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# LEGAL STEPS TO FORMING A 501(C)(3) ORGANIZATION IN THE UNITED STATES

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JUNE 2023

## DISCLAIMER

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This guide is an information document only and does not constitute legal advice. It may not apply to the particular factual or legal circumstances which an organization faces and is not intended to replace independent legal advice.

Although the guide is intended to help organizations understand the basic steps to forming a 501(c)(3) in the United States, neither Thomson Reuters Foundation, nor Taproot, nor Kirkland & Ellis LLP, nor any other contributor verifies the accuracy of, nor assumes liability for, the information within the guide.

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The content in this guide reflects the law in force in the United States as of June 2023.



# TABLE OF CONTENTS

<b>1.</b>	<b>What is 501(c)(3)?</b> .....	<b>4</b>
	Overview .....	4
	Advantages.....	5
	Disadvantages.....	5
	Form 1023.....	5
<b>2.</b>	<b>STEP ONE: Form a not-for-profit corporation in the applicable state</b> .....	<b>6</b>
	Articles of Incorporation .....	7
	Article 1: Corporate Name .....	7
	Article 2: Registered Agent .....	7
	Article 3: Directors.....	7
	Article 4: Purpose.....	8
	Article 5: Other Provisions .....	9
	Article 6: Incorporator.....	9
<b>3.</b>	<b>STEP TWO: Obtain a federal employer identification number</b> .....	<b>10</b>
<b>4.</b>	<b>STEP THREE: Draft your bylaws</b> .....	<b>10</b>
<b>5.</b>	<b>STEP FOUR: Consider adopting a conflict-of-interest policy</b> .....	<b>12</b>
<b>6.</b>	<b>STEP FIVE: Form 990 and forming a compensation committee</b> (see Form 990, Section B, line 15).....	<b>14</b>
<b>7.</b>	<b>STEP SIX: Consider adopting a whistleblower policy</b> (see Form 990, Section B, line 13).....	<b>15</b>
<b>8.</b>	<b>STEP SEVEN: Consider adopting a document retention and destruction policy</b> (see Form 990, Section B, line 14).....	<b>15</b>
<b>9.</b>	<b>STEP EIGHT: Hold the first organizational meeting of your corporation</b> .....	<b>16</b>
<b>10.</b>	<b>STEP NINE: Apply for federal 501(c)(3) status for income tax exemption</b> .....	<b>16</b>
<b>11.</b>	<b>STEP TEN: Register as a charitable organization with state attorney general</b> .....	<b>16</b>
<b>12.</b>	<b>STEP ELEVEN: Apply for other state and local tax exemptions</b> .....	<b>17</b>
<b>13.</b>	<b>Ongoing compliance and reporting requirements</b> .....	<b>17</b>
<b>14.</b>	<b>Alternatives to forming a 501(c)(3) organization</b> .....	<b>18</b>



## OVERVIEW

Are you interested in starting a nonprofit organization? Legally forming a 501(c)(3) public charity may seem daunting, but this guide will walk you through the process. It includes step-by-step directions to form a not-for-profit corporation and apply for federal 501(c)(3) status.

We recommend you consult an attorney and/or an accountant due to the legal and tax issues involved. They can assist with your organization's unique challenges.

## WHAT IS 501(C)3?

501(c)(3) is a tax-exempt status under the United States Internal Revenue Code for nonprofit organizations concerned with providing a public benefit, meaning that such organizations are exempt from paying federal income tax.

To qualify for this status, your organization must be [organized and operated](#) to benefit a certain segment of people or community, not created for the purpose of generating a profit, and for one or more of the following exempt purposes:

- Religious (i.e., the advancement of any religion; churches or mosques)
- Charitable (i.e., relief of the poor, underprivileged or distressed; American Red Cross)
- Scientific in the public interest (i.e., research projects at universities; American Cancer Society)
- Literary or educational (i.e., most schools and museums, orchestras and zoos; Council of Literary Magazines and Presses)
- Public safety testing (i.e., the Insurance Institute for Highway Safety)
- Foster national or international amateur sports competition (i.e., the Boston Amateur Baseball League; NCAA)
- Prevention of cruelty to children or animals (i.e., PETA)
- Private foundations (i.e., Bill & Melinda Gates Foundation; W.M. Keck Foundation)

Before taking the steps to form a 501(c)(3) organization, ensure that your organization does not advance any private interests, as serving in the [public interest](#) is a strict requirement.

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## ADVANTAGES OF 501(C)(3) TAX EXEMPTION

### Tax-Exemption and Public and Private Grants

In addition to the benefit of not paying federal income tax, it is likely you will not have to pay certain state and local taxes. Any donations made to your organization will also be tax deductible to the giver.

### Public and Private Grant Awards

With 501(c)(3) status, your organization will become eligible for public and private grants that are often exclusively available to 501(c)(3) organizations.

### Protection from Personal Liability

Another benefit is that you cannot be responsible for any debts incurred by the organization. This means that any of the 501(c)(3)'s members, directors and staff cannot have their personal assets taken away to pay for any debts.

However, that does not mean directors are never held responsible. One of the main fiduciary duties of a director of a 501(c)(3) organization is to act in the best interest of the organization. If this duty is violated, directors will be held responsible.

## DISADVANTAGES OF 501(C)(3) TAX EXEMPTION

### Timely and Expensive Process

Applying for this status is a long process, and an expensive one, as there are fees required to apply for incorporation and tax exemption. After you do obtain the status, there is a lot of paperwork related to taxes and reporting (including with respect to fundraising) that you will need to file with your state and the IRS annually.

### Government Restrictions and Regulations

Due to their tax-exempt status, 501(c)(3) organizations undergo a lot of government oversight, regulations and restrictions. For example, there are restrictions on types of political activities that the organizations can engage in. There are also restrictions on how directors and officers are paid. Every activity and money transfer must be tracked and recorded in case of an audit, and annual tax filings (Forms 990) are publicly available, which welcomes public scrutiny.

### **Form 1023**

To apply for tax exemption under 501(c)(3), your organization must complete and submit **Form 1023**, the "Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code." However, before you do that, there are some steps to complete, discussed below.

## STEP ONE: FORM A NOT-FOR-PROFIT CORPORATION IN THE APPLICABLE STATE

### CREATING THE PROPER STRUCTURE

- ➔ *If you already have an existing corporation, skip to step four and consider amending your bylaws.*
- ➔ *If you would like to convert your LLC to a corporation, then:*
  - **Option 1:** File a certificate of conversion following your state laws and pay a filing fee.
  - **Option 2:** If your state does not allow statutory conversions, you have to undergo a statutory merger, through which you 1) form a corporation with your LLC members as shareholders (see steps below on how to form a corporation), 2) approve a plan of merger, 3) file a certificate of merger and any other documents required by your state, and 4) swap the membership interests of the LLC members in the LLC for shares in the corporation and transfer the assets by drafting a business asset transfer agreement. You should also check your state laws to see if you have to formally dissolve your LLC, which may require further documentation.
- ➔ *If you are forming a new entity, continue reading.*

Before applying for 501(c)(3) status, your organization will need to form a business structure, also known as a legal entity. Entity formation happens at a state level, rather than the federal level. Typically, you would form the entity in the primary state where your organization will operate, or in a state that is a common site of incorporation, such as Delaware.

For simplicity, many 501(c)(3) organizations choose to use a corporation as their legal entity. While there may be other options depending on the state where you incorporate, the process for having a corporation qualify as a 501(c)(3) is generally the most straightforward.

The process for forming a corporation will vary from state to state. The steps below provide a high-level guide of general applicability across states, but please refer to the website of your state's Secretary of State for more specific instructions on how to form a corporation in your state.

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## ARTICLES OF INCORPORATION

The first step is to file the Articles of Incorporation, a legal document through which you form the corporation. It is important to customize the articles to ensure it meets both your state and IRS requirements. Meeting these requirements from the start will help avoid having to make amendments later on or risk having your 501(c)(3) application rejected. The Articles of Incorporation typically includes the following sections:

- **Article 1: Corporate Name**
  - Create an identity. By naming your entity, you are creating a brand. You do not want people to think that your organization's main purpose is to generate profit, but to serve your mission of benefiting society. Use descriptive words, and if possible, the name should complement your charitable purpose. This will help with fundraising in the future.
  - Do not include a political party in the name. Certain states also prohibit the use of specific words, like bank, trust, or trustee. Be sure to check any naming requirements in your state of incorporation.
  - Be original. The name must be distinguishable from the name of an existing entity in your state of incorporation, or a name the exclusive right to which is currently reserved. Check to make sure the name is not already taken. Many states have searchable online registrars of business names in use in the state. The US Patent and Trademark Office also has a searchable database of names that have already been trademarked.
- **Article 2: Registered Agent**
  - A registered agent and registered office are required because they provide a public record of the name of a person upon whom service of process against the corporation may be made and the address where that person may be found. The registered agent is also the person to whom official correspondence from the Secretary of State is sent.
  - The registered office must be within the state of incorporation and cannot be a post office box.
- **Article 3: Directors**
  - The board of directors is responsible for the management and control of the organization. It is made up of the organization's directors and officers. It does not engage in the day-to-day activities of the organization. It hires staff, assigns priorities for the organization, and ensures the organization has the capacity and the funding to carry out its programs and mission.
  - The incorporator (see Article 6 below) should appoint the first directors.
  - **Requirements.** Do some research into what skills will most benefit your organization (e.g., fundraising, business or legal expertise, PR), and recruit people based on those needs. Directors typically must be at least 18 years old. Otherwise, if there is a certain community or group of people you want to be prioritized to serve as directors, it should be included in the bylaws (e.g., residents of your state, people who have experience with the services your organization is providing or the problem it seeks to solve). Such restrictions may apply to some or all directors (e.g., a majority of the directors must be from the specified group).

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- **Number.** The number of directors required varies from state to state. Having more directors can provide more diverse viewpoints in the event of any conflicts, and can enable the Board to split into committees that can take on more targeted work on behalf of the organization.
  - **Fiduciary Duties.** The board has three fiduciary duties -- the duties of loyalty, care and obedience. The directors must act in the best interest of the organization and no one else (loyalty); the directors must use due diligence and skill when fulfilling their responsibilities (care); and the directors must ensure the organization is following its charitable purpose (obedience).
  - **Voting Rights.** The founder, when on the board, still only gets one vote. Directors should be volunteers (i.e., no salary in their position as directors), and each gets one vote and is an independent actor.
  - **Term and Removal.** Directors serve terms; they are not directors for life. However, directors can serve more than one term if you say they can in the bylaws. Directors can also be removed from the board. Check your state statute for the default removal rules, to the extent you want those rules to apply. Otherwise, you will need to specify how directors will be removed (*e.g.*, with or without cause? Do members (if applicable) or other directors vote on removal, etc.)
- **Article 4: Purpose**
    - The purpose is your mission. It states the reason why the corporation was formed and what the corporation will do.
    - As mentioned before, to be exempt from taxation under 501(c)(3), your organization must be *organized* and *operated* for a specific exempt purpose. The IRS uses the organizational test and operational test to make this determination.

### ***Organizational Test***

- The IRS will look at your formation documents (which could be your articles of incorporation, charter, or articles of association), and trust document or bylaws.
- The document must limit the purpose to one of the exempt purposes mentioned above (i.e., religion, education, science), and also:
  - contain a clause describing the main activity that will accomplish one of the exempt purposes,
  - prohibit earnings to private shareholders or individuals,
  - prohibit illegal activity,
  - limit legislative activity, and
  - contain an acceptable dissolution clause (this explains how the assets of the organization will be distributed in the event of a dissolution).

### **Operational Test**

- The operational test has three requirements:
  - Your organization must be primarily engaged in activities that accomplish one or more of the exempt purposes. It must serve a public interest, not a private interest.
  - Your organization's net earnings do not benefit private shareholders or individuals.
  - Your organization is not substantially involved in influencing legislation and does not participate in any political campaign, on behalf of or against any candidate for public office.

Be sure to state a purpose that can satisfy the above requirements in order to be granted 501(c)(3) status later on and avoid any amendments.

- **Article 5: Other Provisions**

- Statement upon dissolution of the corporation: This statement explains how the assets of the organization will be distributed in the event of dissolution. They generally can be distributed to another 501(c)(3) or a unit of government.
- While there may be an online filing option, you may need to file the Articles of Incorporation on paper in order to include additional provisions, which the IRS will require in your Articles of Incorporation in order to be granted tax-exempt status.

- **Article 6: Incorporator**

- This is the person who will sign the Articles of Incorporation. It can be a person who is 18 years or older, or a corporation.
- You only need one incorporator but can have more than one if you wish.

**Once your Articles of Incorporation have been filed with the Secretary of State's office, you have created an entity!** But you have *not* yet obtained tax-exempt status at the federal or state levels. If you do not complete the steps discussed next, you must submit federal and state income tax returns for the not-for-profit corporation you have created and pay the appropriate taxes.



REUTERS/ Thomas Mukoya

## STEP TWO: OBTAIN A FEDERAL EMPLOYER IDENTIFICATION NUMBER

An employer identification number (EIN) is a 9-digit number assigned to entities for tax filing and reporting purposes, and you can apply for one using [Form SS-4](#). You can file on paper or apply online Monday to Friday 7 a.m. to 10 p.m. EST and it will be issued immediately.

You need an EIN to open a business bank account for the corporation and when you file for federal 501(c)(3) tax-exempt status in step 10.

When applying for an EIN, you will need the entity's legal name, responsible party, and the applicant's Social Security Number (SSN) or Individual Taxpayer Identification Number (ITIN).

## STEP THREE: DRAFT YOUR BYLAWS

Decide how your organization will operate by drafting your bylaws. This is an opportunity for you to set guidelines for the organization to ensure its legality and promote its focus on an exempt purpose. Bylaws clarify who has the power to make decisions and lay out the decision-making process, but they do not address issues of the day-to-day activities of the organization.

- **Structure.** Consider whether the organization will be a membership or non-membership organization. If there are members, state and federal law may mandate that certain actions cannot be taken without a vote of the members, which makes an organization more complicated to operate, as discussed below. Nonprofit organizations which provide services tend not to have members. Members are more common in nonprofit organizations which focus on advocacy.

### **Membership Organization**

- If the organization has members, state laws generally confer legal voting rights on the members. This allows members to participate along with the organization's directors in corporate decision-making. Members will then play a key role in governance. Members can elect board members, approve or reject changes to the Articles of Incorporation or bylaws, and vote for a merger or dissolution of the organization (i.e., major corporate changes).
- When members have voting rights, the control of the organization lies within its membership. Decision-making may be prolonged because a majority of the members must come to an agreement.
- The membership organization must also comply with regulations that protect each member's right to vote (e.g., mandatory annual meeting, giving notice of meetings, etc.)

### **Non-Membership Organization**

- If the organization does not have members, it relies on the board of directors to make big decisions. The board is self-perpetuating in that new directors are elected or appointed by existing directors.

- **Fiscal Year.** Decide your fiscal year. This can be any 12-month period. You can choose when you want it to start/end. The two most common fiscal years for nonprofit organizations are calendar year (a January 1 start) or a July 1 start. It can also start on the date your bylaws are adopted or deemed effective. Your fiscal year determines the due dates for filing the organization's annual reports with the IRS and your state's attorney general.
- **Meetings.** The bylaws should note how often the board will meet and any notice requirements. Below are a few things to consider putting into your bylaws:
  - **Frequency.** Meetings of the board of directors are typically required at least once a year. The time and place do not need to be specified in the bylaws. The board often meets more frequently when the organization is getting started; monthly, weekly, or regularly at times designated by resolution of the board.
  - **Special meetings.** Special meetings can be called when a board decision is needed and there is no timely meeting scheduled. The bylaws should explain who can call a special meeting. By statute, typically the president or the full board of directors may call a special meeting. It's a good idea to grant a portion of the board the power to call a special meeting in case there is an urgent need for a meeting and not all directors are available.
  - **Notice.** You usually need to provide a reasonable notice window in advance of a meeting, so members can arrange to attend.
  - **Quorum.** A quorum is the minimum number of directors required to act. If the number of directors at a meeting is less than the quorum, then the board cannot make binding decisions. A quorum is usually a majority of directors.

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- You should also include the structure of the board of directors as explained in Article 3 above.
  - **Officers.** The bylaws should specify any responsibilities or duties if any officers that are appointed as well.
    - The board of directors elects officers at the annual board meeting.
    - Officers run the board meetings, take meeting notes, etc. They are not usually paid.
    - Common titles include President, Vice President, Secretary and Treasurer.
    - Check your state's requirements for officers. Some state laws require you to fill certain positions (e.g., president, secretary, and treasurer). Typically, one person can have more than one role.
    - You should set a reasonable term (typically between 1 and 3 years) and check your state's statute for the default removal rules. If you don't want to use the default rules, you should specify how officers will be removed (i.e., with or without cause? do members or directors vote on removal? etc.)
  - You can find examples of the format of the bylaws online, at the library, and from other nonprofit organizations. Do not simply update existing sample bylaws or provisions. The content must meet the specific needs of your organization, so it will operate smoothly. The bylaws must comply with the applicable state laws, so use caution with samples, which may comply with the laws of another state.

## STEP FOUR: CONSIDER ADOPTING A CONFLICT-OF-INTEREST POLICY

You should also consider adopting a conflict-of-interest policy in your bylaws. Some states will require you to adopt such a policy. A conflict of interest occurs when the aims of the organization and the aims of another party are incompatible, such as when advancing one's own interest is more important to an individual than advancing the goals of the organization. For example, a board member who owns an office space offers to rent it to the organization. As a board member, the individual's interest should be securing office space at a low cost, but as a landlord, the individual may be interested in maximizing the rent. The individual therefore has a conflict of interest. Avoiding such situations is important because the purpose of your nonprofit is to advance the organization's interest for the benefit of society, and the IRS wants to ensure that you are not operating like a for-profit or benefiting individuals involved in your organization.

### *Conflicts of Interest in Practice*

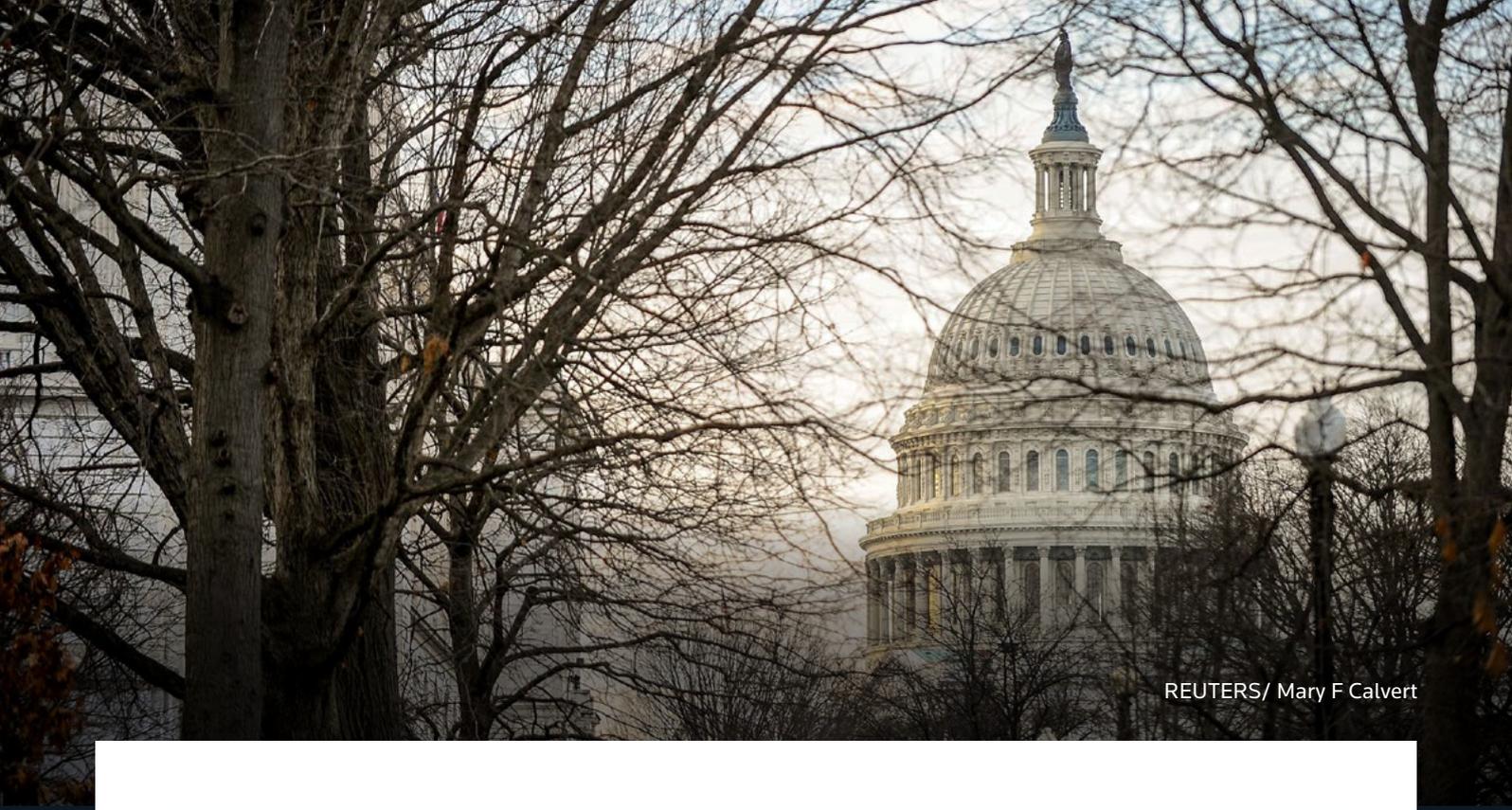
One situation where this comes into play is with respect to excess benefit transactions. Regulated under Section 4958 of the Internal Revenue Code, an excess benefit transaction is a transaction where a tax-exempt organization delivers an economic benefit to an insider that exceeds the fair market value of what the organization receives in return by overpaying for a good or service. An insider is anyone who is in a position to exercise substantial influence over the affairs of the organization over the past five years.

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For example, let's say your nonprofit is in need of a landscaping service to remove some trees for one of its projects. One of your board members owns a landscaping company, so the nonprofit hires this company. If the nonprofit overpays the board member for such service (paying \$2,000 for each tree removal instead of \$1,000 at the market value), this would be considered an excess benefit transaction. Excess benefit transactions are subject to excise tax by the IRS. The disqualified person, in this example the board member, would be liable for the tax, and so would another officer or trustee. Although the excise tax is limited to \$20,000 per transaction, the IRS can impose penalties of equal to 100% for repeat actors. The IRS can also revoke your tax-exempt status. Often times, these transactions are also revealed to the public, which can cause negative publicity and upset donors.

You don't have to adopt a conflict-of-interest policy to apply for tax exemption, *but it is highly recommended* to avoid situations like the above. Appendix A of Form 1023 offers a sample conflict of interest policy should you choose to adopt one. Article III of Appendix A provides two ways to deal with conflicts:

- require disclosure of potential conflicts, and
- prohibit interested parties from determining if there is a conflict and from voting on a matter where they are conflicted.
  - For example, this can occur when a board member who runs a business that sells something the organization needs. If the organization is considering this product in the market from other sellers, then the board member should not participate in the purchasing decision. Even if a board member's prices are the cheapest or they think they can be impartial, it's still good practice to exclude them from the decision.
- Article VI of Appendix A requires an annual statement from each director, officer, etc. The statement says that the person signing the statement:
  - has received a copy of the policy,
  - has read and understands the policy,
  - has agreed to comply with the policy, and
  - understands the organization is charitable and must engage in activities accomplishing its exempt purposes in order to maintain its federal exemption.



REUTERS/ Mary F Calvert

## STEP FIVE: FORM 990 AND FORMING A COMPENSATION COMMITTEE

Once you acquire 501(c)(3) status, you will have to complete Form 990 annually. Form 990 is an IRS form that provides the public with financial information about a nonprofit organization. The form requires you to describe the organization's mission and disclose its revenues, expenses, assets and liabilities. The form provides the IRS with an overview of your organization's activities, governance and detailed financial information. The IRS uses this form to determine whether you still qualify for tax exempt status. If they see that management is over-compensated, your organization may lose its tax-exempt status.

For this reason, you may want to consider forming a compensation committee. The compensation committee determines and reviews the compensation of directors, officers, employees, independent contractors, etc. The committee ensures that compensation is reasonable and tied to the achievement of predetermined performance goals that are keyed to mission-related accomplishments.

The committee's charter lays out how the committee operates and establishes the committee's legal authority. Only independent directors should be appointed to the committee (i.e., unpaid directors).

- Establishing a compensation committee is not a federal requirement. However, your organization will be required to disclose on its Form 990 whether compensation arrangements for certain employees are reviewed and approved by disinterested directors or a compensation committee.
- Whether it is valuable to have such a committee depends on your organization. If you have no paid employees, there is no real need for the committee.

Most organizations that have gross receipts of at least \$200,000 or assets worth at least \$500,000 must file Form 990. But if your organization is under this threshold, you can file Form 990-EZ instead, which is the short-form version.

## STEP SIX: CONSIDER ADOPTING A WHISTLEBLOWER POLICY

Another policy relevant to Form 990 is the whistleblower policy. A whistleblower policy encourages people to report any wrongdoing, such as illegal practices or violations of the organization's policies, to a specified person responsible for handling reports, such as a compliance officer. Having this policy is not a legal requirement, but Form 990 does ask whether you have adopted the policy.

- The policy should specify that the person reporting will be protected from retaliation, and should detail the procedure for investigations (e.g., the compliance officer should report to the board at least annually).
- Similar to the conflict of interest statement, employees, directors, officers, etc., should sign a statement that they:
  - received a copy of the policy,
  - read and understood it and agreed to comply with the policy, and
  - understand that the organization is a charitable organization that must engage in activities that accomplish its exempt purposes to maintain tax-exempt status.

## STEP SEVEN: CONSIDER ADOPTING A DOCUMENT RETENTION AND DESTRUCTION POLICY (SEE FORM 990, SECTION B, LINE 14)

Having a document retention and destruction policy in place ensures that documents are retained pursuant to applicable laws and that documents that may be relevant to legal or governmental proceedings are not destroyed. This policy is not required by law, but Form 990 requires organizations to disclose whether they have adopted a document retention and destruction policy.

The policy should identify the record retention responsibilities of staff, volunteers, board members, etc., for maintaining/documenting the storage and destruction of the organization's documents and records.

It is best to keep records of the following permanently:

- accounting records (both state and federal regulations require that the financial records of the nonprofit be complete, accurate and consistent with Generally Accepted Accounting Principles),
- donations (both cash and non-cash/in-kind gifts),
- Articles of Incorporation, bylaws, amendments, corporate annual reports, board meeting minutes, and
- activity records (fundraisers, how much money came in, who was served).

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## STEP EIGHT: HOLD THE FIRST ORGANIZATIONAL MEETING OF YOUR CORPORATION

The next step is to hold your first organizational meeting. The organizational meeting is an initial meeting in which the formalities of the corporation are determined. This does not have to be an in-person meeting and can instead be documented through a written consent of the company's board of directors, provided that this is permitted under state law.

If your Articles of Incorporation did not establish your board of directors or you want to change them, this is the time to elect your board members. You can also appoint your officers, establish any committees (such as the compensation committee discussed above), adopt your bylaws, conflict of interest policy, whistleblower policy, document retention and destruction policy, and approve any resolutions such as opening the organization's bank account and authorizing applications for federal and state tax-exempt status.

## STEP NINE: APPLY FOR FEDERAL 501(C)(3) STATUS FOR INCOME TAX EXEMPTION

After taking the steps above, you are ready to complete Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code. The purpose of this form is to show you have an exempt purpose (and aren't trying to get a private benefit or abuse the tax exemption).

The Instructions for Form 1023 are available on the IRS's website and explain each line if you have any questions. Organizations must electronically file Form 1023 to apply for recognition of exemption from federal income tax under section 501(c)(3). This is a public form. Once you file with the IRS, the public will be able to access it.

You may be eligible to file Form 1023-EZ, a streamlined version of the application for recognition of tax exemption. You are eligible if your gross income was under \$50,000 in the past 3 years and estimated to be less than \$50,000 for the next 3 years. If you are not eligible to file Form 1023-EZ, you can still file the full Form 1023. A summary of Form 1023-EZ can be found in Annex A.

Once you have the IRS determination letter, you are a tax-exempt organization!

## STEP TEN: REGISTER AS A CHARITABLE ORGANIZATION WITH STATE ATTORNEY GENERAL

Once you are a tax-exempt organization, you are generally required or recommended to register as such with your state's attorney general. If you plan on soliciting contributions before you receive the determination letter, you can register with your state's attorney general early. You may also need to register in other states where you will raise funds.



REUTERS/ Jon Nazca

## STEP ELEVEN: APPLY FOR OTHER STATE AND LOCAL TAX EXEMPTIONS

Once the tax-exempt organization receives its IRS determination letter, you can also apply for applicable tax exemptions at the state and local levels, including income tax exemptions, sales tax exemptions and/or property tax exemptions.

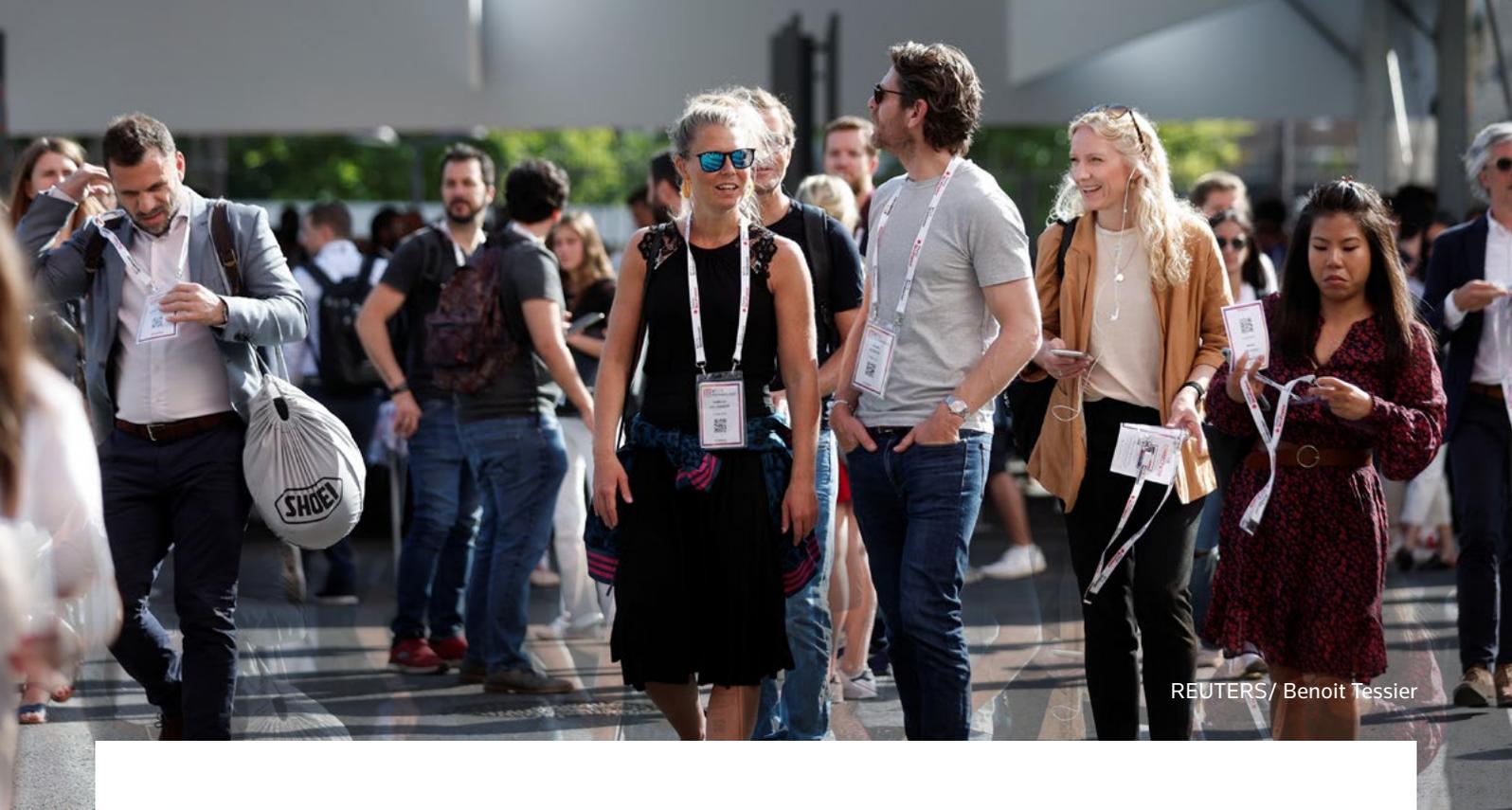
To receive a property tax exemption, the property's title must be in your nonprofit organization's name.

Some states require more than just 501(c)(3) status for a sales tax exemption. Some states ask you to complete another application with its own set of requirements. There may also be procedural requirements to follow (i.e., the organization must be physically located in the same state.) Most states assert that the sales tax exemption will only apply to purchases that relate to the charitable purpose, are made by a person associated with such organization and are paid by such organization.

## ONGOING COMPLIANCE AND REPORTING REQUIREMENTS

Annual reporting varies from state to state. There are other requirements if the organization has employees. If you pay wages to your employees, you must withhold, deposit and pay employment tax, including federal income tax withholding and Social Security and Medicare (FICA) taxes.

We recommend referencing this IRS Compliance Guide for 501(c)(3) Public Charities, so you do not jeopardize your exempt status.



REUTERS/ Benoit Tessier

## ALTERNATIVES TO FORMING A 501(C)(3) ORGANIZATION

If these requirements are too burdensome or overwhelming for your intended purpose, there are alternatives. Some of the options include:

- Create an informal group. Meet, volunteer, and donate money collectively to organizations that further your common goal.
- Work with an existing organization.
- Work with a social enterprise, which is a mission-driven, for-profit business that uses its resources to support a good cause. You may be familiar with companies that donate some of their profits to a good cause (i.e., TOMS, FIGS, Warby Parker, etc.)
- Partner with a fiscal sponsor.
  - A fiscal sponsor is an established not-for-profit organization with recognition of income exemption from the IRS. The fiscal sponsor agrees to work with another entity so that entity can begin its activities and be funded by charitable donations, often by helping to facilitate receiving financial support from potential donors. There is usually a formal, contractual relationship between the fiscal sponsor and the non-exempt organization.
  - **Pros.** The sponsored organization can apply for and receive grants and tax-deductible donations (through the sponsor). The fiscal sponsor should be experienced and able to provide support services to the organization (tax returns, payroll filings, monthly financial statements, financial record-keeping, insurance, personnel policies, etc.)
  - **Cons.** The activities of the sponsored organization must match the purpose/activities of the fiscal sponsor. The fiscal sponsor usually charges a fee (5-15%) for the sponsorship. The sponsor is legally responsible for the sponsored organization so the organization has to comply with the sponsor's requests. The funds received are under the control of the sponsor.

## ANNEX A: FORM 1023-EZ

### Part I: Identification of Applicant

- **Line 1.** Full name as it appears on your Articles of Incorporation and address where the IRS will send correspondence throughout the application process.
- **Line 3.** Fiscal year should match what you stated in your bylaws.
- **Line 4.** Authorized person is lawyer/accountant for whom you have filed [Form 2848](#) (Power of Attorney and Declaration of Representative). This is used if you would like to designate an individual to represent you before the IRS.
- **Line 8.** Same people you listed in your Articles of Incorporation (and any who have since been elected). Enter their personal mailing addresses.
- **Line 9.** If you don't have a website, enter "N/A." If you do, the information on your website should be consistent with what you're telling the IRS about your organization on the application.

### Part II: Organizational Structure

- **Line 1.** A corporation is one of the entities eligible to file Form 1023-EZ.
- **Line 2.** You can check the box if you have an Articles of Incorporation, which is a "necessary organizing document."
- **Line 3.** Enter the stamped date that the Secretary of State filed your Articles of Incorporation.
- **Line 4.** Enter the applicable state of formation.
- **Line 5.** Purpose described in the Articles of Incorporation. See Section 1 of this guide to review acceptable purposes under 501(c)(3).
- **Line 6.** Again, this is asking about purpose. The IRS wants to ensure your organizational documents do not permit activities that are not intended to carry out your mission. The instructions include a sample clause that you may include in the Articles of Incorporation to limit your organization's activities. Review the requirements under Section 2, Article 4 of this guide.
- **Line 7.** Dissolution clause in the Articles of Incorporation must state that the assets of the organization will be distributed for one or more exempt purposes within the meaning of 501(c)(3), or distributed to the federal, state, or local government for a public purpose upon dissolution. See sample clause in the instructions.

### **Part III:** Your Specific Activities

- **Line 1.** Enter your National Taxonomy of Exempt Entities (NTEE) code, which is a three-character series of letters and numbers that generally summarize an organization's purpose. The code summarizes your organization's purpose, and some donors use the codes to identify potential grant recipients.
- **Line 2.** Purpose, again. Check all that apply. Should match your Articles of Incorporation. Definitions are provided in the instructions.
- **Line 3.** The "shall nots." You must attest that you will not engage in prohibited activities.
- **Line 4.** Confirm whether you will attempt to lobby or influence legislation. This is asking whether you will contact or urge the public to contact members of a legislative body for the purpose of proposing, supporting or opposing legislation. Your organization can conduct a limited amount of lobbying activity (such as engage in public policy issues by conducting educational meetings), but cannot intervene in any political campaign activities (if you do this, you can be assessed an excise tax on political expenditures and lose your tax-exempt status).
- **Line 5.** Confirm whether you will compensate any directors or officers.
- **Line 6.** Check yes if you do, but note that this is an area for caution.
- **Line 7.** Okay if you do but need to disclose and might get follow-up questions.
- **Line 8.** Disclose if yes. The IRS is concerned about paying related persons more than market to funnel money out of the organization for private purposes.
- **Lines 9 - 11.** Disclose if yes (and if bingo/gaming, you need a license).

### **Part IV:** Foundation Classification

- 501(c)(3) organizations can be public charities or private foundations.
- You generally want to be a public charity.
- Private foundations have fewer tax advantages. They are subject to a 2% tax on investment income and must make a certain percentage of distributions annually.
- **Line 1.** Probably box 1a, but maybe box 1b if you are offering services for fees.
- Note that the 1/3 public support test requires a public charity to receive 33 1/3% of its support from the public.
  - This includes gifts, grants, contributions, membership fees, and other items.

- Denominator is total support. All the direct and indirect contributions the organization receives in full. The numerator only includes contributions to the extent that they are not more than 2% of the denominator (this does not apply to donations received from governmental units or contributions from other publicly supported charities, unless they are earmarked).
- You have five tax years to meet the test. At the end of the five years, if you don't meet it, the IRS recharacterizes you as a private foundation.

#### **Part V:** Reinstatement After Automatic Revocation

- Does not apply. Basically, if an organization fails to file its Form 990 return for three consecutive years, it automatically loses its exemption.

#### **Part VI:** Signature

- Must be electronically signed by an authorized person (officer or director). Check the penalties of perjury box. Type name and title and date.

#### **Fee and Processing**

- Nonrefundable user fee must be paid online from bank account or credit card.
- When you receive your 501(c)(3) exemption after filing Form 1023, it is retroactive to your date of incorporation, as if you were exempt on day one.
- In the interim, if you have to fill out Form 990, you check "applied for."
- Do not tell donors you are exempt until you have received the determination letter from the IRS. But you can say your exemption is pending. Once you receive your determination letter, then you can tell donors and give them written acknowledgment of donation with your exempt information. Remember, it will be backdated to the effective date, so any interim donations are tax-deductible charitable contributions.
- The general Form 1023 can take 9-12 months. Form 1023-EZ is generally a quicker process for eligible small organizations.
- If you are not eligible for Form 1023-EZ, you will need to file the full Form 1023. It's lengthier and asks for other attachments and supplements and will have a higher user fee.

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# ABOUT US

## THOMSON REUTERS FOUNDATION

The Thomson Reuters Foundation works to advance media freedom, foster more inclusive economies, and promote human rights. Through news, media development, free legal assistance and convening initiatives, the Foundation combines its unique services to drive systemic change.

TrustLaw, an initiative of the Thomson Reuters Foundation, is the world's largest pro bono legal network. Working with leading law firms and corporate legal teams, we facilitate free legal support, ground-breaking legal research and resources for nonprofits and social enterprises in 175 countries.

## TAPROOT

Taproot helps mission-driven organizations amplify their impact by mobilizing skilled volunteers to advance resource equity. Since 2001, our community has served over 19,000 social change organizations and provided almost 2 million hours of service worth over \$300 million. By ensuring nonprofits have access to skilled resources at no cost, we facilitate HR, finance, marketing, and strategy projects that can help them achieve their mission. Volunteers get to support causes they care about in meaningful ways. And the corporations we help to develop skilled volunteering programs boost employee engagement and support their local communities and causes their teams care about.