

Audit Technique Guide – Educational Organizations Other than Schools

Introduction

Education is defined by Treas. Reg. 1.501 (c)(3) – 1(d)(3)(i) as:

- The instruction and training of the individual for the purpose of improving or developing his or her capabilities.
- The instruction of the public on subjects useful to the individual and beneficial to the community.

This concept is carried further in the Treas. Reg. 1.501(c)(3)-1(d)(2) definition of “charitable” to include the “advancement of education.” This broader regulatory language allows those organizations that provide some type of support service for educational organizations, but whose actual activities can’t be defined as educational to be included as educational organizations.

As with all IRC Section 501(c)(3) organizations, an educational organization doesn’t qualify for exemption if more than an insubstantial part of its activities furthers a non-exempt purpose.

Scope for Audits of Educational Organizations Other Than Schools

Educational purposes under IRC Section 501(c)(3) are broader than presenting formal classroom instruction. This encompasses ancillary activities such as granting scholarships. This also includes advocating a particular position or viewpoint in some type of public dissemination, like published literature, media presentations, or the dramatic arts.

Some organizations that educate the public may use commercial methods to provide information. Disseminating information in this way, by itself isn’t a problem if the activity furthers one or more of an organization’s exempt purposes and the organization isn’t operated for the primary purpose of conducting an unrelated trade or business per IRC Section 513. The absence of a profit motive for a particular activity doesn’t bar it from being an unrelated trade or business.

During an audit, maintain a position of disinterested neutrality on an organization’s advocated beliefs. Don’t judge the merits of an organization’s educational or artistic efforts. Instead, focus on whether the organization carries out its purposes in an educational or charitable manner.

Remain professional and objective at all times and ensure that your personal beliefs or opinions on the educational or artistic merit of an organization’s activities don’t influence the audit in any way.

Educational Activities

Among the activities of an educational organization, you may come across:

- Presentations of public discussion groups, forums, panels, lectures or similar programs (on radio, TV or the internet.)
- Instructional courses presented via correspondence, radio, TV or the internet.
- Museums, zoos, planetariums, symphony orchestras and other arts organizations.
- University bookstores and other organizations with school-related functions, such as selling school supplies or operating a cafeteria, promote educational activities if they only operate for students' and faculty's convenience.
- Alumni associations. They may receive rulings as educational organizations even though they're engaged in social and recreational activities, if these activities are incidental to the exempt purpose of advancing the interests of the university. Fraternities and sororities usually pursue recreational purposes with some incidental educational aspects and, exception for some honor societies, don't qualify as educational.

Fraternity Foundations. Fraternities primarily serve social purposes and they don't meet the definitions under IRC Section 501(c)(3). (See Rev. Rul. 69-573, 1969-2 C.B. 125.) To support social fraternities in conducting their educational activities, fraternities formed national fraternity foundations under IRC Section 501(c)(3). These foundations may make charitable grants to both their university and their fraternities, as long as these distributions are to further their IRC Section 501(c)(3) purposes. The foundation must "retain control and discretion as to the use of the funds and maintain records establishing that the funds were used for section IRC Section 501(c)(3) purposes" (Rev. Rul. 68-489, 1968-2 C.B. 210).

While awarding scholarships to qualified members of their fraternity can serve an IRC Section 501(c)(3) purpose, the foundation grants to a fraternity for the building or general renovation of its structure wouldn't serve a charitable purpose. (See Rev. Rul. 64-118, 1964-1 C.B. 182 and Rev. Rul. 75-196, 1975-1 C.B. 155.)

Travel Tours. Travel tour activities of any educational entity must first establish a substantial relationship to the organization's exempt purposes. Analyze each tour to determine the facts and circumstances as to its primary purpose, whether educational or social. When applying the facts and circumstances to the tour activity, consider:

- Existence of a legitimate educational methodology. Is it subject to a structured intent to educate, as opposed to the casual receipt of knowledge? Is the presentation of the subject organized? Are any reports presented? If yes, do they constitute lectures? Are any tests administered?
- Tour structure and design. Are participants made aware they are entering a structured program of study? Are there daily lectures and classroom study with minimal free time?
- Indications of intensive study of subjects on the tour. Is there evidence of substantial class time as opposed to other "leisure" activities? Is there evidence that the tour requirement is part of a college semester course?

- Tour selected for its educational value and qualification of tour leaders. Is the tour location primarily an educational or recreational destination? Are tour leaders certified in their fields of study?

Publishing. Publishing books, magazines, and other literature may have an educational or commercial purpose. Consider:

- The preparation of the material. Is it prepared by scholars with valid credentials? Properly documented as to its sources?
- Does distribution indicate an educational purpose as opposed to ordinary commercial publishing practices?
- Does the dissemination of the material promote its educational value? Does it promote further study and research of the topic?
- How does the organization compile its subscription lists?
- How does the material reach its targeted audience? Is it distributed to bring the greatest assistance to its targeted audience?
- The content of the material. Is reported advertising income taxable as unrelated business income?

Athletic Education. We normally associate youth athletics with molding character and preventing juvenile delinquency. An organization that focuses on teaching and learning and less on competition and recreation can establish itself as an educational organization within IRC Section 501(c)(3). (See Rev. Rul. 77-365, 1977-2 C.B. 192, where an organization that conducts clinics, workshops, and seminars at municipal parks and recreational areas to instruct individuals in a particular sport, merited IRC Section 501(c)(3) status.)

Promoting athletic activities may merit exempt status under another code section. See Rev. Rul. 70-4, 1970-1 C.B. 126.

Hobby Clubs. Analyze a hobby club on a facts and circumstances to distinguish between educational and social purposes.

A coin club, for example, primarily engaged in scholarly meetings including presenting historical research of historical coins' origin, can merit exemption as an educational society under IRC Section 501(c)(3). See Rev. Rul. 66-179, 1966-1 C.B. 139, which discusses how a garden club may qualify under IRC Section 501(c)(3) as an educational organization, a civic organization under IRC Section 501(c)(4), a horticultural organization under IRC Section 501(c)(5), or a social club under IRC Section 501(c)(7).

Methodology Test to Distinguish Education from Propaganda

In *Big Mama Rag, Inc. v. United States*, 631 F.2d 1030 (D.C. Cir. 1980), the U.S. Court of Appeals (D.C. Circuit) held that the IRC Section 501(c)(3) educational regulations violated the First Amendment to the Constitution. In order to more effectively assert the validity of the educational regulations, the IRS developed a test with four criteria. These criteria reflected IRS's long-standing position that the method an organization uses to advocate its position, rather than the position itself, sets the standard for determining

whether an organization has educational purposes. Rev. Proc. 86-43, 1986-2 C.B 729, explains the methodology test for determining if an organization's materials constitute an educational purpose rather than a finding of propaganda. It focuses on the method the organization uses to advocate its position, rather than the position itself. It requires IRS to review the organization's materials for factors that show whether it fails to provide:

- A factual foundation for the viewpoint it advocates.
- Development from the relevant facts that would materially help a listener or reader in a learning process.

Review the organization's issued materials for the following factors, any of which may suggest that the organization may be engaged in propaganda rather than education:

- The presentation of viewpoints unsupported by facts represents a significant portion of the organization's communications.
- The facts that claim to support the viewpoints appear distorted.
- The organization's presentations substantially use inflammatory and disparaging terms and express conclusions based more on strong emotions than on objective evaluations.
- The approach the organization uses in presentations isn't aimed at developing the intended audience or reader's understanding because it doesn't consider their background or training on the subject.

Two court cases, *The Nationalist Movement v. Commissioner*, 102 T C 558 (1994), affirmed per curium, 37 F.3d 216 (5th Cir. 1994), cert. denied, 513 U.S. 1192 (1995), and *National Alliance v. United States*, 710 F.2d 868 (D.C. Cir. 1983), upheld denial of exemption to organizations on the grounds that they failed to operate exclusively for charitable or educational purposes. They provide excellent examples on how to apply the factors to determine if an organization's methodology furthers educational purposes.

An organization may qualify as educational in exceptional circumstances even if one or more of the factors above is present. Review all facts and circumstances that help clarify the organization's methodology, including internal (non-published) or external publicized materials such as:

- Board of Directors meeting minutes, editorial boards, or other committees that affect the organization's program
- Contracts with researchers, authors, or other persons the organization engages to develop materials
- Materials the organization rejected
- Correspondence files
- Fund-raising materials, if not already reviewed as part of the organization's program output
- Materials on the organization's official website(s)

Determine if the organization merits an "action" organization designation as defined in Treas. Reg. 1.501(c)(3)-1(c)(3). (See IRM 7.25.3.17.5, Action Organizations.) Even if an organization's materials seem educational rather than propaganda, they may still

constitute lobbying. Apply both the “ends” test and the “means” test in the regulations, which consist of:

- The organization achieves its main or primary objective or objectives only by passage or defeat of legislation.
- The organization advocates, or campaigns for, attaining its main or primary objectives as distinguished from engaging in nonpartisan analysis, study, or research and making the results available to the public.

Educational Scholarships

Public charities don’t have to meet the scholarship requirements of IRC Section 4945(d)(3), required of private foundations. See IRC Section 4945(d)(3). However, a public charity’s scholarship program must serve charitable and educational purposes rather than private interests. Thus, you should verify in your audit of an organization’s scholarship or fellowship program that it doesn’t serve private interests. Accordingly;

- Look for “thank you” letters that may indicate the payment of a scholarship awarded on a personal rather than objective basis to a child of a friend, officer, employee, or trustee of an organization.
- Check payroll records for names.
- Ask other employees, directors, trustees, officers, and volunteers how the organization selects recipients.
- Determine who meets eligibility for the scholarships or fellowships. Verify that restrictions do not provide benefits to designated individuals or members of a group too small to be a charitable class.
- Look for any relationship between contributors to the organization and scholarship recipients. If found, look further to see if the program allows individuals to claim contribution deductions for otherwise non-deductible tuition payments.
- Review the organization’s methods and criteria for soliciting applicants and awarding scholarship or fellowship grants, as well as selecting recipients on an objective and non-discriminatory basis.
- Review published announcements, brochures, minutes of selection committee, and applications. Verify that standards for merit or financial need are legitimate. If the organization awards grants for reasons other than merit or financial need, determine if the criteria limits grants to individuals from private groups.

Organizational and Operational Requirements

Although the organization may meet all the requirements of an educational organization, it may still not qualify as an IRC Section 501(c)(3) organization. **Example:** The Metropolitan Journal of Computer Science publishes ground breaking research into advances made in the computer industry. While publishing content deemed undeniably educational and they accept no advertisements, you can purchase the journal at city newsstands and bookstores. Their methods of distribution may bar them from qualifying under IRC Section 501(c)(3).

Therefore, to decide whether to sustain exemption, determine if the organization meets the organizational and operational tests. See the Audit Technique Guide for Public Charities

If the organization has royalty income, review the cash disbursement and receipt journals to identify cash advanced to authors and income received from publishers. In Rev. Rul. 66-104, 1966-1 C.B. 135, a nonprofit organization which: makes funds available to authors and editors to prepare teaching materials and write textbooks, and, per terms of the contract with the publisher, receives royalties from published material sales and then shares them with those individuals, doesn't qualify for exemption from federal income tax as a charitable, educational or literary organization under IRC Section 501(c)(3).