

# NON-PROFIT ORGANIZATIONS – 5 Basic Questions

There are millions of nonprofit organizations in the United States doing charitable work with benefits under Section 501(c)(3) of the Internal Revenue Code. These organizations include hospitals, museums, private schools, orchestras, theaters, religious organizations, public broadcasting, shelters, food banks, soup kitchens, and foundations. At SCORE, we have been asked by clients how to obtain such benefits for a nonprofit organization or how to start one with such benefits. While this document will specifically discuss 501(c)(3) organizations, it should be noted that there are quite a few other specialty nonprofits that can be read about at [http://en.wikipedia.org/wiki/501\(c\)](http://en.wikipedia.org/wiki/501(c)) .

Five basic questions will be answered:

- 1) Why should nonprofit organizations apply to the IRS for 501(c)(3) status?
- 2) Who is eligible for this status?
- 3) What responsibilities go along with this status?
- 4) How to apply for this status?
- 5) And what resources are available to the applicant?

1) **Why apply?** Because 501(c)(3) status provides the organization with these benefits:

- A. Exemption from federal income tax.
- B. Eligibility to receive tax deductible charitable contributions.
- C. Donors are more likely to support this type of organization because donations are tax deductible and approval by the IRS implies credibility and that the organization has met organizational and reporting requirements. Many individuals and groups (and most foundations) will not give to a charity if it does not have 501(c)(3) status.
- D. State officials may grant sales tax exemptions based upon this status and the US Postal Service offers reduced postal rates to certain organizations based upon the status.

2) **Who is eligible?** There are three essential requirements to be eligible. The nonprofit entity must be **organized** and **operated exclusively** for one or more **exempt purposes**.

- A. The 501(c)(3) organization must be a corporation, trust, or unincorporated association. The organizing documents (articles of incorporation, trust documents, or articles of association) must limit its purpose to those described in the 501(c)(3) statute and permanently dedicate assets to exempt purposes. Specifically, 501(c)(3) lists charitable, educational, religious, scientific, literary, fostering national or international sports competition, preventing cruelty to children or animals, and testing for public safety as exempt purposes.
- B. Because a substantial portion of the activities must further the exempt purpose, certain other activities are prohibited or restricted such as:
  - i. No participation in federal, state, or local candidate political campaigns.
  - ii. Restrict lobbying to insubstantial activities.
  - iii. Ensure that earnings do not inure to benefit any private individual.
  - iv. Not operate for benefit of private interests, such as its founder, founder's family, shareholders, or persons controlled by such interests.
  - v. Not conduct a trade or business not related to primary purpose.

3) **What are the responsibilities?** Responsibilities to the organization with 501(c)(3) status are:

- A. Record keeping – books and records detailing both financial and non financial activities.

- B. Report filing requirements (generally annually).
- C. Disclosure requirements – Must make Form 1023 and three recent annual returns (form 990) available to the public upon request. Also must document charitable contributions. For example, the donor must obtain written acknowledgment from a charity for any single contribution of \$250.00 or more before donor can claim a charitable deduction.
- D. Must generate public support, if not a private foundation, avoid excess benefits to insiders, and avoid political activity and limit unrelated business activity.

4) **How to apply for 501(c)(3) status** – Prepare and submit to the Internal Revenue Service the IRS Form 1023. (Some organizations are not required to file Form 1023 including churches or any organization (except private foundations) having annual gross receipts of not more than \$5,000.)

- A. Form 1023 is a 12 page, Parts 1-11 application with additional Schedules for churches, schools, medical facilities, supporting organizations, homes for the elderly, low income housing, successors to other organizations, and organizations providing scholarships. In general, this form and accompanying statements must show that:
  - 1. The organization is organized and operated exclusively for, one or more of the purposes specified in section 501(c)(3).
  - 2. No part of the organization's net earnings will inure to the benefit of private shareholders or individuals, including the originator of the organization or family members.
  - 3. The organization will not generally engage in political activity.
- B. Specific comments on form 1023:
  - 1. Organization is required to have a Federal ID number before submitting a 501(c)(3) application. Apply for this number using [IRS Form SS-4](#).
  - 2. Although IRS Form 1023 allows an applicant organization to indicate that it has not yet adopted bylaws, beware, at times the lack of bylaws was a prime reason by the IRS for delays in processing.
  - 3. Federal tax law requires specific wording, which limits an organization's purpose and disposition of assets, to be included in the governing instrument of all 501(c)(3) organizations. For incorporated organizations, this wording must appear in the Articles of Incorporation. For sample wording, go to [www.Form1023Help.com](http://www.Form1023Help.com). This is a useful site, also providing other sample wording, for example for limiting distribution of earnings of corporations and for dissolution of the corporation.
  - 4. Determine if the organization is a **private foundation** or a **public charity** which receives more favorable tax status.
    - i) A private foundation is an organization that receives most of its support from a limited number of sources, such as one family or one corporation. For this type, the help of an experienced or professional agent is often recommended.
    - ii) A public charity receives at least one third of their support from the general public in the form of gifts or contributions or payments for goods or services. Such organizations, however, often need time to show broad public support, therefore may receive an advance ruling from the IRS, good for a five year period, that the organization is likely to be publicly supported.

5. Compensation. Form 1023 dedicates almost three pages to information about compensation to Directors, Officers, Trustees, and Independent Contractors and to interaction with the organization. There is an obvious concern not to allow any preferential treatment to parties to the detriment of the general public and the stated mission of the organization. Excessive compensation and family relationships are scrutinized.

#### 5) Resources:

1. Important forms: order from IRS by phone (800) 829-3676 or online.
  - a. Form 1023 – Application for Recognition of Exemption and Instructions for Form 1023
  - b. Publication 557 – Tax Exempt Status for Your Organization
  - c. Publication 4220 – Applying for 501(c)(3) Tax-Exempt Status
  - d. Form SS-4 - Application for Employer Identification Number
2. Online Publications
  - a. IRS Publication 557: Tax-Exempt Status for Your Organization
  - b. IRS Publication 4420: Applying for 501(c)(3) Tax-Exempt Status
  - c. IRS Publication 4421: Compliance Guide for 501(c)(3) Public Charities
  - d. IRS Form 1023 –Go to www.irs.gov Click Charities & nonprofits, Under IRS Resources, Click 'Forms and Publications. Under download forms and publications, click form and instruction number, enter 1023 in box and click Find.
3. CITIZEN MEDIA LAW PROJECT – Helpful information on the process can be found at: www.citmedialaw.org/legal-guide/forming-nonprofit-corporation.
4. A Good reference on details of form 1023 www.Form1023Help.com .
5. IRS customer service hotline for exempt organizations at (877) 829-5500.
6. Forming a nonprofit organization in Florida. Go to www.citmedialaw.org/legal-guide/forming-nonprofit-corporation , click on State Law- Forming a nonprofit, then click on Florida.

#### General Suggestions for SCORE Counselors working with clients wanting to set up a nonprofit:

1. Review with client that the organization can only operate for charitable purposes, can not benefit any private interests, nor be politically active.
2. Inform client that the IRS will not give 501(c)(3) status unless there is already in existence a nonprofit organization with specified structure as outlined in Form 1023.
3. Provide the client with information on access to form 1023 and related publications or have them request the forms by telephone or online.
4. Suggest that client thoroughly review form 1023 to understand the organizational requirements and structure and then apply to the state of Florida to set up a nonprofit corporation.
5. File 1023 with IRS as soon as possible after filing for non-profit status in Florida.

**NOTE:** This document reviews the organizational phase of setting up a nonprofit with 501(c)(3) status. It is important to note that these organizations generally look for savvy business counsel in many areas including promotion, financing and fund raising, accounting, human resources, planning, networking, and personnel development to establish an effective operation.