

Overview of IRC 501(c)3 Non-Profit Corporations

Organizations recognized as exempt under section 501(c)3 of the Internal Revenue Code are generally not required to pay income tax, which of course, is a beautiful thing if you run a business. This exemption from tax includes all sorts of things, from charitable contribution income to interest and dividends from investments. But, while the 501(c)3 model is naturally very attractive, there are some very specific purposes for which one must exist, and even if a corporation initially qualifies, there are still very specific ways it must act in order to preserve its exemption as the business continues to operate. So, before thinking about forming a 501(c)3 non-profit corporation, it's important to consider what your rights and obligations are going to be going forward.

Organization

In order to qualify under IRC 501(c)3, the organizational documents must be carefully drafted. Generally speaking, the organizational documents must follow the following guidelines:

- a) Organizers must limit the organization's purposes to one or more of the exempt purposes described in section 501(c)3. This is the basic requirement of receiving tax exempt status. While for-profit corporations may engage in a wide range of activities, non-profit corporations must specifically limit those activities in which they actively engage.
- b) The organizers should not empower the organization to engage, other than as an insubstantial part of its activities, in activities that are not in furtherance of one or more of those specific purposes permitted by IRC section 501(c)3. This requirement may be met if the purposes stated in the articles of incorporation are limited in some way by reference to section 501(c)3. In fact, specifically setting forth the purposes of the corporation in the articles of incorporation may help streamline the application process to a certain extent as well.
- c) The organizers should permanently dedicate assets to exempt purposes. To satisfy this requirement, include a provision stating that upon dissolution, any assets remaining in the organization be distributed to an organization that is likewise tax-exempt under section 501(c)3, or to the federal, state or local government for a public purpose. Although it is permissible to rely on state law to establish permanent dedication of assets for exempt purposes, the IRS will process an organization's application for recognition of exemption sooner if its articles or organization include a provision ensuring permanent dedication of assets for exempt purposes.

Operation

Careful drafting of the organizational documents alone is insufficient to guarantee exempt status. The organization must also actually be *operated exclusively* for one or more exempt purposes. This will be satisfied only if the organization engages primarily in activities that accomplish one or more of the exempt purposes specified in section 501(c)(3). Insubstantial participation in activities that are not in furtherance of an exempt purpose will not preclude exempt status. However, care must be taken to monitor such activity. No bright-line test is provided by the Internal Revenue Code or any accompanying regulations as to when activities reach the level of *substantial*.

In addition, a charitable organization under 501(c)(3) cannot be operated for the benefit of private parties such as the organizer, the organizer's family, or other individuals or related entities. However, those parties may be paid reasonable compensation for their involvement of the management of the organization. Nor can a 501(c)(3) organization support political candidate or participate in any type of lobbying activity. While there may be possible organizational structures beneficial to such activities, a 501(c)(3) certainly is not one of them, and in fact, participation in any prohibited activities will likely cause the corporation to lose its tax-exempt status.

How to Obtain 501(c)(3) Tax Exempt Status

Application

The main document that must be filed in order to apply for non-profit recognition under section 501(c)(3) is IRS Form 1023, a substantive and complex web of an application. If exemption is not requested, then contributions to the organization are not tax deductible and the organization could be subject to income tax even though it would have qualified if the appropriate Form 1023 application was filed.

Exempt Groups

A select group of organizations are exempt from filing Form 1023. These include churches, synagogues, temples and mosques, and associations of those organizations, as well as any organization other than a private foundation, that has gross receipts in each taxable year of normally less than \$5,000.

Time For Filing

An organization that files Form 1023 within 27 months after the end of the month in which it was legally formed is eligible for tax exemption from the date of incorporation. If any organization that is required to file Form 1023 fails to do so within 27 months of formation, exempt status will only be effective from the postmark date of the application.

Fees

A user fee must accompany all Forms 1023 submitted to the IRS. The amount of the fee is based upon the actual or anticipated gross receipts of the organization. If gross receipts have not exceeded and will not exceed \$10,000 annually over a four-year period, the user fee is \$400. In all other cases, the user fee is currently \$850.



Additional Forms

In addition to filing the basic Form 1023, the following additional items may need to accompany the filing:

- 1) Form 2848--Power of Attorney and Declaration of Representative, if there is a desire to authorize any person to communicate with the IRS as an advocate regarding the request for recognition of exemption (such as an attorney or accountant);
- 2) Form 8821—Tax Information Authorization, if the filers want basic information to be shared with a person other than an organization's officers.

Filing a 501(c)(3) application is a complex process for which an attorney or experienced CPA can provide invaluable advice and assistance. In addition, there are a number of ongoing requirements that must be met in order to preserve the tax-exempt status of the corporation with which an experienced practitioner will be able to assist.

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