

Applying for 501(c)(3) Tax-free Status*

- Is your community or organization considering applying for grant or foundation money?
- Does your community want to attract tax-deductible contributions?
- Is your community concerned about maintaining its operational structure when its federal empowerment designation expires?
- Did you know that forming a nonprofit corporation is the most common legal structure used by rural Empowerment Zones/Enterprise Communities (EZ/EC) and Champion Communities (CC)?

Before setting off on the grant-writing trail, your community or organization should consider establishing a nonprofit corporation to help attract tax-deductible contributions and private grant money.

What Is a Nonprofit Organization?

Congress recognized that certain enterprises should be free from the burden of having to pay taxes. Thus, organizations that exist for the public benefit are sanctioned under 501(c)(3) of the Internal Revenue Code. Because of this designation, qualifying nonprofit organizations are known as 501(c)(3) organizations. A corporation or organization classified as a nonprofit entity is exempt from paying taxes and generally has greater eligibility for government or foundation grants.

To qualify for tax-exempt status, the organization can be a coalition, a community organization, a corporation, unincorporated association, or trust. The organization does not have to be incorporated, but because board members and others could face potential personal liability for the organization's activities, more nonprofits are choosing to incorporate. The liability protection varies from state to state. Because nonprofit organizations must serve a scientific, literary, educational, artistic or charitable purpose that benefits the public, they are also called public benefit corporations. Nonprofit organizations are not prohibited from making a profit, but there are limitations on how they can make and spend money. Congress has set limitations on nonprofit corporations through strictly enforced rules.

Why Start a Nonprofit Organization?

- A nonprofit organization is an authorized recipient of private, nonprofit or government grants.
- A nonprofit organization can serve as an eligible recipient of tax-deductible contributions.
- Nonprofit status allows an organization to apply for exemption from paying income taxes.
- Forming a nonprofit organization establishes a legal structure for an EZ/EC and CC seeking to implement a community-wide development plan.

How to Start a Nonprofit Organization:

1) Bring together a group of interested citizens to establish a nonprofit community organization. Name your organization, its goals and objectives.

2) Call your Secretary of State's office and request the materials required to establish a nonprofit corporation. The materials will include an articles of incorporation form and instructions; the state's nonprofit statutes, which should be reviewed carefully prior to preparing your articles of incorporation and corporate bylaws; a list of fees for filing; and instructions for post-incorporation activities. The Secretary of State's office will also be able to determine whether your organization's proposed name is available to incorporate under and is not the name of another incorporated organization.

3) Acquire IRS Publication 557, "Tax Exempt Status for Your Organization," from the Internal Revenue Service (IRS) by phoning (800) 829- 3676. You can also obtain other

required IRS publications and forms by visiting the IRS website at: <http://www.irs.gov>.

4) Write and file articles of incorporation with your Secretary of State. The articles of incorporation are difficult to amend, so you may want to consider writing the articles of incorporation in general terms. You can use more specific language in your bylaws. Each state has its own laws and format, but it is important that certain "Internal Revenue Service organizational test language" be inserted into the articles of incorporation. This language deals with the permitted charitable purposes, earnings and provisions regarding dissolution of the corporation. You may want to consider hiring an attorney to help guide you through the process of filing for 501(c)(3) status. Many lawyers will provide this service to you at no cost as part of their professional public service commitment, or you can contact Legal Aid, or state or local bar associations for information on availability of free legal services in your community. Usually, an attorney will file the articles of incorporation and IRS Form 1023. It is a good idea to include a cover letter, which describes the history and activities of the corporation.

5) Write bylaws to address issues such as membership, board-of-directors policies, fiscal management, etc. Bylaws are fairly easy to amend and therefore can contain details regarding operations.

6) Once you have incorporated, the next step is to file for tax-exempt status with the IRS. This is done by filing Form 1023, "Application for Recognition of Exemption Under Section 501(c)(3)." In Form 1023, you will tell the IRS all about your organization and why you should be exempt from taxation. The IRS conducts a thorough, in-depth review of Form 1023, which necessitates that it be prepared professionally.

7) The IRS will also review your group's proposed legislative activities. The IRS looks at the amount of money, resources, staff time, or effort expended on lobbying relative to other activities of the organization. In general, if a substantial part of the activities of your organization consists of promoting a political agenda or otherwise attempting to influence legislation, your

organization's application for exemption from federal income tax will be denied.

8) Once you receive tax-exempt status, there are other IRS returns and reports that must be filed. The most common return is Form 990, if your gross receipts in each tax year are more than \$25,000.

Keep in mind, that you can also make use of another nonprofit organization's 501(c)(3) status by making it an "umbrella organization" or your fiscal agent. You then apply for and administer grants or other funds under that organization's tax-free status. You can also use another 501(c)(3) as your fiscal agent until your 501(c)(3) is approved. If you wish to consider this avenue, contact nonprofit organizations located in your area to inquire about this possibility.

From the IRS you will need:

- *Publication 557: Tax Exempt Status for Your Organization*
- *Form 1023: Application for Recognition of Exemption*
- *Form 8718: User Fee*
- *Form 884: Applying for Tax ID Number*
- *Form 5768: Election/Revocation of Election*
- *Form 2848: Power of Attorney/Declaration of Representation.*
- *Form 872C: Consent Fixing Period of Limitation Upon Assessment of Tax*

Internet Resources:

<http://www.irs.gov> or 877/829-5500

<http://www.hanson.com/articles.htm>, for a generic Articles of Incorporation.

Additional copies of this technote are available from the Office of Community Development, U.S. Department of Agriculture, Rural Development, Room 701, 300 7th Street, S.W. Washington, DC 20024 (1-800-645-4712). Copies may also be obtained at <http://www.rurdev.usda.gov/ocd>

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