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# 501(c)3 FACT SHEET

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*Found online at:* <http://www.ezec.gov/Toolbox/501c3factsheet.html>

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Forming a new non-profit is a process that involves two distinct steps. Generally, interested parties that are not yet a 501(c)3 will need to file articles of incorporation with the appropriate agency in their state (usually the state's secretary of state). Next, they will also need to secure federal income tax exemption by filing the appropriate forms with the Internal Revenue Service (IRS). Local bar associations may be able to direct Councils to "pro bono" or reduced-cost legal services from lawyers experienced in the non-profit sector. Please be aware that it usually takes 4 to 6 months to go through the process.

When in the process of procuring and filing the appropriate forms required to apply for non-profit incorporation, interested parties may want to contact the state charity registration office. Be aware that procedures vary from state to state; so each party should consult with an attorney.

## Steps and Considerations in Attaining 501(c)3 Status

1. Take the issue to the interested parties. Make sure everyone understands the difference between non-profit and independent entity status. If appropriate, vote upon which status the group wishes to pursue, and brainstorm strategies for communicating the desire to become independent with all current cooperators.
2. Consult with a lawyer with experience working in the non-profit sector. These services may be available pro bono.
3. Preparation:
  - Budget \$500 for the application fee.
  - Obtain Tax ID Number using form IRS Form SS4: Application for Employee Identification Number.
  - Develop a budget for the next two years.
  - Prepare bylaws and articles of incorporation. These may be modified versions of the bylaws and articles of incorporation other similar organizations have submitted to the IRS in their 501(c)3 applications.
  - Designate a committee of "incorporators" who will have primary responsibility for developing by-laws and dealing with preparation of other documents for the IRS application.

- Parties and their incorporators will develop and approve the by-laws and the rules governing how candidates will run for and serve on the Executive Board.
  - Incorporators will **not** automatically become Executive Board members of the non-profit, but must run for their positions just as required of all Executive Board candidates.
  - File articles of incorporation with Probate Judge.
  - When incorporation paperwork is received and bylaws are written, file for 501(c)3 status with the IRS.
4. Compile documents for application to submit to IRS:
- Form 8718: User Fee for Exempt Organization Determination Letter Request (this form is basically a cover page for your application).
  - Complete relevant parts 1-4 of form 1023, the Application for Recognition of Exemption. Depending upon the kind of exempt organization the organization chooses to be, you will be using different schedules on form 1023.
  - Financial statements and budgets.
  - Bylaws.
  - Incorporation documents.
  - Signatures.
  - Check for \$500.
5. Form 1023 requirements:
- Part 1: Administrative information, address (cannot be a PO Box), attach incorporation document, bylaws and articles, signature by officer.
  - Part 2: Describe activities in detail. Must specify that your organization is not financially accountable to another organization or involved in politics or influencing legislation.
  - Part 3: Administrative information. Examine the application and fill out relevant "schedules" according to any special activities of your Council.
  - Part 4: Financial statements. May want to base this on a template developed by an accountant or one used by other similar organizations in their non-profit status applications.
6. Help and forms are available on the IRS website at [www.irs.gov](http://www.irs.gov). To find the correct amount for user fees and the length of time to process a request, call 877-829-5500 for assistance from the IRS.

## **Common Mistakes made by New 501(c)3**

Each state is different and certain requirements may be different when responding to IRS.

### **Form 990**

IRS Form 990 is the annual "Return of Organization Exempt From Income Tax". It is not required when gross receipts are less than \$25,000. It might be a better idea to file a "blank" Form 990, than to not file at all. To file a "blank" return, complete all the identifying information at the top of the return, check the box

indicating that gross receipts are normally less than \$25,000, sign and date the return, and send it to IRS, Ogden, Utah 84201.

### **Employment Taxes**

It is never a good idea to ignore a Form 941, "Employer's Quarterly Federal Tax Return," sent to you by the IRS. If you do not need to file the return, because you had no payroll for the quarter, or because you have no employees, complete the return anyway, and send it in (keeping a copy for your own records). It is tempting, when hiring workers for the first time, to treat them as independent contractors rather than employees. Withholding, quarterly deposits, etc. can be a bother. But misclassification of employees is, by far, the most common issue that IRS auditors raise with non-profit organizations. There are times, of course, when workers really are independent contractors. Many organizations overlook the need to report compensation of \$600 or more to the IRS. Awards, fees, and similar payments must be reported on Form 1099-MISC, which must be sent to the recipient no later than January 31st, and to the IRS, with a Form 1096 transmittal, no later than February 28.

There are 8 types of tax-exempt 501(c)3 organizations: charitable; religious; educational; scientific; literary organizations; those that test for public safety; support national and international sports competitions; and those that work to prevent cruelty to children or animals. Many community and economic development organizations have chosen to classify themselves as educational organizations. However, be aware that 501(c)3 public charities are supposed to receive at least one third of their support from the general public. Some organizations find themselves relying heavily on donations from founders or board members, or going back year after year to the same foundations or corporations for income, which may not count as "public" support.

### **Unrelated Business Income**

Many organizations keep their members informed with a regular newsletter or via the website, and help defray the costs by accepting paid advertising. Unfortunately, the IRS considers this advertising income to be unrelated to exempt purposes, and **therefore taxable**. Up to \$1,000 in unrelated income can be earned without having to pay tax, but an organization that receives at least \$1,000 in advertising or other unrelated receipts must file Form 990-T, and pay any tax due.

## **Frequently Asked Questions on Tax Exempt Status**

### **How do we get a tax ID number?**

Use IRS Form SS-4 to obtain an EIN (Employer Identification Number), an identifying number for all Federal tax purposes, whether you plan to have employees or not. You can apply for an EIN separately if you need one immediately (for banking, for instance), or instead attach a completed Form SS-4 to your application for tax-exempt status. NOTE: This number does not, in any way, indicate whether or not your organization is exempt from tax!

### **How much will it cost to get our tax-exempt status?**

The IRS has charged a non-refundable processing fee for exemption applications since 1987. There is currently a two-tier fee schedule. Organizations whose gross receipts have averaged, or will average, not more than \$10,000 per year pay \$150. Larger organizations pay \$500. A new IRS Revenue Procedure announcing the fees comes out each January; if you are submitting your application late in the year, there may be some benefit to getting it in before January 1.

Other costs you might incur when setting up a new non-profit organization include incorporation, charitable solicitation and other state or local registration fees (for your articles of incorporation, bylaws and exemption application professionally prepared).

### **How long will it take to get our tax-exempt status?**

The IRS is currently saying that it takes an average of 120 days to process an application. Roughly a quarter to a third of the applications they receive do not require further work, and are processed in six to ten weeks.

### **Can we ask for donations before we get our tax-exempt status?**

The "effective date" of your group's tax-exempt status will be the day it was originally created. This means that contributions that your organization received after incorporation, but before the IRS issued your exemption letter will not be tax exempt.

### **Can we pay salaries to board members? Can we rent a building owned by a board member, or purchase equipment from a board member?**

Tax law always permits the payment of reasonable compensation for goods or services actually rendered. If the IRS finds that amounts received by insiders are unreasonably high, however, they can fine both the insider who received the payment, and the board members who approved the payment. It is a good idea, therefore, to fully document the board's decision-making process when any kind of payment will be made to an insider.

## **Hints to Remember:**

- ↳ When the IRS returns your application for clarification, ensure that all documents are promptly returned so as not to delay your application.
- ↳ Be sure that you photocopy everything you send to IRS, as documents can be lost.
- ↳ When listing your board members on your incorporation papers, make sure that you do not list everybody, or they will all have to sign!