the normal federal court system.</td>
</tr>
<tr>
<td>Treasury Regulations</td>
<td>First promulgated in 1960 and amended thereafter, Treasury Regulations are “issued by the Internal Revenue Service and Treasury Department to provide guidance for new legislation or to address issues that arise with respect to existing Internal Revenue Code sections.”(^4)</td>
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\(^3\) Note that Section 501(c)(3) does not itself state that exempt organizations can receive tax deductible contributions. Rather, Section 170(c)(2) of the Internal Revenue Code provides that contributions made to seven out of the eight kinds of 501(c)(3) organizations (all except “testing for public safety”) are deductible.

| IRS Revenue Rulings | “A revenue ruling is an official interpretation by the IRS of the Internal Revenue Code, related statutes, tax treaties and regulations. It is the conclusion of the IRS on how the law is applied to a specific set of facts.”\(^5\) |
| IRS Revenue Procedures | “A revenue procedure is an official statement of a procedure that affects the rights or duties of taxpayers or other members of the public under the Internal Revenue Code, related statutes, tax treaties and regulations and that should be a matter of public knowledge.”\(^6\) |
| **Legal advice provided by IRS attorneys:** |  |
| • General Counsel Memoranda | General Counsel Memoranda are non-precedential "legal memorandums from the Office of Chief Counsel ... prepared in response to a formal request for legal advice[,] They are primarily prepared ... in connection with... proposed determinations ... of the Service. ... The body of the GCM contains a lengthy legal analysis of the substantive issues, and the recommendations and opinions of the Office of Chief Counsel.”\(^7\) |
| • Technical Advice Memoranda | “A technical advice memorandum, or TAM, is guidance furnished by the Office of Chief Counsel upon the request of an IRS director or an area director, appeals, in response to technical or procedural questions that develop during a proceeding. ... Technical Advice Memoranda are issued ... [to] provide the interpretation of proper application of tax laws, tax treaties, regulations, revenue rulings or other precedents. The advice rendered represents a final determination of the position of the IRS, but only with respect to the specific issue in the specific case in which the advice is issued.”\(^8\) TAMs may also be issued by the Tax Exempt and Government Entities Division of the IRS. |
| • Chief Counsel Advice | “Chief Counsel Advice” is general term for non-precedential materials issued by the office of the IRS’s Chief Counsel containing legal opinions and advice to IRS personnel facing specific issues. |
| **Other IRS decisions:** |  |
| • Private Letter Rulings | “A private letter ruling, or PLR, is a written statement issued to a taxpayer that interprets and applies tax laws to the taxpayer's specific set of facts. ... A PLR is issued in response to a written request submitted by a taxpayer and is binding on the IRS ... . A PLR may not be relied on as precedent by other taxpayers or IRS personnel.”\(^9\) |
| • Non Docketed Service Advice Reviews | Non Docketed Service Advice Reviews constitute non-precedential determinations on tax issues directed to taxpayers in letter form. |

\(^7\) Taxation With Representation Fund v. IRS, 646 F.2d 666, 669 (D.C. Cir. 1981).
The IRS makes a large amount of the above material available on its website pursuant to the Freedom of Information Act, in its Electronic Reading Room.\textsuperscript{10}

As noted above, some of these materials (in particular certain past IRS decisions and internal advisory memoranda) are considered “non-precedential.” This means that these materials may not be relied upon by the public as a basis to argue that the IRS should grant an exemption, and may not be relied upon by the IRS as a basis for granting or rejecting an exemption. Therefore, applicants should not cite these materials to the IRS as a basis for requesting Section 501(c)(3) status. Nevertheless, these materials are informative with respect to how the IRS will apply those rules and decisions that are binding on the agency.

The following sections discuss the law and tests applied by the IRS to journalism organizations claiming a tax exemption, and the pitfalls faced by organizations in the IRS review process.

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**Note: Tax-Exempt Status under State Law**

This paper addresses the standards applied by the IRS in determining whether to grant federal tax-exempt status to journalism organizations. There is a separate issue as to whether a non-profit is exempt from taxation at the state level.

State tax exemptions depend on the laws of the specific states in which a non-profit is organized and/or operates. In general, there are five ways in which states handle their own tax exemptions:

- No corporate tax exemption for non-profits, normally because the state does not charge corporate taxes at all (there might, however, be exemptions from state sales and other taxes);
- An automatic exemption granted upon the filing of a non-profit’s articles of organization with the state;
- An automatic exemption upon the non-profit’s receipt of a federal Section 501(c)(3) exemption;
- An exemption upon formal notification of the state that the non-profit has received a federal 501(c)(3) exemption; or
- A separate state application process for tax-exempt status, independent of federal 501(c)(3) status.

A non-profit should check with the department of taxation or revenue in each state in which it operates to determine how the state handles its tax exemptions.

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\textsuperscript{10} http://www.irs.gov/foia/article/0,,id=110353,00.html (last updated December 30, 2011).
The “Organizational” and “Operational” Tests

Section 501(c)(3) directs the IRS to consider whether an applicant is “organized and operated exclusively” for one or more of the eight exempt purposes discussed above. Regulations promulgated by the Treasury Department state that this language creates two tests for exempt status, the “Organizational Test” and the “Operational Test.”

The Organizational Test

To be recognized by the IRS, an entity must be formally organized under the laws of a particular state. Although the specific procedure will vary from state to state, this will always involve the drafting and filing of organizational documents (whether referred to as “articles of organization,” “articles of incorporation,” a “charter,” “by-laws,” or another form of document). For more information on forming a non-profit organization, see the Digital Media Law Project’s Legal Guide at http://www.citmedialaw.org/legal-guide/forming-nonprofit-corporation.

However, when forming a non-profit for which you intend to seek tax-exempt status, there are separate requirements imposed by the IRS; simply forming as a non-profit entity under state law is not sufficient. Specifically, the IRS’s Organizational Test scrutinizes the purposes for which a non-profit is created and the powers granted to the non-profit in its organizational documents. The Treasury Regulations governing the Organizational Test state:

(i) An organization is organized exclusively for one or more exempt purposes only if its articles of organization (referred to in this section as its articles) ... :

(a) Limit the purposes of such organization to one or more exempt purposes; and

(b) Do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

(ii) In meeting the organizational test, the organization’s purposes, as stated in its articles, may be as broad as, or more specific than, the purposes stated in section 501(c)(3). ... [If] the articles state that the organization is formed for charitable purposes, such articles ordinarily shall be sufficient for purposes of the organizational test ...

(iii) An organization is not organized exclusively for one or more exempt purposes if its articles expressly empower it to carry on, otherwise than as an insubstantial part of its activities, activities which are not in furtherance of one or more exempt purposes, even though such organization is, by the terms of such articles, created for a purpose that is no broader than the purposes specified in section 501(c)(3). ...

(iv) In no case shall an organization be considered to be organized exclusively for one or more exempt purposes, if, by the terms of its articles, the purposes for which such

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11 Treas. Reg. § 1.501(c)(3)-1(b) (as amended in 2008).
organization is created are broader than the purposes specified in section 501(c)(3). The fact that the actual operations of such an organization have been exclusively in furtherance of one or more exempt purposes shall not be sufficient to permit the organization to meet the organizational test. Similarly, such an organization will not meet the organizational test as a result of statements or other evidence that the members thereof intend to operate only in furtherance of one or more exempt purposes.  

More succinctly, the organizational documents for a tax-exempt entity must meet a two-prong test: first, they must reflect that the entity’s purpose is no broader than the eight purposes set forth in Section 501(c)(3); and second, they must reflect that the entity has not expressly been granted powers to carry on activities outside of the scope of the Section 501(c)(3) purposes.

1. Do your organizational documents state only tax-exempt purposes?

The first prong is easily met; a non-profit can satisfy this requirement by reciting some or all of the Section 501(c)(3) purposes as its purpose in its articles of organization. A news organization should be careful if it mentions its journalistic mission in the statement of its purpose, because journalism is not automatically considered to be educational in nature. This does not, of course, mean that a 501(c)(3) organization cannot engage in journalism. However, to qualify for a tax exemption, the purpose of the organization must be one or more of the eight 501(c)(3) purposes, and journalism may be the method by which those purposes are fulfilled (instead of a purpose unto itself).

Applicants should also beware of using boilerplate language that states that the organization is created "for all legal purposes," or similar language; the scope of "legal purposes" is far broader than the scope of tax-exempt purposes.

2. Do your organizational documents grant powers inconsistent with tax-exempt purposes?

The second prong is also relatively straightforward, and simply means that the organization cannot expressly be granted powers inconsistent with the 501(c)(3) purposes. In other words, if an organization claims that it is intended for “charitable” purposes, it should not be specifically empowered to conduct other business for profit.

Note that the second prong of the Organizational Test focuses on whether any of the organization’s granted powers are expressly intended for non-exempt purposes. The United States Tax Court has stated that an applicant should not fail the second prong merely because it is granted broad powers that could be used for either exempt or non-exempt purposes; rather, the IRS should consider the actual motivations in granting those powers and how the organization has used them.  

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13 Peoples Translation Serv./Newsfront Int’l v. Comm’r, 72 T.C. 42, 48 (1979) (“The issue of ‘organized’ is primarily a question of fact not to be determined merely by an examination of the certificate of incorporation but by the actual objects motivating the organization and the subsequent conduct of the organization. ... The mere existence of power to engage in activities other than those set out in section 501(c)(3) does not in itself prevent petitioner from meeting the organizational test.”)
Because the Organizational Test might require the IRS to consider how an organization's granted powers are actually used,\textsuperscript{14} it overlaps with the Operational Test discussed in the next section. However, it is important to remember that the Operational Test does not trump the Organizational Test. If the granted powers of a non-profit \textit{explicitly} exceed the exempt purposes set forth in Section 501(c)(3), the non-profit cannot satisfy the Organizational Test by limiting itself in practice to exercising its powers in furtherance of exempt purposes.\textsuperscript{15}

\textbf{The Operational Test}

Although a journalism venture seeking tax-exempt status must satisfy both the Organizational and Operational Tests, the majority of news ventures that fail to pass IRS review stumble at the latter test. Compared to the regulations governing the Organizational Test, the Treasury Regulations defining the Operational Test are deceptively simple, stating that:

An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.\textsuperscript{16}

Interpreting the Operational Test’s potentially contradictory use of terms such as “exclusively,” “primarily” and “insubstantial,” the Tax Court has held that:

The word “exclusively” has not been literally construed to mean “solely” or “absolutely without exception,”... and ... a nonexempt purpose even perhaps somewhat beyond a de minimis level has been permitted without loss of exemption[.] ... Nevertheless, there is a limit beyond which the statute may not be stretched. ... “[T]he presence of a single [nonexempt] ... purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly [exempt] ... purposes.”\textsuperscript{17}

Unlike the Organizational Test, a journalism venture cannot satisfy the Operational Test simply by asserting that it is operating in furtherance of one or more of the eight 501(c)(3) purposes. Rather, the IRS will undertake a comprehensive review of the manner in which a venture functions to see whether it fits within the legal definition of one or more of those purposes.

In particular, a publisher cannot invoke the educational nature of its publications and expect the IRS to ignore the fact that those publications are generating significant profits. The IRS recognizes that particular activities can be undertaken in furtherance of both exempt and non-exempt purposes, and courts have held that the IRS may consider whether the non-exempt purposes of a particular activity (in particular, the generation of profits) outweigh the exempt purposes. In \textit{Fides Publishers Association v.}

\begin{footnotesize}
\textsuperscript{14} See Presbyterian and Reformed Pub. Co. v. Comm’r, 743 F.2d 148, 155 (3rd Cir. 1984) (“If, for example, an organization’s management decisions replicate those of commercial enterprises, it is a fair inference that at least one purpose is commercial, and hence nonexempt.”).

\textsuperscript{15} Treas. Reg. § 1.501(c)(3)-1(b)(1)(iv) (as amended in 2008).

\textsuperscript{16} Treas. Reg. § 1.501(c)(3)-1(c)(1) (as amended in 2008).

\textsuperscript{17} Manning Ass’n v. Comm’r, 93 T.C. 596, 603-04 (1989) (punctuation standardized) (quoting Better Business Bureau v. United States, 326 U.S. 279, 283 (1945)).
\end{footnotesize}
*United States*, the U.S. District Court for the Northern District of Indiana held that the IRS properly denied an exemption for a publisher of religious literature; although the publisher’s activity might have served an educational purpose, the court found that it was also engaging in “the publication and distribution of religious literature at a profit.”18 The court explained that requiring the IRS to disregard any non-exempt aspects of educational activity would permit every publisher to claim “an exemption on the ground that it furthers the education of the public.”19

The Treasury Regulations also state that an organization will fail the Operational Test if its earnings “inure in whole or in part to the benefit of private shareholders or individuals,”20 or if it is an “action organization” (i.e., an organization involved in advocacy, lobbying, or political campaigning).21 These limitations are important, and will be discussed further below, but the primary stumbling block for most journalism ventures applying for tax exempt status is not that they benefit private entities or engage in political activity. Instead, the most significant issue appears to be simply showing that the organization is operated within the definition of one of the exempt purposes specified in section 501(c)(3). For journalism and publishing organizations, that almost always means establishing that the organization is being operated for an “educational” purpose, as discussed in the next section.

**“Educational” Defined, and Redefined**

The majority of journalism non-profits that attempt to obtain 501(c)(3) status claim to be “educational” in nature, because that category is generally considered to be best suited to a news outlet’s purpose of disseminating truthful information to the public.22 However, it is not enough that an applicant believes that it is educational in a general sense. Journalism organizations frequently fail to receive exemptions because they either (1) fail to understand the specific legal contours of the educational category, or (2) try to stretch the category to fit their business models rather than design their business models to fit the category.

The confusion that exists over the IRS’s definition of an “educational” organization cannot be laid entirely at the feet of the applicants. Over the past fifty years, the IRS has followed (or created for itself) a number of tests in an effort to turn Section 501(c)(3)’s general reference to educational purposes into a workable objective standard, and the resulting analysis is multi-layered and complex. The following sections attempt to separate the IRS’s definition of “educational” activity into discrete elements.

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18 263 F. Supp. 924, 935 (N.D. Ind. 1967).
19 Id.
20 Treas. Reg. § 1.501(c)(3)-1(c)(2) (as amended in 2008).
22 Some news organizations also (or alternatively) claim to be “charitable” or “literary” in nature. Nevertheless, the IRS will usually apply its analysis for “educational” organizations to news outlets even when they invoke these other categories. The “literary” category, in particular, is poorly developed in IRS jurisprudence, and is normally conflated with the “educational” category. See Boris I. Bittker & Lawrence Lokken, *Federal Taxation of Income, Estates and Gifts* ¶ 100.3.8 (2011).
Distinguishing Education from Advocacy: IRS Revenue Procedure 86-43

One of the IRS’s principal tasks in evaluating publishers claiming to be “educational” is distinguishing educational organizations from those engaged in non-educational advocacy. At one time in its history, the IRS relied upon a subjective, viewpoint-based standard set forth in the Treasury Regulations for this distinction; however, that test was ruled unconstitutional in 1980 (see sidebar for more information).

Without the Treasury Regulations to guide its analysis, the IRS announced that it would follow a “methodology” test. This test, instead of focusing on the viewpoint voiced by an applicant, considers the methods an applicant uses in conveying its message. The methodology test was eventually codified in 1986 in Revenue Procedure 86-43:

[Section 3].03 The presence of any of the following factors in the presentations made by an organization is indicative that the method used by the organization to advocate its viewpoints or positions is not educational.

1. The presentation of viewpoints or positions unsupported by facts is a significant portion of the organization's communications.
2. The facts that purport to support the viewpoints or positions are distorted.
3. The organization's presentations make substantial use of inflammatory and disparaging terms and express conclusions more on the basis of strong emotional feelings than of objective evaluations.
4. The approach used in the organization's presentations is not aimed at developing an understanding on the part of the intended audience or readership because it does not consider their background or training in the subject matter.

[Section 3].04 There may be exceptional circumstances, however, where an organization's advocacy may be educational even if one of more of the factors listed in section 3.03 are present. The Service will look to all the facts and circumstances to determine whether an

Historical Note: The Treasury Regulations’ Definition of “Educational”

Normally, the first place to turn when interpreting section 501(c)(3) is the Treasury Regulations, and indeed the Regulations do contain a definition of “educational”:

(3) Educational defined--(i) In general. The term educational, as used in section 501(c)(3), relates to:

(a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or
(b) The instruction of the public on subjects useful to the individual and beneficial to the community.

An organization may be educational even though it advocates a particular position or viewpoint so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion. On the other hand, an organization is not educational if its principal function is the mere presentation of unsupported opinion.

Treas. Reg. § 1.501(c)(3)-1(d)(3)(i) (as amended in 2008). The Regulations also include a non-exclusive list of examples of “educational” activities, including: (i) operation of traditional schools, with a regular curriculum, faculty and enrolled body of students; (ii) presentation of public discussion groups, forums, panels, lectures, or similar programs, including by radio or television; (iii) offering remote learning via correspondence or utilization of TV or radio; or (iv) operation of cultural centers

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organization may be considered educational despite the presence of one or more of such factors.\textsuperscript{23}

Revenue Procedure 86-43 survived a First Amendment challenge in court, with the Tax Court ruling that the “methodology” approach does not suffer from the same issues that rendered the definition of “educational” in the Treasury Regulations unconstitutional.\textsuperscript{24}

\textbf{A General Definition of Education: IRS Revenue Ruling 67-4}

Although the methodology test of Revenue Procedure 86-43 provides a framework for distinguishing advocacy from education, it is of limited use as a generally applicable test of whether a publisher’s operations are “educational.” In 2006, the office of the Chief Counsel of the IRS (in a non-precedential advisory memorandum) suggested that the first three factors of Revenue Procedure 86-43 normally relate to whether an organization is engaged in advocacy rather than education, and that only the fourth factor – whether the approach in a publication or presentation considers the audience’s background or training – relates to whether content is educational in nature.\textsuperscript{25}

Plainly, the fourth factor of the methodology test is insufficient by itself to determine whether a publisher is engaged in educational activity. Instead, the IRS has looked to its own precedents – most significantly, Revenue Ruling 67-4,\textsuperscript{26} in which the agency ruled upon an application filed by an organization engaged in publishing scientific and medical literature. In that decision, the IRS stated:

\begin{quote}
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such as museums, zoos, planetariums, and symphony orchestras. Treas. Reg. § 1.501(c)(3)-1(d)(3)(ii) (as amended in 2008).

The Treasury Regulations thus attempted to accomplish two goals: to define “educational” activity generally, and then specifically to distinguish “advocacy” that does not fall within the “educational” category. They were, for the most part, not successful. Although the examples included are somewhat useful, the general definition of “educational” set forth in the Regulations is so vague as to be nearly useless.

In fact, in the 1980 case of \textit{Big Mama Rag, Inc. v. United States}, the U.S. Court of Appeals for the District of Columbia Circuit ruled that that the definition was constitutionally defective. Because the definition allowed the IRS wide subjective discretion as to which organizations would be deemed “educational,” the court held that it violated the First Amendment to the U.S. Constitution. In particular, the court found that the Regulations’ reference to a “full and fair exposition of pertinent facts” enabled the IRS to unlawfully discriminate against viewpoints of which it disapproved. 631 F.2d 1030, 1035-39 (D.C. Cir. 1980).

The \textit{Big Mama Rag} decision was a turning point in the IRS’s consideration of publishing organizations, requiring the IRS to rethink its standards as discussed in the main text.

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\textsuperscript{24} Nationalist Movement v. Comm’r, 102 T.C. 558, 588-89 (1994).

\textsuperscript{25} I.R.S. Chief Couns. Adv. 2006-20001 (May 9, 2006).

\textsuperscript{26} As stated above, a “Revenue Ruling” is a decision by the IRS in a particular case, setting forth principles of law that are binding upon the IRS in future cases. A “Revenue Procedure,” in contrast, is a generally applicable statement of standards and procedures that the IRS will follow, and is not tied to the facts of a particular case.
An organization ...may qualify for exemption from Federal income tax under section 501(c)(3) of the Code if

(1) the **content** of the publication is educational,

(2) the **preparation** of material follows methods generally accepted as ‘educational’ in character,

(3) the **distribution** of the materials is necessary or valuable in achieving the organization’s educational and scientific purposes, and

(4) the manner in which the distribution is accomplished is **distinguishable from ordinary commercial publishing practices**.27

This four-part test forms the framework for the majority of IRS decisions regarding journalism organizations, and each element will be discussed in turn below.

1. **Is the content of the publication educational?**

Both prior to and following Revenue Ruling 67-4, the IRS considered a number of factors to determine whether the content of a particular publication was educational in nature.

In Revenue Ruling 66-220, issued in 1966, the IRS determined that a non-profit broadcasting station, which disseminated music, literary productions, news reports, lectures, and discussions on subjects of interest to the community, qualified for a tax-exemption. The IRS reached this result by comparing the broadcaster’s content to examples of educational organizations set forth in the Treasury Regulations (specifically, the example of an organization involved in offering “public discussions, forums, lectures, panels, and other similar programs broadcast on radio and television”).28 Although the Treasury Regulations' specific definition of "educational" content was held unconstitutional in 1980 (see p. 9, sidebar), the examples of educational content contained in the Regulations are still informative.

Later the same year, the IRS distinguished these kinds of broadcasts from “the expression of opinion with little or no relevant factual material,” in a “style...similar to that of newspaper columnists” with “topics rang[ing] over the entire field of current events.”29 In opining that an organization engaged in such activity would not qualify for an exemption, the Chief Counsel of the IRS wrote that such material “could hardly be said [to represent] the use of traditionally accepted methods of education,” or “to be in substantial conformity with the standards observed by regularly established educational institutions[.]”30

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30 Id.
In 1983, the U.S. Court of Appeals for the D.C. Circuit acknowledged that some evaluation of the plausibility of an organization’s message might be necessary when considering whether the content of its publications are educational. Thus, in *National Alliance v. United States*, the Court of Appeals affirmed the IRS’s denial of a tax exemption for the National Alliance, a white separatist political organization, stating that “[a]s the truth of [a] view asserted becomes less and less demonstrable, ‘instruction’ or ‘education’ must ... require more than mere assertion and repetition.” Although likely driven by the court’s abhorrence for the National Alliance’s message, this decision does indicate that a publisher can expect greater scrutiny when its content appears either to consist primarily of opinion or to contradict generally accepted fact.

The fourth factor of the Revenue Procedure 86-43 “methodology” test is also relevant in this context; namely, whether the “approach used in the organization’s presentations is not aimed at developing an understanding on the part of the intended audience or readership because it does not consider their background or training in the subject matter.” The IRS has specifically considered whether methods claimed to be educational “provide an effective means for the increased diffusion and application of knowledge ... [through] analysis as well as imparting substantive knowledge[.]”

The U.S. Tax Court held in 1988 that the publication of a magazine by a fraternity was not educational because, even if the content conveyed information or provided instruction to the fraternity’s members, that was not the type of public benefit contemplated by Section 501(c)(3): “Whether a purpose is educational has been interpreted to be more than conveying information or providing instruction. ... An educational purpose is served only where a public interest, rather than a private interest of the petitioning organization, is the primary beneficiary of the educational activity.”

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Considering decisions such as those collected above, the IRS’s determination as to whether content is “educational” may consider the following factors:

- **Format** – is information conveyed in a method similar to the examples set forth in the Treasury Regulations (“public discussions, forums, lectures, panels, and other similar programs”)?
- **Support** – is the information presented with factual support commensurate to the nature of the message being conveyed, or is it being presented as unsupported opinion (in a manner suggesting advocacy)?
- **Instructional method** – does the material include both factual information and analysis of the facts?
- **Tailoring** – does the presentation of the information take into account the audience’s background or training in the subject matter?
- **Targeting** – does the education or instruction support a public interest, or does it primarily serve the members of the organization seeking the tax exemption?

The IRS has also recognized that some content not meeting these standards might be permissible if it assists an organization to reach an audience for other more educational content. In a 1987 Technical Advice Memorandum, the Office of the Chief Counsel stated that a non-profit organization operated to disseminate health and nutrition information would not lose its 501(c)(3) status after it acquired a magazine containing some non-educational content, because the magazine was used to promote the organization’s educational mission:

> It is our conclusion that the publication of [the magazine] ... does further the goals of [the non-profit], and that the magazine clearly assists [the non-profit] in its implementation of its educational and scientific programs. ... Admittedly, [the magazine] contains many features that do not further the health related goals of [the non-profit], but we believe that the mix of general material and health material serves the purpose of enabling [the non-profit] to reach that segment of the population that it desires to provide with health information. ... [O]ur examination of [the magazine] for the years involved indicates that the health and nutrition material presented is educational in content[.]

Accordingly, inclusion of content that is not strictly educational in nature might still be held to serve an educational purpose. However, the IRS is unlikely to find that content is educational as a whole if opinion and entertainment content outweighs the educational content in a publication, or constitutes an independent, substantial purpose for the publication.

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35I.R.S. Tech. Adv. Mem. 87-51-007 (September 14, 1987). Notably, the non-profit at issue also regularly donated space in the magazine to publicize and promote its other educational activities, used the magazine to conduct a series of medical surveys, and used responses to the surveys in part to help direct people to medical care.
2. Does the preparation of material follow methods generally accepted as educational in character?

There is little guidance on this element of the four-part test, although one General Counsel Memorandum from 1982 indicates that that the following facts support a finding that a publication is prepared in an “educational” manner:

(1) the organization is run by experts in the relevant field;
(2) the selection process for articles depends on their educational value rather than commercial appeal;
(3) the articles focus on issues of public policy rather than issues of mass appeal; and
(4) the articles are written by leading authors, journalists, professors and educators. 36

Considering these factors, investigative news organizations and organizations that conduct expert statistical research or analysis are likely to fare better than news organizations publishing articles of general public appeal. If an applicant has highly-trained journalists, researchers, or other experts on staff, it will be important to call that fact to the IRS’s attention.

The IRS has denied at least one 501(c)(3) application from a newspaper because (among other reasons) it found the paper’s staff to be indistinguishable from that of an ordinary newsroom, stating: “The newspaper operates with a paid staff. The staff has no special skills and abilities than those that are generally found on the staff of any other newspaper.” 37

3. Is the distribution of the materials necessary or valuable in achieving the organization’s educational purposes?

This element is likely to be met by an organization whose primary activity is the publication of material. As one federal district court has stated, “Certainly there is no better way to capture the attention of a widely dispersed public. The publication of literature is, concededly, the common method in carrying out the religious and educational purposes of any exempt organization.” 38 More explanation might be required, however, for an organization engaged in various charitable activities that publishes content as just one part of its work.

4. Is the manner in which the distribution is accomplished distinguishable from ordinary commercial publishing practices?

The last factor under the four-part test set out in Revenue Ruling 67-4 is perhaps the most controversial, and reflects the IRS’s attempt to draw a line between (a) non-profit publishing and (b) for-profit publishing that simply fails to make any money.

In 1982, the IRS General Counsel's Office issued a memorandum summarizing the kinds of activity that the IRS would characterize as indistinguishable from commercial operations:

37 Rev. Rul. 77-4, 1977-1 C.B. 141.

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Practices which have been considered to reflect a purpose to engage in publishing operations for ordinary commercial gain are: (1) conducting as its sole activity publishing activities using standard commercial techniques which generate ongoing profits; (2) pricing its materials ‘competitively’ with other commercial publications or to return a profit; (3) conducting an enterprise in a manner in which all participants expect to receive a monetary return; (4) publishing its materials almost exclusively for sale, with only a de minimis amount of material donated to charity; (5) existing or accumulating large profits; and accumulating profits from sales activities which are greatly in excess of the amounts expended for educational programs.\(^{39}\)

Notwithstanding this attempt at clarification, a review of IRS and court rulings on this issue demonstrate that the agency’s analysis generally reduces to two issues: (a) whether the organization is using traditionally commercial models for generating revenue (such as advertising and subscriptions); and (b) the profitability of the organization.

(a) Use of Commercial Revenue Models

There is significant confusion over the ability of a non-profit to rely upon advertising and other traditional commercial models for revenues. This is likely because the IRS recognizes that some 501(c)(3) organizations will generate revenue from methods unrelated to their exempt purpose, and requires an otherwise tax-exempt organization to pay tax on such “unrelated business taxable income.”\(^{40}\) Some applicants have therefore inferred that a tax-exempt organization is free to earn revenue from advertising, etc., so long as it pays taxes on that income.

This view is not entirely correct. In fact, the taxability of advertising and other commercial revenues is distinct from the more fundamental question of whether the use of such revenue models demonstrates a commercial motive that will disqualify a non-profit from 501(c)(3) status (see p. 17, sidebar). The U.S. Tax Court has stated that “[w]hile the sale of advertising space will not automatically disqualify a journal from tax-exempt status ..., the absence of advertisements in the bulletin underscores petitioner’s lack of commercial intent.”\(^{41}\)

The IRS has been particularly consistent in rejecting applications from publishers of newspapers and newsletters whose revenue models track those of their for-profit counterparts. In Revenue Ruling 77-4, the IRS decided that an “ethnic-oriented” newspaper was not operated for “educational” purposes because of its financial and revenue structure (despite its lack of profits):

The organization is a nonprofit corporation the only activity of which is the publication and distribution of a weekly newspaper that presents local, national, and world news. The pages of the newspaper are equally divided between community interest items of significance to the members of a certain ethnic group, national and international news articles of special interest to the members of the group, and regular commercial advertising. It also republishes syndicated editorials. The newspaper operates with a paid staff. ... The corporation’s income is derived from the sale of advertising and the sale of subscriptions to the general public. Its primary expenses are the payment of

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**Footnotes:**

41 Peoples Translation Serv., 72 T.C. at 50.
wages and printing costs. Although the organization has been in existence several years, it has yet to realize a profit from its operations. ... This organization's only activities are preparing and publishing a newspaper, soliciting advertising, and selling subscriptions to that newspaper in a manner indistinguishable from ordinary commercial publishing practices. Accordingly, it is not operated exclusively for charitable and educational purposes and thus does not qualify for exemption from Federal income tax under section 501(c)(3) of the Code.\textsuperscript{42}

The IRS has similarly and repeatedly denied exemptions based upon the nature of the revenues earned by a publishing organization in later cases:

- The operation of a newspaper was found to be indistinguishable from commercial practices and ineligible for an exemption where “income appears to be derived from 1) sales of the newspaper; 2) advertisements; and 3) subscription fees.”\textsuperscript{43}

- A non-profit formed “for the publication of a newsletter and other publications to disseminate civic, social, business and other news and information and to otherwise serve the welfare and best interests of the ... community” was denied an exemption; although the newsletter would be distributed for free, a set percentage of each page was allocated for advertising and the organization received no contributions or grants.\textsuperscript{44}

- Denying an exemption to a free community newspaper to unite “men and women in social work,” the IRS stated, “Although you will not sell subscriptions to your newspaper, you anticipate that you will be substantially supported by selling advertisements. Thus the operation of your newspaper is indistinguishable from many ordinary publishing practices.”\textsuperscript{45}

- A non-profit organized to publish never-before-published works from well known children’s authors in serial format through newspapers was denied a 501(c)(3) exemption: “The financial information, regardless of your characterization, does not indicate that your fees are very distinguishable from those any book owner or publisher would charge for publication in a similar matter. In fact you have modified your fee structure to be able to become more competitive.”\textsuperscript{46}

In contrast, organizations that avoid advertising, subscription fees, and other such models are much more likely to be found to be operating in a non-commercial manner. For example, in Technical Advice Memorandum 98-35-003, the IRS found that a non-profit organized to provide consumer awareness and protection through radio programming did not lose its 501(c)(3) exemption as a result of a change of the focus of its programming, where such changes were insubstantial and the content was not being exploited for profit:

\textsuperscript{42} Rev. Rul. 77-4, 1977-1 C.B. 141.
\textsuperscript{44} I.R.S. Non Docketed Serv. Adv. Review 1856R (Feb. 18, 1988).
So, Are a Non-Profit Organization’s Advertising Revenues Taxable?

As discussed above, if a tax-exempt organization is allowed to generate revenues through advertising, a separate question arises as to whether the non-profit must pay taxes on those revenues as “unrelated business taxable income.”

In United States v. American College of Physicians, the Supreme Court of the United States considered this question and held that there is no per se rule that the advertising revenues of an otherwise tax-exempt publication are taxable. 475 U.S. 834, 846-47 (1986). Rather, advertising revenue will not be taxable if the non-profit’s “business of selling advertising space is ‘substantially related’ – or, ... ‘contributes importantly’ – to the purposes for which [the taxpayer] enjoys an exemption from federal taxation.” Id. at 847.

Regarding the specific medical journal at issue, the Supreme Court affirmed the trial court’s determination that “[the publisher] did not use the advertising to provide its readers a comprehensive or systematic presentation of any aspect of the goods or services publicized. Those companies willing to pay for advertising space got it; others did not ... Some ads even concerned matters that had no conceivable relationship to the [publisher’s] tax-exempt purposes.” Id. at 849. Accordingly, the Court held that the advertising was not related to the

continued on next page

[Taxpayer]’s format has been modified from the original consumer education program to include other matters. However, all programming of this nature is insubstantial. In addition, there are no syndicated shows, no advertising sales and no charges for other stations to purchase the show. Therefore, [Taxpayer]’s radio programming and other consumer education activities are not being operated in a commercial manner so as to preclude exemption under section 501(c)(3) of the Code.47

Charging customers subscription fees and using other traditional for-profit revenue models is more likely to be acceptable to the IRS where a non-profit can show that its efforts at non-profit fundraising have been unsuccessful. Thus, in Pulpit Resource v. Commissioner, the Tax Court held that the publisher of “Pulpit Resource” was entitled to an exemption notwithstanding operating on a subscription fee basis:

Apparently, the only way petitioner could accomplish its objective ... was by selling Pulpit Resource at a price sufficient to pay for its cost and provide [its founder] with a reasonable salary. It apparently received few, if any, contributions and a contest for best sermons met with little financial success. There is no evidence that petitioner was in competition with any commercial enterprise conducting the same business activity. The market for petitioner’s product was so limited in scope that it would not attract a truly commercial enterprise. While the petitioner projected a profit from its sales for 1977, the amount was small and it was dedicated to be used for religious purposes.48

Accordingly, a journalism organization is more likely to pass scrutiny for “commercial operation” if it can avoid using advertising, subscription fees, and similar revenue-generating activity, and instead rely on traditional non-profit fundraising. Moreover, even a failed attempt to rely on fundraising might help to establish that use of ordinary commercial revenue models is necessary, particularly if advertising, etc., are used to make up the shortfall from fundraising rather than substitute for fundraising entirely.

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publisher’s educational purposes and that the revenue derived from the advertising was taxable. Id. But the Court noted that a publisher might control its publication of advertisements in such a way as to reflect an intention to contribute importantly to its educational functions. By coordinating the content of the advertisements with the editorial content of the issue, or by publishing only advertisements reflecting new developments in the [field], for example, perhaps [a publisher] could satisfy the stringent standards erected by Congress and the Treasury.

Id. at 849-50. This would, however, require interaction between the editorial and business sides of a news venture in a manner that could raise ethical concerns. The editorial staff would need control over advertising to ensure that the advertising directly serves the educational mission. In addition, an organization publishing news on a wide range of topics, rather than a single “field” of educational content, might find it difficult to satisfy these requirements.

(b) Profitability

The IRS is particularly concerned with determining whether an organization’s “exempt purpose transcends the profit motive rather than the other way around.”49 However, the mere fact that a venture is not profitable is not determinative of whether exempt purposes exceed profit motives. Although operation at a loss and at a small scale are at least indicative of operation for a charitable or other tax-exempt purpose, the IRS will investigate whether a lack of profits is merely the result of poor business planning as opposed to charitable intent.50

Thus, in Revenue Ruling 77-4, the fact that a newspaper had been operating without a profit for several years was not sufficient to support a finding of non-commercial operation where it was otherwise indistinguishable from a for-profit business.51 In contrast, the fact that a non-profit organization shows substantial accumulated profits may be enough for the IRS to deny or revoke an exemption.52 The IRS will carefully consider an accumulation of profits to determine whether it is the result of commercial activity or an unpredicted rise in interest in the organization’s materials.53

Rulings in which subscription fees and advertising have been found not to bar an exemption generally involve close attention to whether those revenues cover or exceed costs. While “[f]urnishing ... services at cost lacks the donative element necessary to establish ... activity as charitable,” charging subscription fees below cost can support a finding of non-commercial intent.54 Thus, the IRS ruled that a non-profit publisher of religious literature was tax-exempt, despite its reliance on advertising and subscriptions, where those revenues were not sufficient to support its operations:

49 Elision Guild, Inc. v. United States, 412 F.2d 121, 124 (1st Cir. 1969).
50 Id. at 125.
51 Rev. Rul. 77-4, 1977-1 C.B. 141.
52 Incorp. Trustees of Gospel Worker Soc’y v. United States, 510 F. Supp. 374 (D.D.C. 1981), aff’d w/o opinion, 672 F.2d 894 (D.C. Cir. 1981) (publisher of nondenominational religious literature lost 501(c)(3) exemption based upon substantial accumulated profits, abrupt increase in salaries of its top personnel and fact that publisher was in direct competition with commercial publishers).
53 See Presbyterian and Reformed Publ’g Co., 743 F.2d at 157-59 (where non-profit organization had historically required donations to meet costs, sudden accumulation of profits due to unanticipated demand for books published by organization would not cause organization to lose exempt status, particularly where accumulated profits would be used to expand exempt activities).
54 Peoples Translation Serv., 72 T.C. at 49-50. See also Pulpit Resource, 70 T.C. at 610-11 (charging subscription fees that are low, but not below cost, “suggests a commercial as opposed to a charitable purpose”).
The organization is not operated in an ordinary commercial manner. Subscriptions are procured through the cooperation and effort of individual churches and church-associated groups. Although the organization receives substantial income from the sale of subscriptions and advertising space, such revenue does not cover its costs of operations. It must depend upon contributions to make up the difference. No earnings inure to the benefit of any private shareholder or individual.\textsuperscript{55}

Despite this preference for keeping revenues from advertising and subscriptions below cost, “it has been recognized that it is often necessary for an organization to earn a profit from a business activity in order to carry out its charitable purpose.”\textsuperscript{56} In \textit{Pulpit Resource}, the Tax Court held that a modest profit made by a religious publisher from subscription fees did not disqualify it for a tax exemption, where the record reflected that the publisher had attempted but failed to raise funds in other ways and donated its profits to charity.\textsuperscript{57}

Similarly, the IRS ruled that a non-profit organization operated to disseminate a health and nutrition magazine did not lose its 501(c)(3) status after its acquisition of a magazine, despite fact that the magazine generated substantial revenues through subscription fees and newsstand sales, and carried paid advertising that covered costs:

An important distinguishing feature is that [the magazine] is not operated to produce a profit. Prices are set at a rate that covers costs. [The magazine]'s expenses include costs which a commercially oriented magazine would never have. The best example is the expense incurred in conducting its frequent reader participation surveys, tabulating the results, analysis of results, and the expense of notification of readers who are at particularly high risk with regard to a specific disease or condition. To our knowledge, [the magazine at issue] is unique, and is consequently not in competition with other publications. [The publisher] does not advertise its magazine. It does accept commercial advertising, but does not accept the advertisements of products that it considers to be medically harmful. Consequently, it receives no revenue from the two most lucrative sources of advertising income - tobacco and alcohol advertising.\textsuperscript{58}

It was clearly relevant to the IRS’s determination that the advertising was tailored to the educational message of the organization and that advertising revenues were used to pay for extraordinary costs associated with the development of educational content.

\textsuperscript{56} \textit{Pulpit Resource}, 70 T.C. at 611.
\textsuperscript{57} Id. at 611-12.
Private Benefits

Section 501(c)(3) and the relevant provisions of the Treasury Regulations state explicitly that an organization does not qualify for a tax exemption if it is operated in whole or in part for the benefit of persons with a private and personal interest in the activities of the organization. In the context of journalism non-profits, this issue is ordinarily addressed through the four-part test set forth in Revenue Ruling 67-4, the fourth part of which asks whether a journalism or publishing non-profit operates in a manner “distinguishable from ordinary commercial publishing practices.”

Partnering With For-Profit Organizations

A complicating factor is that journalism non-profits often collaborate with for-profit businesses or work through for-profit channels to achieve their exempt purposes. For example, a non-profit news outlet might distribute its content to a regular commercial broadcaster for dissemination. Such interaction with for-profit businesses will not automatically disqualify a non-profit for exemption, but the non-profit should be careful to keep the line between its operations and those of its partners clear.

In 1980, the U.S. Tax Court clarified that some partnerships with for-profit organizations are appropriate. In Plumstead Theatre Society, Inc. v. Commissioner of Internal Revenue, the Tax Court reviewed a limited partnership between Plumstead Theatre Society (a non-profit theater production company), two individuals, and a for-profit corporation to produce a theatrical show at the Kennedy Center, after the IRS denied Plumstead a tax exemption. The Tax Court reversed the IRS ruling, finding that Plumstead had kept its charitable operations distinct from the profit motives of its partners:

After entering into an agreement with the Kennedy Center, petitioner [Plumstead] discovered it was in need of funds for its share of the capitalization costs of [the show]. The record shows that in an arm’s-length transaction, it obtained those funds by selling a portion of its interest in the play itself, for a reasonable price. Petitioner is not obligated for the return of any capital contribution made by the limited partners from its own funds, and the partnership has no interest in petitioner or in any other plays it is planning to produce. The limited partners have no control over the way petitioner operates or manages its affairs, and none of the limited partners nor any officer or director of [the for-profit company] is an officer or director of [the non-profit].

Similarly, in 2001 the IRS determined that a non-profit producer of educational media could carry out its purposes by syndicating its content to both non-profit and for-profit broadcasters:

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59 See 26 U.S.C. § 501(c)(3) (“no part of the net earnings of which inures to the benefit of any private shareholder or individual”); Treas. Reg. § 1.501(c)(3)-1(c)(2) (as amended in 2008) (“An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.”). “Private shareholder or individual” is in turn defined as referring to “persons having a personal and private interest in the activities of the organization.” Treas. Reg. § 1.501(a)(1)-1(c) (as amended in 2008).


61 Plumstead Theatre Soc’y, Inc. v. Comm’r, 74 T.C. 1324 (1980), aff’d, 675 F.2d 244 (9th Cir. 1982) (per curiam).

62 Id., 74 T.C. at 1333-34.
The Service has also accepted the view that organizations ... exempt under section 501(c)(3) of the Code may carry out their charitable purposes through other organizations, including organizations not exempt under section 501(c)(3).

... Through [the non-profit] 's video production and satellite uplink transmission services, [the non-profit] will be providing the general public with the opportunity to view programs of an educational, cultural, and informative nature on public access channels and commercial network news television programs. The service contributes importantly to the accomplishment of [the non-profit]’s educational purposes within the meaning of sections 1.501(c)(3)-1(d)(3) and 1.513-1(d)(2) of the regulations.63

In 2004, in a case involving the dissemination of teacher training seminars through partnership with a for-profit company specializing in interactive video training, the IRS confirmed that such partnerships are acceptable so long as they do not compromise the non-profit’s tax-exempt purpose:

A § 501(c)(3) organization may form and participate in a partnership and meet the operational test if 1) participation in the partnership furthers a charitable purpose, and 2) the partnership arrangement permits the exempt organization to act exclusively in furtherance of its exempt purpose and only incidentally for the benefit of the for-profit partners.64

However, the IRS will deny an exemption where it cannot distinguish between the operations of a non-profit and a related for-profit. In 2010, the IRS ruled that an online social networking service that was formed to encourage charitable activity did not qualify for a section 501(c)(3) exemption, because its operations were indistinguishable from those of its for-profit subsidiary. The IRS explained its decision to the non-profit as follows:

[Y]ou will operate for the more than insubstantial non-exempt purpose of benefitting your proposed for-profit subsidiary. ... Your actual activities consist of aggregating news articles from online sources through your website and then linking them to a variety of needs posted by organizations exempt under section 501(c)(3) of the Code. ... [I]t is difficult to distinguish between your activities and the activities of your proposed for-profit subsidiary. ... [I]t appears that both you and your for-profit subsidiary will assist non-profit organizations and news organizations and connect them both to the general public, while using your technology. While your for-profit may also provide additional services (e.g., B-to-B services), there is little meaningful separation between the activities you and your for-profit subsidiary will engage in. ... Further, a comprehensive review of the facts indicates that your for-profit subsidiary will benefit substantially from your operations, which is not allowed under section 501(c)(3) of the Code.65

The bottom line is that non-profit organizations may work with and through for-profit businesses without being disqualified under section 501(c)(3), but must be careful that their operations do not merge with for-profit concerns such that it appears the non-profit is being operated for the purpose of benefitting the for-profit.

Political Activity and “Action Organizations”

In addition to the IRS’s general consideration of whether a non-profit’s content crosses the boundary between educational content and non-educational advocacy, there are also significant specific limitations on the ability of tax-exempt organizations to participate in political activity. This includes the type of political endorsements which are a typical function of commercial news outlets.

Section 501(c)(3) itself states that the tax exemption for charitable, educational, etc. organizations only applies to those organizations

no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation ... and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.66

This prohibition has two distinct parts. First, a tax exempt organization may not devote a “substantial part” of its activities to attempting to influence legislation. Second, a tax exempt organization is completely barred (even in insubstantial ways) from supporting or opposing candidates for public office. The IRS is particularly concerned about this latter prohibition during election years, and clarified its position in a 2004 news release:

These organizations cannot endorse any candidates, make donations to their campaigns, engage in fund raising, distribute statements, or become involved in any other activities that may be beneficial or detrimental to any particular candidate. Even activities that encourage people to vote for or against a particular candidate on the basis of nonpartisan criteria violate the political campaign prohibition of section 501(c)(3).67

The Treasury Regulations characterize those entities that engage in lobbying, propaganda or political campaigns (and that are thereby disqualified from a tax exemption) as “action organizations”:

[1.501(c)(3)-1(c)(3)](ii) An organization is an action organization if a substantial part of its activities is attempting to influence legislation by propaganda or otherwise. For this purpose, an organization will be regarded as attempting to influence legislation if the organization:

(a) Contacts, or urges the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation; or

(b) Advocates the adoption or rejection of legislation.

The term legislation, as used in this subdivision, includes action by the Congress, by any State legislature, by any local council or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure. An organization

will not fail to meet the operational test merely because it advocates, as an insubstantial part of its activities, the adoption or rejection of legislation. ...

(iii) An organization is an action organization if it participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.

The term candidate for public office means an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, State, or local. Activities which constitute participation or intervention in a political campaign on behalf of or in opposition to a candidate include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to such a candidate.68

An organization will also be disqualified under the Treasury regulations as an action organization if “(a) its main or primary objective or objectives (as distinguished from its incidental or secondary objectives) may be attained only by legislation or a defeat of proposed legislation; and (b) it advocates, or campaigns for, the attainment of such main or primary objective or objectives.”69

Two Exceptions

There are two important exceptions to the general limitation on lobbying activity.

1. Non-Partisan Analysis

Treasury regulations specifically state that “engaging in nonpartisan analysis, study, or research and making the results thereof available to the public” will not disqualify an organization from an exemption.70 Thus, journalism outlets acting as non-partisan watchdogs or commentators on political issues will not be classed as action organizations because of that activity. For example, in Technical Advice Memorandum 98-35-003, the IRS found that an organization that commented on political issues and legislation was not engaged in lobbying:

It is clear that [the non-profit] engaged in various activities of a political nature. However, many of these matters were of an educational nature and were related to the overall consumer educational program carried on by [the non-profit]. In other instances specific legislation was not even pending before Congress when the activities were carried on. [The non-profit] has no political agenda and has not backed or supported any candidate for election. [The non-profit] has encouraged its audience to write to Congress and express their opinion and [the non-profit]'s publications have provided the names and addresses of Congressmen. However, [the non-profit] never dictated what its readers should say to their Congressmen.71

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70 Id.
News organizations should expect that the IRS will carefully review a non-profit’s political research and commentary to be sure that it is actually non-partisan. Note also that analysis of particular candidates for election might be deemed to be partisan if it inures to the benefit or detriment of a particular candidate, even if the analysis is neutral in tone and does not consider formal party affiliation.\(^\text{72}\)

2. Insubstantial Lobbying Activity

Although tax exempt organizations are completely barred from endorsing particular candidates or engaging in substantial lobbying activity, they are permitted to engage in an *insubstantial* amount of lobbying activity that does not support a particular candidate. The IRS applies one of two tests to determine whether a non-profit’s lobbying activity is substantial. Importantly, the non-profit has the ability to choose which test is applied, by either doing nothing or filing a form with the IRS.

(a) *The Substantial Part Test*

If the non-profit does nothing, the default test applied by the IRS will be the “Substantial Part” test:

Whether an organization’s attempts to influence legislation, i.e., *lobbying*, constitute a substantial part of its overall activities is determined on the basis of all the pertinent facts and circumstances in each case. The IRS considers a variety of factors, including the time devoted (by both compensated and volunteer workers) and the expenditures devoted by the organization to the activity, when determining whether the lobbying activity is substantial.

Under the substantial part test, an organization that conducts excessive lobbying in any taxable year may lose its tax-exempt status, resulting in all of its income being subject to tax. In addition, section 501(c)(3) organizations that lose their tax-exempt status due to excessive lobbying, other than churches and private foundations, are subject to an excise tax equal to five percent of their lobbying expenditures for the year in which they cease to qualify for exemption.

Further, a tax equal to five percent of the lobbying expenditures for the year may be imposed against organization managers, jointly and severally, who agree to the making of such expenditures knowing that the expenditures would likely result in the loss of tax-exempt status.\(^\text{73}\)

Because the “Substantial Part” test is vague and circumstance-driven, it can be difficult for an organization to be sure when it has crossed the line into engaging in substantial political activity.

\(^\text{72}\) *See Ass’n of the Bar of the City of New York v. Comm’r*, 858 F.2d 876, 879-881 (2nd Cir. 1988) (rating candidates for judicial elections held to be impermissible political intervention, even though ratings were based upon neutral criteria and did not consider party affiliation).

(b) The Expenditure Test

In the alternative, a tax-exempt educational organization may at any time file IRS Form 5768 and thereby elect to have the IRS apply the “Expenditure Test,” which provides substantially more clarity:

Organizations other than churches and private foundations may elect the expenditure test under section 501(h) [of the Internal Revenue Code] as an alternative method for measuring lobbying activity. Under the expenditure test, the extent of an organization’s lobbying activity will not jeopardize its tax-exempt status, provided its expenditures, related to such activity, do not normally exceed an amount specified in section 4911. This limit is generally based upon the size of the organization and may not exceed $1,000,000, as indicated in the table below.

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<tbody>
<tr>
<td>≤ $500,000</td>
<td>20% of the exempt purpose expenditures</td>
</tr>
<tr>
<td>&gt;$500,00 but ≤ $1,000,000</td>
<td>$100,000 plus 15% of the excess of exempt purpose expenditures over $500,000</td>
</tr>
<tr>
<td>&gt; $1,000,000 but ≤ $1,500,000</td>
<td>$175,000 plus 10% of the excess of exempt purpose expenditures over $1,000,000</td>
</tr>
<tr>
<td>&gt;$1,500,000</td>
<td>$225,000 plus 5% of the exempt purpose expenditures over $1,500,000</td>
</tr>
</tbody>
</table>

Organizations electing to use the expenditure test must file Form 5768, *Election/Revocation of Election by an Eligible IRC Section 501(c)(3) Organization to Make Expenditures to Influence Legislation*, at any time during the tax year for which it is to be effective. The election remains in effect for succeeding years unless it is revoked by the organization. Revocation of the election is effective beginning with the year following the year in which the revocation is filed.

Under the expenditure test, an organization that engages in excessive lobbying activity over a four-year period may lose its tax-exempt status, making all of its income for that period subject to tax. Should the organization exceed its lobbying expenditure dollar limit in a particular year, it must pay an excise tax equal to 25 percent of the excess.\(^{74}\)

Barring rare circumstances, the clarity of the “Expenditure Test” means that there are few drawbacks to electing this test in the event that an organization is inclined to engage in some degree of lobbying.

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Conclusion

As demonstrated above, the standards applied by the IRS to determine whether a journalism or publishing non-profit is entitled to a tax exemption are multifaceted and complex. This paper does not comment on whether these standards are appropriate, nor does it offer an opinion on whether or how these standards might be amended by the IRS or the United States Congress. That being said, any attempt to correct perceived problems with the IRS’s analysis of journalism non-profits must begin with a clear understanding of the standards that IRS currently applies and how it came to do so. It is the author’s hope that this paper will assist with that understanding.
Appendix:

Standards for Eligibility of Journalism Non-Profits for Federal Tax Exemption

Reference Chart
STANDARDS FOR ELIGIBILITY OF JOURNALISM NON-PROFITS FOR FEDERAL TAX EXEMPTION

Do you qualify for a federal tax exemption under Section 501(c)(3) of the Internal Revenue Code?

- Are you organized exclusively for tax-exempt purposes under the law of your state?
- Are your purposes, as stated in your articles of organization, exclusively tax-exempt?
- Are your granted powers consistent with your tax-exempt purposes?
- Is the content of your publication educational?
- Does the preparation of your material follow methods generally accepted as educational in character?

Do you qualify for a state tax exemption under state law?

- Are you operated exclusively for tax-exempt purposes?
- Are you operated exclusively for educational purposes?
- Is the distribution of the materials necessary or valuable in achieving your educational purposes?
- Is the manner in which the distribution is accomplished distinguishable from ordinary commercial publishing practices?
- Are you using commercial revenue streams such as advertising or subscription fees without attempting fundraising?
- Are you generating profits in a way that indicates a lack of charitable intent?

- Are your operations benefit private individuals?
- Are you working with a for-profit business to carry out your tax-exempt purpose?
- Is your political activity limited to non-partisan political research or an insubstantial amount of lobbying?
- Are you a watchdog over other media or journalism entities?

- Are you engaged in political activity?

This chart shows questions that the IRS has considered in past cases when reviewing the eligibility of journalism and publishing non-profits for a tax exemption under Section 501(c)(3) of the Internal Revenue Code. These questions are arranged hierarchically, from most general down to most specific.

This is not a flowchart. Due to the highly fact-specific nature of the IRS review process and the fact that the IRS will balance various factors, it is not possible to break down the agency's analysis into simple yes/no questions. Rather, it shows the relationships between the various questions for which the IRS will attempt to seek answers in the course of its review.

If you are allowed to use advertising, is advertising revenue taxable?