

INUREMENT – IS THAT REALLY A WORD?

Although it is doubtful the word “inurement” is used in normal conversations, the IRS has a particular fondness for its use and is one of the areas they plan to examine in their 2011 audit work plan. However, even the IRS seems to have difficulty formulating an exact definition of the term, stating that, “Inurement is likely to arise where the financial benefit represents a transfer of the organization’s financial resources to an individual solely by virtue of the individual’s relationship with the organization, and without regard to accomplishing exempt purposes”.

The term appears to be used most frequently when the IRS is discussing organizations exempt under 501(c) (6) which code section states “no part of the net earnings” of an organization may “inure to the benefit of any private shareholder or individual”. However, the term applies to a number of exempt organizations including 501 (c) (3), (4) and (5) organizations.

However much fun we like to make of the term, the doctrine of private inurement fundamentally distinguishes exempt organizations from taxable entities and is a critical component in receiving and maintaining tax exemption. It should also be pointed out that it doesn’t just refer to an individual or family member having a close relationship with the organization receiving a benefit, but also any entity such as a corporation, partnership or other legal entity.

The best way to define inurement is by examples, and a few of the more common ones we have seen are presented below:

1. Rebates to members of the organization – such activity could result in enforcement of the inurement doctrine if the organization discriminates as to which members receive the rebate.
2. Financial assistance – an organization will sometimes provide assistance to financially distressed members. In most instances, this will be found to constitute inurement.
3. Compensation – excessive salaries can constitute inurement.
4. Insider transactions – financial transactions, such as unsecured loans or excessive rent, that benefit officers and directors would constitute inurement.
5. No De Minimis rule – even a minor amount of benefit could result in loss of exemption since “no part” of the net earnings may inure to any person.

As in all areas of governance, accountability and transparency, if the transaction benefits one person or even a group and doesn’t seem to further the exempt purpose of the organization, better have the CPA and/or lawyer take a closer look.