



501(c)(3)

Do you need it?

How to get it,

How to keep it!

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What is 501(c)(3)?

- A 501(c)(3) is a type of exempt organization.
- It must be organized and operated exclusively for one or more exempt purposes:
 - Charitable,
 - Educational,
 - Religious,
 - Scientific,
 - Literary,
 - Testing for public safety,
 - Fostering national or international amateur sports competition, and/or
 - Preventing cruelty to animals or children.

What's the difference between “tax exempt” and “non-profit”?

- “Tax exempt” is defined as organizations meeting the requirements set forth in the Internal Revenue Code.
- “Non-profit” is defined as a state law concept encompassing benefits such as income tax exemptions.
- Most federal tax-exempt organizations are non-profits, but being organized as a non-profit at the state level does not automatically make the organization exempt from federal income tax.




Qualifying for Tax Exemption Under 501(c)(3)

- The Internal Revenue Code requires that an organization seeking exempt status must show that:
 - It was organized and operates exclusively for exempt purposes, and
 - No part of the organization's net earnings inured to the benefit of any private shareholder or individual.

Benefits of 501(c)(3) Status

- Exemption from Federal income tax
- Tax-deductible contributions for donors
- State and city property tax exemption (by application or legislative act)
- Can issue tax exempt bonds (usually schools and hospitals)
- Reduced postal rates (by application)
- Exemption from Federal unemployment tax (for churches and religious organizations)
- Tax exempt financing (with some institutions)
- Ability to file an informational return rather than an income tax return



Does your organization need 501(c)(3) tax status?

- Business income related to organization's mission?
- Eligibility for grants?
- Fundraising?
- Tax deductible donations?



Process of Starting a Non-profit Organization

■ Step 1: Formation

- Drafting bylaws which set forth the structure of the organization and create a governing board with final authority for the organization.
- Incorporating through Articles of Incorporation as a non-profit corporation in the state of choice.

■ Step 2: Obtaining tax-exempt status

- Obtaining tax-exempt status from the IRS.
- Obtaining tax exempt status from the state in which the organization is based.

■ Step 3: Ongoing compliance

- Annual reporting requirements, and sound corporate record keeping practices.



STEP 1

FORMATION



Organizing Under State Law – Types of Organizations

- Choose one of four forms:
 - Corporation
 - Unincorporated association
 - Charitable trust
 - Limited liability company
 - Not available in Arkansas
- Incorporation is usually preferable for most not-for-profit organizations.

Table – Types of Organizations

<i>Type</i>	<i>Formalities</i>	<i>Governance</i>	<i>Management</i>
Corporation	Filing, Formalities required	Defined Governance	Entity Separate from Directors and Officers
Unincorporated Association	No filing, Formalities required	Undefined Governance	Members required; law not well established
Charitable Trust	No filing	Formed by Trust Document	Trustees manage
Limited Liability Company	Varies by State (Not available in AR)	Governance Varied	Law not well established



Bylaws – In General

- Develop Bylaws and Board of Directors
- Bylaws
 - Purpose - establish internal rules and regulations, providing guidance on management procedures of the organization.
 - To the extent possible, general procedures are preferred.

Bylaws – Minimum Information

- Minimum information to include:
 - name,
 - purpose,
 - membership,
 - fiscal accounting period,
 - meeting notice and procedures,
 - definition of a quorum,
 - board size,
 - compensation,
 - function,
 - terms,
 - termination and election/appointment procedures, and
 - method for amendment.

Articles of Incorporation (AOI) - Filing

- File with the Arkansas Secretary of State
 - www.ark.org/sos/ofs/docs/index.php
 - Filing fees:
 - Articles of Incorporation for Domestic Non-Profit Corporation
 - \$45 online, \$50 paper
 - Certificate of Amendment of a Non-Profit Corporation
 - \$45 online, \$50 paper
 - Articles of Dissolution of a Non-Profit Corporation
 - \$45 online, \$50 paper

AOI – Necessary Information

■ Name

- Must be consistent with purpose and distinguishable; may be reserved/registered in advance.

■ Type (choose one)

- Public Benefit – formed for the public good and are 501(c)(3) eligible.
- Mutual Benefit – formed to benefit, represent, and serve members and are NOT “tax exempt” as to donor contributions (no deduction).
- Religious – formed for religious purposes and have First Amendment exemptions from some requirements (no inspection of membership list).

■ Members

- Indicate whether the corporation will have members. Many non-profit corporations decide not to adopt a membership structure in the interest of efficiency and leave the decision making up to the directors.

AOI – Necessary Information

■ Dissolution

- In the event the directors want to dissolve the corporation, they must distribute all of its assets to another 501(c)(3) non-profit corporation. To establish that an organization's assets will be permanently dedicated to an exempt purpose, the articles of incorporation should contain a provision for assets to be distributed to a 501(c)(3) non-profit in the event of dissolution.

■ Registered office/agent

- Must include street address for registered office and agent. The registered agent is the “mailbox” for the corporation. The registered agent's address must be a street address in Arkansas and the agent must be located at that address. A post office or “mail drop” may not be used as the registered agent address.

■ Incorporators

- An incorporator is the person responsible for filing the articles of incorporation. He/she may or may not be an officer, member or the registered agent.



STEP 2

OBTAINING TAX EXEMPT STATUS

Other Types of Exempt Organizations

- Types of exempt organizations other than 501(c)(3):
 - Religious or apostolic orgs 501(d)
 - Farmers' coops 521
 - Ship owners' protection & indemnity assn 526
 - Political organizations 527
 - Homeowners' associations 528
 - Qualified tuition programs 529
 - State, political subdivisions, instrumentalities
 - Native American tribes

Primary Purpose Test

- Upon application to the IRS, the organization must show that its primary purpose is “charitable” and it exists to benefit the public.
- The organization passes the test - only if it engages primarily in activities that accomplish exempt purposes specified in section 501(c)(3).
- IRS looks at the purpose toward which the activities are directed, not the nature of the activities themselves.
- Status is “recognized” – when the IRS sends the determination letter indicating approval.

What to Submit to the IRS

- Must submit:
 - Employer Identification Number (EIN)
 - Apply online or by mail
 - Online
 - <http://www.irs.gov/businesses/small/article/0,,id=98350,00.html>
 - Mail - Form SS-4
 - <http://www.irs.gov/pub/irs-pdf/fss4.pdf>
 - <http://www.irs.gov/pub/irs-pdf/iss4.pdf>
 - EIN – a nine-digit number that the IRS assigns to business entities.
 - Must have EIN BEFORE submitting Form 1023, 1024, or 1028.
 - Application for recognition of exemption
 - Form 1023, 1024, or 1028
 - Must be complete and attach all schedules, statements, and other documents required by the form.

Form 1023

- Generally, the two substantive pieces of information required by the IRS are:
 - Statement of activities detailing, as specifically as possible, the proposed activities of the new organization.
 - Estimated or actual budgets for three years.
- <http://www.irs.gov/pub/irs-pdf/f1023.pdf>
- <http://www.irs.gov/pub/irs-pdf/i1023.pdf>
- <http://www.irs.gov/publications/p557/index.html>

Form 1023 – Parts I-IV

- Part I - Identification of Applicant
 - Date of formation
 - Effective date of exempt status is retroactive to this date unless the 1023 is filed more than 15 months from legal formation.
- Part II – Organizational Structure
 - Must be a corporation, unincorporated association, or charitable trust.
- Part III – Required Provisions in Your Organizing Document
 - must be able to check lines 1 (exempt purpose) and 2a (dissolution provision)
- Part IV – Narrative Description of Your Activities
 - Include past, present, and planned activities.

Form 1023 – Parts V-VIII

- Part V – Compensation and Other Financial Arrangements with Your Officers, Directors, Trustees, Employees, and Independent Contractors
 - Must list trustees/directors and officers names, addresses, and compensation (any economic benefit). Also identify disqualified persons.
- Part VI – Members and Other Individuals and Organizations that Receive Benefits
- Part VII – Your History
 - Must disclose if you are a “successor” organization. If so, file Schedule G.
- Part VIII – Your Specific Activities
 - Must describe any attempts to influence legislation and make disclosure of any political campaign participation.

Form 1023 – Part IX

■ Part IX – Financial Data

- If in existence less than 5 yrs, complete the statement for each year in existence and provide projections of likely revenues and expenses based on a reasonable good faith estimate for a total of:
 - 3 years if you have not completed one tax year, or
 - 4 years if you have completed one tax year.
- If in existence 5 or more yrs, complete the schedule for the most recent 5 tax yrs. Provide a separate statement that includes information about the most recent 5 tax yrs because the data table has not been updated to provide for a 5th year.

Form 1023 – Parts X and XI

- Part X – Public Charity Status
 - Public charity or private foundation
 - Organization may request a definitive ruling that it is a public charity.
 - Ruling depends on –
 - The date formed or date exemption will be effective,
 - Whether the organization has completed a tax year, and
 - The amount and type of income.
 - New filer – will be classified as a publicly supported charity if it can show that it is reasonably expected to be publicly support when it applies. Retains this status for first 5 tax years.
- Part XI – User Fee - \$750 (\$300 if revenues do not exceed \$10K annually over a 4 yr period)



Form 1023 – Where to Submit and Status

- Submit form to:
 - Internal Revenue Service
P.O. Box 12192
Covington, KY 41012-0192
- Application Status
 - IRS reviews 1023 and separates applications into three groups:
 - 1) Those that can be processed immediately based on the information submitted.
 - 2) Those that need minor additional information to be resolved.
 - 3) Those that require additional development
 - If in the first or second group, you will receive your determination letter or a request for additional information within approximately 60 days of the date submitted.
 - If in the third group, you will be contacted once your application has been assigned to an exempt organization specialist.

Obtaining Tax Exempt Status in Arkansas

- To obtain exemption from Arkansas income tax:
 - Submit a copy of 1) the IRS Determination Letter, 2) pages 1 and 2 of the IRS form 1023, and 3) a statement declaring Arkansas Code Exemption to:
 - Arkansas Dept. of Finance & Admin.
Corporation Income Tax Section
PO Box 919
Little Rock, AR 72203-0919
 - Organizations without an IRS ruling letter:
 - Submit Arkansas Form AR 1023CT, a copy of Articles of Incorporation, Articles of Association, copy of Trust Indenture or Agreement, and copy of Bylaws.



STEP 3

COMPLIANCE



Areas of Compliance

- Director Standard of Conduct
- Solicitation of Funds
- Private Benefit/Inurement
- Political Campaign Activity
- Lobbying Public Officials
- Excessive Unrelated Business Income
- Filing with the IRS, AG, DFA, and SOS
- Recordkeeping

Director Standard of Conduct

- Directors of non-profit corporations organized under the Arkansas Nonprofit Corporations Act of 1993 must discharge duties in good faith with the care of an ordinarily prudent person and act in the best interests of the non-profit corporation.
- Director is entitled to rely on information from officers, employees, attorneys, CPAs, etc.
- But, there is no “good faith” if the director has knowledge that makes reliance unwarranted.

Solicitation

- Before soliciting in Arkansas, charitable organizations must submit the Charitable Organization Application for Registration along with a copy of the IRS Determination Letter, any contracts with paid solicitors, commercial co-venturers or fund-raising counsel, the most recent IRS Form 990, and an Irrevocable Consent for Service. There is no fee.
- Submit form to:
 - Office of the Attorney General
ATTN: Fund-Raiser Registration
323 Center Street, Suite 200
Little Rock, AR 72201-2610
Telephone: (800) 482-8982
Fax: (501) 682-8118
http://ag.arkansas.gov/consumers_protection_charitable_registration.html

Private Benefit / Private Inurement

■ Private Benefit

- 501(c)(3) organizations must avoid all activities that will *substantially* benefit the private interest of *any* individual or organization.

■ Private Inurement

- *No part* of the organization's net earning may be used to the benefit of an insider.
- Transactions that may be regarded as “private inurement” if unreasonable:
 - Compensation to employees and consultants
 - Borrowing money or other property
 - Lending of money or other property
 - Rental as either landlord or tenant
 - Availability of facilities or services
 - Sales or purchase of property
 - Involvement in partnership or other joint venture

Political Campaign Activity and Lobbying

- NO funds or resources may be used to support a candidate for public office.
- Resources used to influence legislation are *strictly limited*.
- Substantial Part Test
 - If a substantial part of your organization's activities consist of propaganda or otherwise attempting to influence legislation, exemption will be denied.
 - "Substantial" probably means anything over 5%.
- Public Charity may elect to replace the "substantial part test" with sliding scale "expenditure test."
 - Election is made by filing Form 5768 to make the 501(h) election.

Excess Unrelated Business Income

■ Unrelated Business Income


- Income from a trade or business, regularly carried on, that is not substantially related to the charitable, educational, or other purpose that is the basis of the organization's exemption.
- Subject to tax at the regular corporate rates.

■ Effect on Tax-Exempt Status

- If unrelated business income is a “substantial portion” of an exempt organization's income, may lose tax exempt status.
- There is no fixed percentage or test defining “substantial.” The IRS did not revoke an organization's tax exemption when 75% of its income was from unrelated sources.
- If you have an issue in this area, talk to an attorney or accountant.

Filing

- IRS Form 990, 990-EZ, or 990-N
 - See video lecture soon available on Legal e-Source for more information.
 - <http://legalesource.uark.edu>
- Arkansas Filings
 - AR does not require returns of exempt organizations unless unrelated business income.
 - Report unrelated business income to DFA on Form AR1100CT
 - File a copy of the Form 990 filed with the IRS with the AR Attorney General's office for Public Review.
 - http://www.ag.arkansas.gov/pdfs/charitables/Charity_Registration.pdf
 - File Annual Disclosure of Information with the AR Secretary of State (SOS) – due by August 1 of each year.
 - http://www.sos.arkansas.gov/legislative_changes/569.pdf



Recordkeeping - Requirements

- Federal tax law requires that:
 - A donor must obtain a written acknowledgement from a charity for any single contribution of \$250 or more before the donor can claim a charitable contribution on his or her federal income tax return.
 - A charitable organization must provide a written disclosure to a donor who makes a payment in excess of \$75 partly as a contribution and partly for goods and services provided by the organization.
 - Quid pro quo contribution

Recordkeeping – Disclosure Statement

- Statement must:
 - Inform the donor that the amount of the contribution that is deductible for federal income tax purposes is limited to the excess of any money (and the value of any property other than money) contributed by the donor over the fair market value (FMV) of goods or services provided by the charity, AND
 - Provide the donor with a good faith estimate of the FMV of the goods or services that the donor received.
- Must furnish the statement in connection with either the solicitation or the receipt of the quid pro quo contribution.

Recordkeeping – Disclosure

Statement Not Needed If:

- The goods or services given to the donor are of insubstantial value.
- There is no donative element involved in a particular transaction with a charity (ex: purchase from a museum gift shop).
- There is only an intangible religious benefit provided by the donor. This benefit must be provided to the donor by an organization organized exclusively for religious purposes, and must be of a type that generally is not sold in a commercial transaction outside of the donative context.
- The donor makes a payment of \$75 or less per year and receives only annual membership benefits that consist of:
 - Any rights or privileges (with some exceptions) that the taxpayer can exercise often during the membership period.
 - Admission to events that are open only to members and the cost per person is within the limits for low-cost articles described in Revenue Procedure 90-12.
 - Exception: the right to purchase tickets for college athletic events.

Recordkeeping – Penalties and Reporting of Cash

- Penalty for failure to disclose:
 - If disclosure of a quid pro quo contribution of \$75 or more is not made, the penalty is \$10 per contribution, not to exceed \$5,000 per fund-raising event or mailing. If the organization can show that the failure was due to reasonable cause, it will avoid the penalty.
- Report of Cash Received
 - An exempt organization that (in the course of its activities) receives more than \$10,000 cash in one transaction (or two or more related transactions) that is not a charitable contribution, must report the transaction to the IRS on Form 8300.

Resources

- IRS website
 - www.irs.gov/charities/
- Stay Exempt website
 - www.stayexempt.org
- UA Legal e-Source
 - <http://legalesource.uark.edu>
- UA Legal Clinic
 - <http://law.uark.edu/clinics.php>
 - (479) 575-3056
- Nonprofit Risk Management Center
 - www.nonprofitrisk.org
- ACE (Arkansas Coalition for Excellence)
 - www.acenonprofit.org

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