

Recent Developments to the Law of Tax-Exempt Organizations

By Robert L. Jones, III

The One Big Beautiful Bill Act (OBBBA), signed July 4, 2025, is a major tax law extending and expanding the 2017 Tax Cuts and Jobs Act (TCJA). Recent legal developments affecting tax-exempt organizations include new excise taxes on executive compensation, changes to charitable deduction rules, and increased scrutiny of donor-advised funds and international activities. Section 4960 of the Internal Revenue Code (IRC) imposes a 21% excise tax on an applicable tax-exempt organization to the extent it pays more than \$1 million in remuneration to a covered employee or pays an excess parachute payment to a covered employee. For this purpose, a covered employee generally includes one of the organization's five highest-compensated employees for the year, and once an individual becomes a covered employee, that status generally continues for future years. IRC Section 4968 applies a progressive excise tax regime for certain colleges and universities with more than 3,000 tuition-paying students. IRC Section 170 was adjusted to modify the corporate and individual charitable deductions. These are just a few of the highlights of the issues that affect tax-exempt organizations following the OBBBA.

Despite the recent changes, certain rules continue to apply to tax-exempt organizations. Those rules include the requirement to create a nonprofit corporation, trust, or association under state law, with nonprofit corporations being the most common due to their liability protection and governance structure. Proper articles of incorporation are critical and must include specific IRS-required language, including a dissolution clause. Organizations must also adopt bylaws and governance policies addressing board structure, conflicts of interest, and compliance practices. To obtain IRS recognition, most charities file IRS Form 1023, providing detailed information about their structure, activities, and finances.

In addition, maintaining tax-exempt status requires ongoing compliance, especially the annual filing of Form 990, which ensures transparency and public disclosure. Failure to file for three consecutive years results in automatic revocation. IRC Section 501(c)(3) organizations face strict limits on lobbying and an absolute prohibition on political campaign activity. They may also be subject to unrelated business income tax (UBIT) if they generate income from activities unrelated to their exempt purpose.

The recent changes did not affect the continuing requirement that organizations avoid private inurement and excessive private benefit. The current rules and regulations require that insiders, such as directors or officers, not receive unreasonable compensation or personal advantages from the organization's assets. Intermediate sanctions allow the IRS to impose excise taxes on improper transactions rather than immediately revoking exemption, which can be the ultimate penalty in such circumstances. Strong governance practices, including independent board oversight and documentation, help ensure compliance with the fiduciary duties of board members and officers of tax-exempt organizations, including the duties of care, loyalty, and obedience.

All IRC Section 501(c)(3) organizations are presumed to be private foundations unless they meet certain public support tests under IRC Section 509(a). Private foundations are subject to stricter rules, including excise taxes, minimum distribution requirements, and prohibitions on self-dealing and lobbying. Public charities, by contrast, must maintain sufficient public support to retain their status.

Additionally, IRC Section 508 still imposes certain notice and operational rules on tax-exempt organizations. New IRC Section 501(c)(3) organizations must file Form 1023/1023-EZ within 27 months from the date of formation. The IRC still exempts churches, conventions of churches, and very small organizations from some of these requirements. However, without recognition, contributions may not be deductible under IRC Section 170, even if the organization otherwise qualifies under IRC Section 501(c)(3).

The recent changes continue to emphasize that forming and maintaining a tax-exempt organization requires careful planning, strict compliance, and ongoing governance oversight.



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continued on next page

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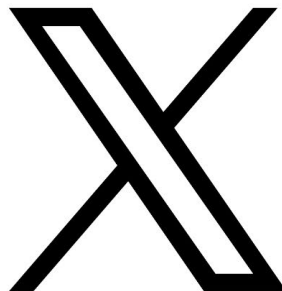


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