

UNDERSTANDING PRIVATE BENEFIT AND PRIVATE INUREMENT

Private Benefit

A public charity is prohibited from allowing “more than an insubstantial” (not defined by the rules) accrual of benefits, including non-monetary benefits, to individuals or organizations, either directly or indirectly.¹ The sanction for private benefit can be revocation of tax exempt status.

This rule spawned from the fundamental requirement that a charitable organization operate exclusively for exempt purposes. The IRS focuses on whether an organization’s operations further its tax exempt purposes only, and will find private benefit where it determines the organization’s operations benefit private individuals or for-profit entities. An individual’s or entity’s relationship to the organization does not matter, and therefore can include disinterested or unrelated persons. Importantly (and counter-intuitively), a violation can be found even when the public charity or foundation is furthering its charitable purpose during the activities that give rise to the private benefit, and it can make no difference whether the private benefit was reasonable or excessive.

Private benefit can occur even where the person being benefited has no relationship to the organization or its people. A private benefit must be not more than insubstantial.

Private Inurement

No part of a tax exempt organization’s net earnings may “inure” to the benefit of a person who has a personal and private interest in the activities of the organization.² This rule is very similar to the private benefit rule, and in many cases what will constitute private inurement will also constitute private benefit. The sanction can be revocation of tax exempt status.

¹ Reg. § 1.501(c)(3)-1(b)(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). Thus, an organization that is empowered by its articles *to engage in a manufacturing business, or to engage in the operation of a social club* does not meet the organizational test regardless of the fact that its articles may state that such organization is created *for charitable purposes within the meaning of section 501(c)(3) of the Code.* (Bold emphasis added, italics emphasis in original).

² IRC § 501(c)(3). See Reg. § 1.501(c)(3)-1(c)(2) (“(2) *Distribution of earnings.* 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. For the definition of the words *private shareholder or individual*, see paragraph (c) of §1.501(a)-1.”)