

STARTING A 501(c)(3) ORGANIZATION:

INSTRUCTIONS, SUGGESTIONS & EXAMPLES

GET READY, GET SET: WHAT YOU NEED TO
KNOW BEFORE STARTING A NONPROFIT

Included In This Packet:

- Nonprofit vs. Tax-Exempt status
- What is a 501(c)(3)?
- Private Foundation vs. Public Charity
- Benefits and Advantages of Incorporation
- Preparations needed to file for 501 (c)(3) status
- Stages of Formation
- Filing and Applying for 501(c)(3) status
- And so much more!

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GETTING STARTED

The primary purpose of this publication is to present an accessible guide on the many topics pertaining to the process of starting a 501 (c)(3) organization with the sound construction needed to be successful and sustainable. The materials presented are based upon nonprofit best practices, and though there will be a brief mention of other types of tax exempt organizations for educational purposes, the focus of this guide is on the 501 (c)(3) organization. It is the Oklahoma Center for Nonprofits' mission to educate nonprofit leaders and staff on best practices so that they can grow, develop, and accomplish their stated missions.

Note—This guide is not intended to be a substitute for professional legal advice. If your organization feels unsure at any point in the process, it is always advisable to seek the help of a nonprofit lawyer.

The nonprofit sector holds a special position in the lives of communities and individuals around the globe. It is the responsibility of this sector to provide essential services, goods, and programs to communities that are in need for the uninhibited sake of the organization's stated mission. There are over 1.5 million nonprofit organizations registered with the IRS, employing an estimated 10.7 million people—approximately 10 percent of the US workforce.¹ In Oklahoma, there are more than 18,000 registered nonprofits.

While the mission of the organization is certainly its most valuable catalyst for purpose, founding an organization that will thrive for many years requires special knowledge. In order for an organization to make the desired impact it seeks, it must have a solid foundation. People often begin the process of starting a nonprofit without proper research and find themselves in a situation that jeopardizes the life of the organization. Use this guide to prepare and create a sturdy base for a sustainable organization that can achieve its greatest potential.

¹ Salamon, Sokolowski, and Geller, "Holding the Fort: Nonprofit Employment During a Decade of Turmoil."

FROM THE TOP: THE PROCESS OF DISCOVERY FOR YOUR ORGANIZATION

Just like a business start up, it takes time, energy, and money to create a nonprofit. As such, the founding of an organization should be approached from a business-minded perspective. It is in the best interest of all parties associated with the organization to give adequate time and thought to all facets of the organization.

The process of getting 501(c)(3) classification from the IRS can take up to 2 years for 1023 and six months for the 1023 EZ and requires accurate financial records and a good understanding of what the IRS requires from tax exempt organizations. Additionally, your nonprofit must also register with your state and pay the fees associated with this called *incorporation fees*. You might also need legal counsel to guide you through the process of becoming a 501(c)(3) - especially if your organization was previously a for-profit business, may have been closely associated with a for-profit business, or was based in another country. If there is uncertainty at any stage of the process, it is certainly worth the time to consult with a nonprofit specialist. There are many “legal” ways one could start an organization, but not all of those options will be good for the well being of a particular organization.

*Nothing, in my opinion, is more
deserving of our attention than
the intellectual and moral
associations of America.*
— Alexis de Tocqueville, 1835



NONPROFIT VS. TAX EXEMPT STATUS

Often the most time consuming and confusing task in the process of conceiving an organization is comprehending the various vocabulary and hierarchical distinctions involved in the process. The first distinction to address is the difference between *nonprofit* and *tax-exempt* status.

In its simplest form, A *nonprofit organization* is a group formed for purposes other than generating profit and in which no part of the organization's net income is distributed to its members, directors, or officers.

Nonprofit organizations must be designated as nonprofit when created and may only pursue purposes permitted by state and federal statutes for nonprofit organizations. This process will be addressed in further detail later. For federal tax purposes, an organization is exempt from taxation if it is organized and operated exclusively for religious, charitable, scientific, public safety, literary, educational, prevention of cruelty to children or animals, and/or to develop national or international sports.²

Although closely linked more often than not, there are two distinct processes for achieving both of these statuses.

- *Nonprofit* "status" is commonly synonymous with the *nonprofit corporation* status granted by the state

and therefore must be applied for through the Secretary of State. The primary reason for this synonymy is that most often the first step an organization takes in the establishing process is filing for *nonprofit corporation* status.

- *Tax-exempt* status is granted by the federal government under section 501(c)(3) of the IRS tax code.

Nearly all *nonprofit* organizations seek *tax-exempt* status. However, in order to receive federal tax exemption an organization must be registered as a *nonprofit* in its state.³

The Internal Revenue Code (IRC) designates different nonprofit organizations into sub-sections under the 501(c) section based on the organization's function and purpose. The title "501 (c)(3)" refers to the sub-section in which it is filed under, the IRC section 501 (c) (3). The 501 (c) classification denotes tax-exempt status under federal law. Not all nonprofit organizations are tax-exempt under federal law.

In order to gain *tax exempt* status, the organization must file Form 1023 for exempt status under 501 (c)(3) or Form 1024 for exempt status under another subsection of the 501 (c) family.⁴ This process will be addressed in detail at a later point in this document.

COMMON TYPES OF TAX-EXEMPT ORGANIZATIONS:

- 501 (c)(3) - Religious, Educational, or Charitable
- 501 (c)(4) - Civic Leagues, Social Welfare Organizations
- 501 (c)(5) - Labor, Agricultural, or Horticultural
- 501 (c)(6) - Business Leagues, Chambers of Commerce
- 501 (c)(7) - Social and Recreational Clubs
- 501 (c)(8) - Fraternal Beneficiary Societies
- 501 (c)(10) - Domestic Fraternal Societies and Associations
- 501 (c)(19) - Veterans' Organizations

² Staff, L. I. I. "Non-Profit Organizations." *LII / Legal Information Institute*, August 6, 2007. https://www.law.cornell.edu/wex/non-profit_organizations.

³ University of Kansas Community Tool Box. "Chapter 43. Managing Finances | Section 4. Understanding Nonprofit Status and Tax Exemption | Main Section | Community Tool Box." Accessed November 16, 2015. <http://ctb.ku.edu/en/table-of-contents/finances/managing-finances/nonprofit-status-tax-exemption/main>.

⁴ Lois G. Lerner and Roberta "Bobby" Zarin. "Free 501c3 Help Book Published by the IRS to Help You Complete the Form 1023 Application." *IRS 501(c)(3) Form 1023 Help - Nonprofit Application For 501(c)(3) Tax Exemption*. Accessed November 16, 2015. <http://form1023.org/501c3-help-book>.

BRIEF INTRO: ABOUT THE 501 (c)(3)

There are many factors to consider when deciding whether or not to create an organization. Perhaps you are involved in charitable activity, see needs not being met within your own community, or have an idea to better help other communities. Whatever the reason, it is important to fully comprehend the commitment of establishing and running a business with tax-exempt status.

501(c) organizations are tax-exempt nonprofits in the United States. Section 501(c) of the United States Internal Revenue Code (26 U.S.C. § 501(c)) lists 29 types of nonprofit organizations that are exempt from some federal income taxes.

501(c)(3) organizations are highly regulated entities. Strict rules apply to both the activities and the governance of these organizations. No part of the activities or the net earnings can unfairly benefit any director, officer, or private individual, and no officer or private individual can share in the distribution of any of the corporate assets in the event the organization shuts down. This is why it is best practice to not pay board members for their service or allow staff members to be on the board. The founder of the organization should also eventually choose between being a volunteer board or paid staff member to avoid any notion that s/he is unfairly benefitting from the organization's earnings. For the good of the organization, the founder should not be allowed to be both a board member and a paid staff member.

One of the most distinct provisions unique to Section 501(c)(3) organizations, as compared with other tax exempt entities, is the tax deductibility of donations. 26 U.S.C. § 170, provides a deduction for federal income tax purposes for some donors who make charitable contributions to most types of 501(c)(3) organizations.

Other unique provisions tend to vary by state. Like federal law, most states allow for deductibility of donations for state income tax purposes. Also, many states allow 501(c)(3) organizations to be exempt from sales tax on purchases, as well as exemption from property taxes. In Oklahoma, only some 501 (c)(3) organizations are exempt from sales tax, and the entities that qualify for sales tax exemption in Oklahoma are specifically legislated. For more information on sales tax exemption, go to <https://www.ok.gov>, type "sales tax exemption" in the search bar, and click on the sales tax exemption packet — or follow this hyperlink: <https://www.ok.gov/tax/documents/PktE.pdf>.

Furthermore, lobbying, propaganda or other legislative activity must be kept relatively insubstantial. Intervention in political campaigns or the endorsement/anti-endorsement of candidates for public office is strictly prohibited.

ENTITIES THAT CAN SEEK 501(c)(3) DETERMINATION INCLUDE:

- **Corporations:** a company or group of people authorized to act as a single entity (legally a person) and recognized as such in law. The majority of 501(c)(3) organizations are nonprofit corporations.
- **Trusts:** a fiduciary arrangement that allows a third party, or trustee, to hold assets on behalf of a beneficiary or beneficiaries.
- **Unincorporated Associations:** an unincorporated organization, other than one created by a trust, consisting of three or more members joined by mutual consent for a common, nonprofit purpose.
- **LLCs:** A limited liability company (LLC) is a business structure that combines the pass-through taxation of a partnership or sole proprietorship with the limited liability of a corporation.

EXCLUSION FROM PRIVATE FOUNDATION STATUS: THE 509(a) DISTINCTION

Every organization domestic or foreign that qualifies for tax exemption as an organization described in section 501(c)(3) is a *private foundation* **unless** it falls into one of the four categories specifically excluded from the definition of that term (referred to in section IRC 509(a)).⁵ Section 509(a) essentially divides the 501(c)(3) class into two categories: *Private Foundations* or *Public Charities*.⁶ Any organization that is excluded from *private foundation* status under section 509(a) is considered a *public charity*.

509 (a) DISTINCTION: CATEGORIES OF PUBLIC CHARITIES

509 (a):

1. **Public Supported Charity**—
2. **Service Providing or Gross Receipts Organization**— Generally available for organizations that receive few gifts or grants, but which normally receive their support from fees for services such as admissions or sales of material supporting their exempt function
3. **Supporting Organization**— Supports Public Supported Charities or Service Providing Organizations.
4. **Public Safety Test**— (very rare and beyond the scope of this publication)

Public Charities are what most people recognize as those organizations with **active programs**. Examples include churches, benevolence organizations, animal welfare agencies, and educational organizations. They receive a substantial portion of their revenue from the general public, donors, or from government contracts.

In order to remain a public charity (and not a private foundation), a 501(c)(3) must pass the *Public Support Test*. This means the organization must obtain at least 1/3 of its

donated revenue from a fairly broad base of public support. Public support can be from individuals, companies and/or other public charities.

Donations to public charities can be tax deductible to the individual donor up to 50% of the donor's income. Corporate limits are generally 10% of total revenue. In addition, public charities must maintain a governing body that is mostly made up of unrelated individuals.

There are various categories of foundations, but for the purpose of this paper only two will receive elaboration.

A *private foundation* is often referred to as a ***non-operating foundation***, as it typically does not have active programs. Revenue may come from a relatively small number of donors, or even a single donor. Private foundations are thought of as nonprofits which support the work of public charities through grants, though that is not always the case. Donations to private foundations can be tax deductible up to 30% of the donor's income.

Governance of a private foundation can be much more closely held than in a public charity. A family foundation is an example of a private foundation.

The other less common category is the ***private operating foundation***. These organizations often maintain active programs similar to public charities, but may have attributes similar to a foundation. As such, private operating foundations are often considered hybrids. Most of the earnings must be allocated to conduct programs, and donation deductibility is similar to a public charity.

⁵"Private Foundations." Accessed November 16, 2015. <https://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Private-Foundations>.

⁶"Public Charities." Accessed November 16, 2015. <https://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Public-Charities>.

BENEFITS AND DISADVANTAGES OF INCORPORATION: YOUR ORGANIZATION WITH FORMAL BUSINESS STRUCTURE

Incorporating with the state comes with a great deal of responsibility. However, there are many benefits for the organization that are unlocked once it has received formal nonprofit corporation status. Below are the advantages and disadvantages adapted from Anthony Mancuso's book *How to Form a Nonprofit Corporation*.⁷

Benefits of the Nonprofit Corporation:

1. Tax Exemptions

Nonprofit Corporations are eligible for state and federal exemptions from payment of corporate income taxes. Also, a select few of nonprofits are eligible for state sales tax exemption.

2. Receiving Public and Private Donations

Corporation status will increase the organizations chances of receiving donations and attracting important donors.

3. Protection from Personal Liability

Protecting the members of your organization from personal liability is one of the main reasons for forming a corporation.

4. Separate and Perpetual Legal Existence

The people who work for the organization are separate from the legal entity of the organization. Corporate liabilities are not the liabilities of anyone who works or volunteers for the organization. Separate and perpetual legal existence also means that the organization itself exists perpetually and continues to operate despite personnel and management fluctuations.

5. Employee Benefits

Life insurance, reimbursement of medical expenses, and coverage by an approved corporate employee pension or retirement plan are some of the benefits corporations can offer.

6. Formality and Structure

The formal corporate documents the articles, bylaws, minutes of meetings, and board resolutions that you will prepare as a nonprofit will actually be quite useful to your organization. They will outline the groups purposes, embody its operating rules, and provide structure and procedures for decision making and dispute resolution.

7. Miscellaneous Benefits

There are additional advantages given to certain types of tax-exempt nonprofit corporations that can greatly impact the organization such as:

- Your nonprofit may qualify for exemptions from property taxes
- 501(c)(3) organizations receive lower postal rates on third-class bulk mailings
- Many publications offer cheaper classified advertising rates to nonprofit organizations

⁷ Anthony Mancuso, *How to Form a Nonprofit Corporation*, 6th ed (Berkeley, Calif: Nolo, 2004).

- Nonprofits are exclusive beneficiaries of free radio and television public service announcements (PSA's) provided by local media outlets
- 501(c)(3) performing arts groups are qualified to participate in the performance programs sponsored by federally supported colleges and universities.

There are few drawbacks to organization as a nonprofit corporation, particularly when the organization will be seeking federal tax exemption under section 501(c)(3). While establishing and maintaining a nonprofit corporation does require more work when compared to an unincorporated association, the same work will have to be done for an unincorporated association in the event that it is seeking federal tax exemption.⁸

Disadvantages of Corporation and 501(c)(3) Status:

1. Official Paperwork

- Incorporation Documents (articles of incorporation, bylaws, and minutes of first meeting of the board of directors)
- Annual tax and reporting returns with the state and IRS
- Regularly prepare minutes of ongoing corporate meetings, and occasionally forms for amending articles and bylaws
- Organized bookkeeping system and experienced nonprofit tax advisor

2. Incorporation Fees and Costs

There are fees associated with filing for corporation status. If you decide to seek professional guidance in the process, then paying an attorney will add to the overall cost of incorporating. The cost of the federal tax exemption fee is dependent on the estimated gross receipts. The costs will be highlighted later during the discussion of the filing process.

3. Time and Energy needed to Run a Nonprofit

There are many new tasks and responsibilities that come with the decision to incorporate and become a tax-exempt organization. Some tasks include:

- Setting up and balancing books and bank accounts
- Depositing and reporting payroll taxes
- Extracting year-end figures for annual tax informational returns
- Regular board meetings documented with written minutes
- State and Federal tax procedures
- Operations expansion
- Employee expansion
- Office space and equipment
- Cultivating donors

⁸ Megan C. Sanders, "Private Foundations: A Practical Guide to Key Issues, Choices, and Risks," accessed December 16, 2015, http://moorenonprofitlaw.com/wp-content/uploads/2015/09/Private_Foundations__A_Practical_Guide_to_Key_Issues-Choices-and-Risks-paper.pdf. 2.

4. Restrictions on Paying Directors and Officers

Staff salaries must be based on comparable models in similar-sized organizations. Directors can also be reimbursed for the expense of attending director meetings. In all cases, however, these payments should be reasonable.⁹

5. Restrictions Upon Dissolution

In the event of the dissolution of the corporation, after paying or adequately providing for the debts and obligations of the corporation, all assets shall be distributed for one or more exempt purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code, or corresponding Section of any future federal tax code. The organization must distribute its assets to other 501(c)(3) organizations. No part of the assets can go to an individual.

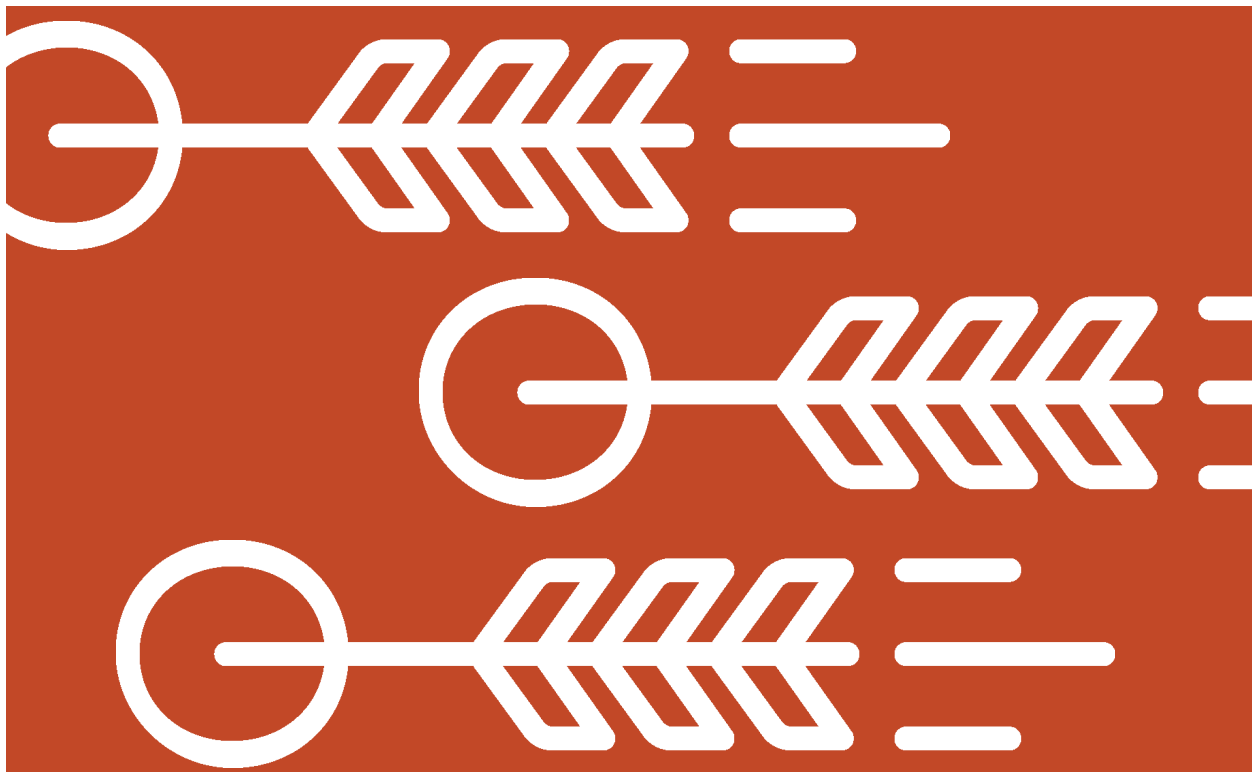
6. Restrictions on Political Activities

An organization may not participate in political campaigns for or against candidates for public office, and cannot substantially engage in legislative or grassroots political activities except as permitted under federal tax regulations.

7. Oversight by the Attorney General

Each state's attorney general has broad power to oversee the operations of 501(c)(3) nonprofits.

It is crucial that the founders of an organization evaluate all the advantages and disadvantages of starting and running a tax-exempt organization. This list highlights some of the main points of interest, but is not an exhaustive list. For a complete list of the obligations of an organization, go to the IRS website. Publication 557, *Tax-Exempt Status for Your Organization* is a comprehensive guide for organizations considering applying for 501(c)(3) status.



⁹ Anthony Mancuso, *How to Form a Nonprofit Corporation*, 6th ed (Berkeley, Calif: Nolo, 2004). 1/13.

MAPPING YOUR ORGANIZATION'S TRAJECTORY: THE POSSIBILITY OF STARTING SMALL

While the temptation to complete the entire process of filing for incorporation and 501(c)(3) status may be strong, an organization that is young and still transforming might benefit from considering a number of other options. This section is specifically included for those organizations that are in the early conceptual stages of development and may not have the capabilities, or desire, to take on the responsibilities of running a corporation.

FOUR STAGES OF DEVELOPMENT:

1. Begin as an unincorporated association
2. Find a 501(c)(3) organization to serve as an incubator
3. Incorporate at the State level
4. Apply for federal tax-exempt status

According to the Minnesota Council of Nonprofits, "It is common for organizations to go through four distinct stages during development. (...) many new nonprofits find it more manageable to grow slowly into their nonprofit status."¹⁰

1. Operate as an Unincorporated Association

The first option is beginning your operations as an *Unincorporated Association*. If a group of people get together to benefit the public, even if they have not filed any paperwork, that group of individuals is considered an *Unincorporated Association*. This structure is primarily utilized by small groups that are united for purposes that may bring about good in their communities, but operate under the parameters set by the IRS or would not benefit from the organizational structure of a corporation and all the work it entails.

For example, if members of your community decide to meet monthly and educate people for free on the benefits of exercise, that is considered an *Unincorporated Association*. However, if the organization begins to operate within the parameters of a corporation, Incorporation is highly recommended and in some cases required:

- If the association accrues more \$5,000 a year in revenue, it will need to file a 990-N and apply for tax-exempt recognition from the IRS by completing Form 1023.
- If the association must apply for tax-exempt recognition, it will need the same provisions as a corporation included in Form 1023.
- If you decide to pay an employee for any services, then incorporation is recommended for liability purposes.
- If the association would like to hold real property, then it will need to incorporate.

If your organization is quite small and operates within the above boundaries this may be a good option due to the limited amount of extra work. Associations making below \$5,000 a year can have good programs without filing Form 1023 or an annual tax return.

Practically speaking, if an association files for tax-exemption, then incorporation is advisable and likely easier because the organizing documents requested on the Form 1023 must be created in order to incorporate.

¹⁰ "Start a Nonprofit | Minnesota Council of Nonprofits," accessed December 15, 2015, <http://www.minnesotanonprofits.org/nonprofit-resources/start-a-nonprofit>.

While there are benefits to adopting the loose organizational structure of the unincorporated association, mainly regarding reporting requirements, as you grow there are certain drawbacks to operating in this manner.

Drawbacks of Unincorporated Associations¹¹

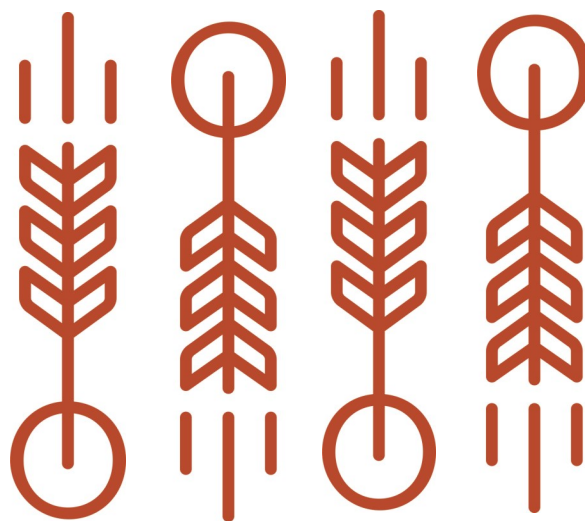
- Formation of an unincorporated association is not governed by state.
- There is little case law pertaining to unincorporated associations, leaving an element of the unknown.
- Because unincorporated associations are so flexible, a founder has less assurance that his or her wishes as to the direction and purpose of the organization will remain unchanged.
- Many unincorporated associations may also find they have trouble with potential lenders who are more comfortable dealing with corporations than with unincorporated associations.
- Donations received are **not** tax deductible for either the organization or the donor.

2. Operate under an Umbrella Organization

Another option to consider is searching for a larger tax-exempt organization to serve as an *incubator* for your organization or program. This arrangement is ideal for organizations that would like to focus on programs, work on a limited-time project, or test a program idea. In addition to being able to utilize the umbrella organization's tax-exempt status, the umbrella organization can help a startup nonprofit get a foothold into

the nonprofit sector until it is officially recognized as a tax-exempt 501(c)(3). The umbrella organization provides fiduciary oversight for its sponsored organizations, and may also provide financial management services, shared office space, and accounting and administrative services. Grants or donations to the sponsored group are received by the sponsoring organization, which manages the grant.¹² All donations to the program or organization will be accepted by and distributed through the umbrella organization.

It should be noted that operating under the umbrella of another organization can be complex, and any arrangements made should be tailored to the organization's needs. Organizations considering this option should identify several possible sponsors with missions in sync with their own and thoroughly vet each possibility to find the best fit in terms of missions, work atmosphere, and location. It is strongly recommended that both parties consult with legal professionals to ensure their interests are being met in the sponsorship agreement.¹³



¹¹ Megan C. Sanders, "Private Foundations: A Practical Guide to Key Issues, Choices, and Risks," accessed December 16, 2015, http://moorenonprofitlaw.com/wp-content/uploads/2015/09/Private_Foundations__A_Practical_Guide_to_Key_Issues-Choices-and-Risks-paper.pdf.

¹² "How Can a Fiscal Sponsor Help Your Nonprofit Startup?," *About.com Money*, accessed December 16, 2015, <http://nonprofit.about.com/od/glossary/g/fiscalsponsor.htm>.

¹³ "Alternatives to Starting a Nonprofit | Minnesota Council of Nonprofits," accessed December 16, 2015, <http://www.minnesotanonprofits.org/nonprofit-resources/start-a-nonprofit/alternatives..>

STAGES OF FORMATION: FROM CONCEPTION TO FILING FOR 501 (c)(3) STATUS

Approaching the formation of a nonprofit as one large process can be overwhelming. This is precisely the reason it is often beneficial to break the process into stages. If your organization has no need to grow slowly, as outlined in the previous section, the process can be divided into **three stages**. Each stage presents certain challenges, but this paper will guide you through each of the challenges and provide clarification on areas often overlooked. All forms and examples mentioned will be included in the *Bibliography* or *Important Links* section at the end of the guide.

THREE STAGES OF FORMATION:

1. Discovery Stage
2. Preparatory Stage
3. Federal Application

The Discovery Stage:

The time devoted to composing the first draft of the organization's mission statement, choosing an acceptable name, recruiting board members, and forming the brand and vision is dedicated to the discovery stage. This is the opening stage in which you conceptualize the grounds that your organization will use as its foundation. Use this stage to research other nonprofits with similar missions, visions, brands, and ideas to discover the true impact your organization hopes to make. Be sure to research objectively to discover whether the community you hope to serve truly needs the services your organization will offer or if the services are being offered by another organization. Discover what makes your organization worth the time and work it will take to operate. The important items to consider in this stage are the organization's mission statement, name, and board members.

Board Recruitment:

Much can be written on the topic of board composition and responsibilities. For the purposes of this publication, only the basic knowledge of the duties of board members and some insight on recruiting good board members for your organization will be addressed.

*The initial board of directors will assume much of the responsibility in starting a new nonprofit. They determine the direction and goals of the organization and set forth precedents for future board members. The first board writes the articles of incorporation and approves the original bylaws, does much of the initial fundraising, and hires staff as the organization takes shape and becomes an entity in and of itself. This initial all-volunteer period can prove to be very challenging for new organizations, making it essential that initial board members are dedicated to the nonprofit's mission and to the success of the organization.*¹⁴

The directors first selected and listed in the incorporation papers will not be permanent – most boards of directors change membership overtime – but serious thought should be put into asking someone to serve in this role. The board has a legal responsibility to the

¹⁴ "Steps to Forming a Nonprofit: Visionary Stage | Minnesota Council of Nonprofits," accessed January 7, 2016, <http://www.minnesotanonprofits.org/nonprofit-resources/start-a-nonprofit/steps/visionary>.

organization. They must be willing to put forth their time, expertise, and money to help establish the nonprofit, and possess the skills and experience necessary to grow the organization. Most importantly directors should be people who share your vision and believe in the cause.

Try and determine what kind of experience, diversity, and skills your board needs and recruit board members appropriately. Your directors do not have to be citizens of this country or residents of the state in which you are incorporating. However, they must all be real people who have agreed to take on this important responsibility. The directors you choose in your start-up phase will do things like: vote on and accept the bylaws, take part in creating the organization's bank account, file for charitable contributions, and file for 501(c)3 Status.

The importance of a diverse and attentive board cannot be overstated. The board serves as the oversight of the Chief Executive Officer (CEO) and ensures that the organization's mission is being upheld in all facets of its operations and programs. The foundational legal duties of each board member are described as *Duty of Care*, *Duty of Loyalty*, and *Duty of Obedience*.

It is nonprofit best practice that an organization's board should represent a diverse spectrum of talents, professions, expertise, races, and backgrounds. The board members be unrelated. Many difficult situations can be avoided simply by taking the effort to ensure the board is composed of competent, knowledgeable, dedicated, and unrelated professionals.

Duty of Care:

*"The duty of care describes the level of competence that is expected of a board member, and is commonly expressed as the duty of 'care that an ordinarily prudent person would exercise in a like position and under similar circumstances.' This means that a board member owes the duty to exercise reasonable care when he or she makes a decision as a steward of the organization."*¹⁵

Duty of Loyalty:

*"The duty of loyalty is a standard of faithfulness; a board member must give undivided allegiance when making decisions affecting the organization. This means that a board member can never use information obtained as a member for personal gain, but must act in the best interests of the organization."*¹⁶

Duty of Obedience:

*"The duty of obedience requires board members to be faithful to the organization's mission. They are not permitted to act in a way that is inconsistent with the central goals of the organization. A basis for this rule lies in the public's trust that the organization will manage donated funds to fulfill the organization's mission."*¹⁷

¹⁵ "Board Responsibilities and Structures - FAQs" (BoardSource, 2013).2.

¹⁶ Ibid. 2.

¹⁷ Ibid. 2.

The Preparatory Stage

The next stage in receiving tax-exempt status pertains to the preparation of the necessary documents pertinent to the organization's articles of incorporation, initial business plans, and bylaws. It is in this stage that your organization will incorporate, apply for a Federal Employee Identification number (EIN), open a bank account, create a business plan with a budget, draft the corporate bylaws, and hold the first board meeting.

Keep in mind that this is a guide based on what you need to know presented in this order for learning purposes. Many of these steps may occur simultaneously or at different points in your organizations development. In other words, the large stages are chronological, but the smaller tasks within those stages sometimes unfold in a different order.

The Incorporation Process:

The first official step in becoming a tax-exempt organization is to file incorporation papers with the Oklahoma secretary of state.

"Although the laws of many states permit some rules for the governance of the corporation to be set out in either the articles or the bylaws, the articles of incorporation should be as general as possible and should contain only the minimum that is required by state law. The goal is to have a general and flexible document that will not need to be amended, since any changes to the articles of incorporation require filing special paperwork with the state and paying a filing fee."¹⁸

There are several things you will need to have ready in order to complete this process.

What you will need:

1. A useable name

In order to file you will need to be sure that the name you want to use for your organization is not already being used or is too similar to that of another organization. If "The Food Pantry" is already being used, for example, your organization cannot choose "Pantries for Food" for its name. Even though it is technically different, it is too similar and will yield problems later for your organization. According to the Oklahoma Secretary of State the following guidelines must be followed when selecting a corporation name:

- The name of the corporation which **shall** contain one of the words "association", "company", "club", "foundation", "fund", "incorporated", "institute", "society", "union", "syndicate", "limited" or one of the abbreviations "co.", "corp.", "inc.", "Ltd.", or words or abbreviation of like import in other languages provided that such abbreviations are written in Roman characters or letters.¹⁹
- The name will be distinguishable when compared to the records in the office of the Secretary of State from the names of: 1) corporations, both domestic and foreign, then existing or which have existed at any time during the preceding three years; or 2) then existing domestic and foreign limited partnerships; or 3) then existing domestic and foreign limited liability companies; or 4) trade names or fictitious names; or 5) corporate, limited partnership or limited liability company names reserved with the Secretary of State.²⁰
- Name Availability can be checked in advance by visiting the Secretary of State's website located at <https://www.sos.ok.gov>, clicking of the *Business Services* tab, and then clicking *Name Availability*. You can also call (405) 522 - 2520 or go in person.

¹⁸ D. Benson Tesdahl, *Better Bylaws: Creating Effective Rules or Your Nonprofit Board*, Second Edition (BoardSource, 2015). 9.

¹⁹ Oklahoma Secretary of State, "Procedures for Organizing an Oklahoma Not For Profit Corporation," accessed January 11, 2016, <https://www.sos.ok.gov/forms/FM0008.PDF>. 1.

²⁰ *Ibid.* 1.

2. Organizational structure

You also must decide which business structure you would like to operate. The most common is the *Nonprofit Corporation*. The Oklahoma Secretary of State has published a guide to organizational structure so you can review which type of structure will be right for your organization here at: <https://www.sos.ok.gov/corp/organization.aspx>

3. Exempt Purpose

You must state the reason your organization feels it should be tax exempt in your organizing documents. This means that your organization exists for one or more of the following purposes: charitable, educational, religious, scientific, literary, fostering national or international sports competition, preventing cruelty to children or animals, and testing for public safety. Determine which of these best describe your organization's purpose before filling out the incorporation papers. Examples of the language needed in founding documents will be addressed in the next section.

4. Registered Agent

You must have an individual or corporate entity residing in the state who will be the recipient of official correspondence for the organization. They do not assume any personal liability and can be either a person already associated with your organization or a company that specializes in providing this service. Many registered agent companies can be found online or by finding a list of Registered Agents on the Secretary of State's website.

The registered agent will be the point of contact for the state when they need to contact the organization. This prevents official documents from going to multiple locations and individuals, or getting misplaced or delayed.

5. Directors

You must decide on at least three directors and include their addresses in the incorporation documents. Only three are required but more can be listed. The number of directors should reflect the needs of the organization. Some organizations have five or seven directors while others may have anywhere from 11 to 31.

After you have determined that your name is available, selected your organizational structure, decided upon a registered agent, and determined your board of directors, you are ready to officially file your incorporation papers by going to the Secretary of State's online registration forms for Business Entity Filings. Be sure you select the Not for Profit Corporation—or follow the hyperlink: <https://www.sos.ok.gov/corp/filing.aspx>. There is a \$25 processing fee to file.

Sample of Tax-Exempt Language Required in Founding Documents:

Purpose Clause:

"This *corporation* is organized exclusively for religious, charitable, scientific, literary or educational purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code or the corresponding section of any future United States Internal Revenue law."

Dissolution Clause:

"In the event of the dissolution of the corporation, after paying or adequately providing for the debts and obligations of the corporation, all assets shall be distributed for one or more exempt purposes within the meaning of the section in which the organization has received its tax-exempt

status, or corresponding Section of any future federal tax code. Upon inaction of the Board to adequately dispose of the assets upon dissolution, such assets shall be disposed of by a Court of Competent Jurisdiction in Oklahoma County.”

Private Inurement:

“No part of the net earnings of the *corporation* shall inure to the benefit of, or be distributable to, any of its members, trustees, officers or other private persons, except that the *corporation* shall be authorized to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the exempt purposes.”

Apply for a Federal Employee Identification Number (EIN):

After you have incorporated with the State, visit <https://www.irs.gov>, click on the *Filing* tab, choose *Corporations* in the left hand category column, select *Employer ID Number*, and *Apply for an EIN Online*. This is free. Even if you do not have any employees, the EIN number serves as a kind-of social security number for your organization which you will use in all of your correspondence with the IRS when you go to file for your 501(c)(3) status, and later when you file your annual 990s. The EIN number and incorporation certificate from the Secretary of State are what you will need to open a bank account.

Create a Business Plan with a Budget:

Creating a thoughtful business plan during the beginning stages of a new nonprofit can provide a sense of direction to the organization as it develops. A plan should include what the organization’s goals are, what programs it will operate, where it will get funding, whether or not it will conduct events, have staff, volunteers, and more. It should also include a budget plan that includes where funding will come from, whether or not programs will rely on grants, individual donations, state or federal contracts, as well as expected expenses.

A business plan and budget are not only useful in thinking through the structure of the organization, but they are required as part of the narrative section of IRS form 1023, Application for Tax-Exempt Status.²¹

²¹ “Steps to Forming a Nonprofit: Planning Stage | Minnesota Council of Nonprofits,” accessed January 19, 2016, <http://www.minnesotanonprofits.org/nonprofit-resources/steps/planning>.

**MEMBERSHIP
VS.
NON-
MEMBERSHIP**

Deciding between a membership and non-membership structure should be the first decision when drafting the bylaws. Membership will dictate some of the provisions included in the original bylaws.

In the context of organizational structure and bylaws, the definition of membership differs from the common use of the word.

If an organization chooses to have “Formal Members” it gives those members legal voting rights. This means they have a legal right to cast votes pertaining to the operation of the organization and the election of its directors. Most organizations choose the non-membership structure simply because it legally entitles only the directors to participate in the governance of the organization

If your organization chooses the “formal membership” structure the member powers should be included in the bylaws.



Draft the Corporate Bylaws:

The bylaws of an organization should address specific issues that pertain to the governance and corporate structure. The organization should append the bylaws to the Form 1023 needed when filing for tax-exempt status.

It is important that the bylaws be tailored to the needs of the organization while including the general provisions needed to operate within the legal parameters of the state. Each organization is unique and may require different provisions stated in their bylaws.

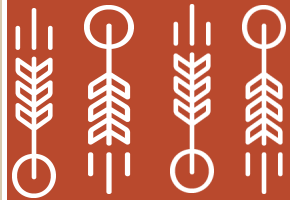
The ultimate goal for the original bylaws is to have the important issues regarding the governance of the organization addressed while giving the organization the freedom to expand and personalize its bylaws in the future. It is important that an organization does not create bylaws that will inhibit the ability to carry out the mission of the organization. Below is a general list for basic guidance. If more help is needed, please contact the Oklahoma Center for Nonprofits or a nonprofit lawyer to assist in the preparation of your bylaws.

BYLAW PROVISIONS:

1. Purpose and Distributions: Principal Office and Other Offices	<ul style="list-style-type: none"> • Regular Meetings • Quorum 	6. Execution of Instruments
2. Members	<ul style="list-style-type: none"> • Adjournment 	<ul style="list-style-type: none"> • Contracts • Checks and Drafts
3. Directors	<ul style="list-style-type: none"> • Fees and Compensation • Action without Meeting • Etc. 	<ul style="list-style-type: none"> • Deposits; Bank Accounts • Loans
<ul style="list-style-type: none"> • Power and number of Directors (we suggest a range for number of directors) • Election Process • Term of Office • Vacancies • Resignations and removals • Place of Meetings 	4. Committees	7. Amendments
	<ul style="list-style-type: none"> • Executive • Governance 	8. Policies
	5. Officers	9. Liability and Indemnification of Directors and Officers
	<ul style="list-style-type: none"> • Secretary, Board Chair, Treasurer, President, Etc. 	

IMPORTANT POLICIES:

- Conflict of Interest
- Financial Policies and Procedures
- Fundraising
- Gift Acceptance
- Loan/Debt
- Nondiscrimination
- Lobbying/Advocacy
- Media
- Investment
- Record Retention/ Destruction (Sarbanes-Oxley)
- Whistleblower (Sarbanes-Oxley)

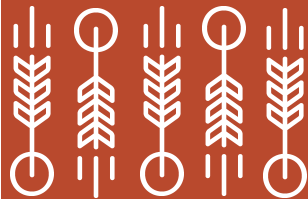


ABOUT BYLAWS:

- Bylaws are subordinate to the articles of incorporation, and if there is a conflict, the articles will always take precedence.
- Bylaws contain the primary governance details of the organization and essentially form a contract between the corporation and its directors and officers.

ABOUT MEETING MINUTES:

Minutes are the permanent record of all of the board and committee meetings. They are a necessary legal document that convey what actions were taken during the meeting and may be used in court should the need arise. The minutes are not a “word-for-word” account of the meeting; rather, they are a record of the decisions made and actions taken. All minutes must be written, reviewed and approved by the board, signed by the secretary and board chair, and archived.



WHAT TO INCLUDE IN THE ORGANIZATIONAL MINUTES

- Accept the Articles of Incorporation
- Ratify All acts taken by your Incorporators
- Adopt Bylaws
- Adopt Corporate Seal
- Elect Officers
- Who can execute contracts
- Who can file licenses— Form 1023
- Duties of Officers
- (EIN) and Bank Account
- Payment of Expenses
- Salaries/Employees
- Etc.

Hold the First Board Meeting:

The first official meeting of the initial board members or incorporators marks the formal beginning of the organization. It is at this meeting that the initial board must approve the drafted bylaws, adopt its principles, vote on new board members and officers in the manner dictated by the bylaws, discuss the mission statement, and begin the process of obtaining tax-exempt status.

The Federal Application Stage:

Filing Form 1023 for 501(c)(3) status is typically the stage that requires the most time and effort. Your organization can begin to operate and perform its mission after you have incorporated with the State; however, the organization cannot receive tax-deductible donations or grants until it has been granted 501(c)(3) status by the IRS. In other words, you may receive donations before you get your 501(c)(3) status, but you need to be clear with your donors that their contribution is not tax-deductible.

If your organization files the Form 1023 within the 27 month filing period, which starts officially on the day of incorporating with the State, and is granted tax-exempt status, all donations received while the application was pending qualify for exemption. If the application is disallowed, the contributions would not qualify for exemption.

There are good guidelines and sample forms for filing 501(c)(3) paperwork at IRS.gov that we recommend you look over carefully as your organization gets ready to file. Both preparing to file Form 1023 and the process of actually filling out the paperwork itself take a considerable amount of time and energy. The preparation for and completion of all the necessary forms can take 6 months to a year and another 1-2 years before your papers are reviewed by the IRS and your status is determined. Have patience and know that it could take several years to receive your 501(c)(3) status.

Form 1023:

In order for a corporation or other qualifying entity to receive 501(c)(3) status, it must apply to the IRS for recognition by filing Form 1023, or Form 1023-EZ, *Application for Recognition of Tax Exemption*. The application is a thorough examination of the organization’s structure, governance, and programs. Which form you file as well as how much you pay is dependent on the organization’s assets and annual gross receipts. If the organization has less than \$250,000 in assets and annual gross receipts of

\$50,000 or less, that organization may file the online Form 1023-EZ, *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*.

If the organization does not meet this criteria, it must file the Form 1023. The user fees are \$850 for an organization filing Form 1023 and \$400 for Form 1023-EZ. It is a good idea to read through the Form 1023 even if you qualify for the 1023-EZ to understand what the IRS requires of larger organizations. The IRS has published a Form 1023-EZ checklist at: <https://www.irs.gov/pub/irs-pdf/i1023ez.pdf> that organizations should complete prior to filing Form 1023-EZ. Once the checklist is completed, go to www.irs.gov/form1023 or www.pay.gov, enter “Form 1023-EZ” in the search box,” and click on *continue to this form*. Form 1023-EZ can only be filed electronically and printed copy submissions are not accepted.

There are two options available when filing Form 1023. You may choose to fill out the original PDF version located at: <https://www.irs.gov/pub/irs-pdf/f1023.pdf>, print off and attach the necessary documents, and send the form *and* the associated user fee to:

Internal Revenue Service
P.O. Box 12192
Covington, KY 41012-0192

Or, you may fill out the interactive Form 1023 at: <https://www.irs.gov/pub/irs-pdf/f1023i.pdf>. Both must be printed off and mailed to the address above, but the interactive Form 1023 has helpful tips to make filling out the form less cumbersome. Generally, Form 1023 should be filed within 15 months of the organization’s formation. For practical reasons, many organizations find it better to apply as soon as possible following formation. Extensions beyond 15 months may be possible under a variety of circumstances. After a period exceeding 27 months following corporate formation, retroactivity of 501(c)(3) status is likely limited.

The IRS has also put together a list of *Top Ten Tips to Shorten the Tax-Exempt Application Process* available at: <https://www.irs.gov/Charities-&-Non-Profits/Top-Ten-Reasons-for-Delays-in-Processing-Exempt-Organization-Applications>. For more tips on the application process, the IRS webpage has a wealth of information about all things related to tax-exempt organizations.

Compliance:

As addressed previously in the paper, having 501(c)(3) status comes with compliance requirements, such as operating the organization within the IRS regulations. In addition, all organizations must file some version of Form 990 with the IRS each year. Additional compliance requirements exist at the state level.

Failure to comply with IRS regulation will result in the revocation of the organizations tax-exempt status and in some cases, the board members responsible for the unlawful actions taken can be held personally liable.



Annual Reporting:

The annual 990 has different returns based on annual gross receipts. Small tax-exempt organizations with annual gross receipts normally \$50,000 or less must submit Form 990-N, Electronic Notice (e-postcard).²²

The Form 990-EZ is a shortened version of the Form 990 for use by small tax-exempt organizations. An organization may file a 990-EZ if its gross receipts are less than \$200,000 a year *and* its total assets at the end of the year are less than \$500,000. If an organization does not meet the above criteria, then it must file the Form 990. (*Note: If your organization is a private foundation, then it must file the 990-PF*). If an organization fails to file an annual return for 3 consecutive years it will automatically lose its tax-exempt status.

CLOSING REMARKS

This publication is intended as a general guide for founding a 501(c)(3) organization in Oklahoma, and is not intended to cover the entire spectrum of running a nonprofit corporation with tax-exempt status. There are many reputable comprehensive guides that delve into specific information that may not have been mentioned in this publication. Please utilize the bibliography for a large list of reputable resources to consult.

The Oklahoma Center for Nonprofits exists to serve and educate the nonprofit sector of Oklahoma. Please do not hesitate to contact the Center with any questions you may have about your nonprofit organization.

Disclaimer:

While some of the information in this guide does apply broadly to most nonprofits, it is important to recognize that the rules and guidelines set forth for charitable organizations change over time and vary from state-to-state. This guide contains legal information, but is in no way a substitute for professional legal advice. It is always advisable to consult with an attorney who specializes in interpreting nonprofit law.

²² Publication 557 (Rev. February 2015) - p557.pdf." Accessed February 2, 2016. <https://www.irs.gov/pub/irs-pdf/p557.pdf>. 11.

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IMPORTANT LINKS

Here is list of links addressed in this guide plus some others that pertain to tax-exempt organizations.

Oklahoma Center for Nonprofits:

<http://www.okcnp.org/>

Oklahoma Secretary of State:

<https://www.sos.ok.gov/>

(EIN):

<https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Apply-for-an-Employer-Identification-Number-%28EIN%29-Online>

Understanding Your EIN:

<https://www.irs.gov/pub/irs-pdf/p1635.pdf>

Form 1023:

www.irs.gov/form1023

www.pay.gov

Form 1023 Interactive:

<https://www.irs.gov/pub/irs-pdf/f1023i.pdf>

Form 1023:

<https://www.irs.gov/pub/irs-pdf/f1023.pdf>

Form 1023-EZ:

<https://www.irs.gov/pub/irs-pdf/i1023ez.pdf>

Ten Reasons for Delays in Processing Tax-Exempt Applications:

<https://www.irs.gov/Charities-&-Non-Profits/Top-Ten-Reasons-for-Delays-in-Processing-Exempt-Organization-Applications>

A Complete Guide for Starting a Nonprofit Organization:

<http://form1023.org/wp-content/uploads/IRS-501c3-book.pdf>

Form 990:

<https://www.irs.gov/pub/irs-pdf/i990.pdf>

IRS Publications:

Instructions for Form 1023:

<https://www.irs.gov/pub/irs-pdf/i1023.pdf>

Tax-Exempt Status for Your Organization:

<https://www.irs.gov/pub/irs-pdf/p557.pdf>

Applying for 501(c)(3) Tax-Exempt Status:

<https://www.irs.gov/pub/irs-pdf/p4220.pdf>

Compliance Guide for 501(c)(3) Public Charities:

<https://www.irs.gov/pub/irs-pdf/p4221pc.pdf>

Compliance Guide for 501(c)(3) Private Foundations:

<https://www.irs.gov/pub/irs-pdf/p4221pf.pdf>

Other Sources:

<http://moorenonprofitlaw.com/wp-content/uploads/2015/09/Private-Foundations-A-Practical-Guide-to-Key-Issues-Choices-and-Risks-paper.pdf>

<http://www.sos.wa.gov/assets/charities/Washington%20Nonprofit%20Handbook.pdf>

TAX-EXEMPTION CHECKLIST

- Compile materials from the Secretary of State website: <https://www.sos.ok.gov/>
- Choose a corporate name
- Check name availability
- Register your corporate name
- Protect your name
- Prepare Articles of Incorporation
- File articles of incorporation
- Prepare bylaws
- Prepare membership provisions (if needed)
- Prepare and file your Federal Tax Exemption Application
- Register your Charitable Organization with the Secretary of State
- Set up a Corporate Records Book
- Prepare minutes of first Board of Directors meeting
- Place minutes and attachments in Corporate Records Book
- Prepare assignment of leases and deeds
- File final papers for Prior Organization (existing groups only)
- Notify others of your incorporation (existing groups only)
- File assumed business name statement
- Apply for Federal Nonprofit Mailing Permit
- Apply for property tax exemptions
- File corporate report form
- Register with the Attorney General
- Comply with political reporting requirements

GUIDE TO FORM 1023: DOCUMENTS AND REQUIRED MATERIALS CHECKLIST*

Required Documents:

- Articles of Incorporation**
- Bylaws**
- Conflict of Interest Policy**

Before drafting your responses for Form 1023, it may be helpful to gather the following information, which will help you answer questions posed by the Form 1023:

Description of Activities

Form 1023 requires a description of the organization's past, present, and planned activities. With respect to each activity, you should be prepared to describe:

- What the activity is;
- Who conducts it;
- Where it will take place;
- When the activity is conducted;
- How it will be funded;
- How it furthers the organization's tax-exempt purposes;
- What percentage of the organization's total time is dedicated to such activity.

Director/Officer Resumes

Form 1023 asks for resumes or summaries of the qualifications of the organization's officers, directors, trustees, highest compensated employees (who receive over \$50,000 per year) and highest compensated independent contractors (who receive over \$50,000 per year).

Financial Data

Form 1023 requires historical and/or projected financial data. If the organization has been in existence for four or more years, it must provide information regarding its revenues and expenses regarding the past four years. If it has been in existence for more than one year, but less than four years, it must provide revenue and expense information for each year it has been in existence, plus projected revenue and expense information for a total of three years of financial information. If the organization has been in existence for less than one year, it must provide projections of its likely revenues and expenses for the current year and the two subsequent years, based on reasonable and good faith estimates of its future finances.

*Adapted and drawn from:

Washington Attorneys Assisting Community Organizations and King County Bar Association Young Lawyers Division, "Washington Nonprofit Handbook," accessed February 23, 2016, http://www.sos.wa.gov/_assets/charities/Washington%20Nonprofit%20Handbook.pdf.

Information to Include if Applicable:

Form 1023 asks for a variety of other documents and information, which may or may not be applicable to your organization. After reading the list below, it may be helpful to gather any of the following documents that are relevant to your organization and its activities:

Printed materials

Printed materials detailing the history of the organization, its activities and/or its plans for the future, which might include newsletters, brochures, pamphlets, descriptive literature, published materials, etc.

Materials Prepared for Members

If the group is a membership organization, any materials prepared for members, such as membership application forms, promotional materials, sample membership certificates or identification cards, sample copies of member-only publications, etc.

Media Coverage

If the organization has received media coverage, copies of newspaper clippings, transcripts of interviews, etc.

Events

If appropriate, a "schedule of events," showing where and when the organization has held informational, educational, performance or other events during the last 12 months, including approximate attendance.

Fundraising Activities

Information regarding the organization's fundraising plans, including how it plans to raise funds and in which jurisdictions it will undertake such activities.

Grantmaking Activities (Private Foundations)

If the organization will be making grants to other organizations:

- Copies of any grant agreements;
- A description of records your organization keeps regarding its grants;
- Information regarding your selection process, including whether a grant proposal or application is required;
- A description of your organization's procedures for oversight of distributions to ensure that its resources are used for tax-exempt purposes (e.g., conducting pre-grant inquiry and/or requiring periodic or final reports regarding the use of grant funds).

Scholarships or Grants

If the organization will have a scholarship or grant program:

- A description of how potential applicants will hear about the program;
- A description of eligibility requirements;

- A sample of the application form(s) applicants will be required to submit;
- A description of the selection process, including a description of any selection committee and how members of the selection committee are chosen;
- Any guidelines prepared for the selection committee's use;
- Conditions placed upon grants or scholarships, including any requirements for reports and a description of action that will be taken if the terms of the grant are violated;
- Records the organization keeps regarding its grants or scholarships.

Other Materials

If relevant, gather the following:

- Copies of leases, loan agreements or other contracts between the organization and its officers, directors, highest compensated employees, highest compensated independent contractors or any entity in which any of the above individuals owns more than a 35% interest;
- Independent appraisals or other data substantiating the value of any assets the organization is renting or purchasing from related parties;
- Copies of any agreements pursuant to which another individual or organization will raise funds for your organization or pursuant to which your organization will raise funds for any other organization.

Information Required for Schedules

The Form 1023 has a number of schedules, which must be filled out if applicable to the organization. These include special schedules if the organization is a church, school, hospital, supporting organization, organization that provides low-income housing or scholarships. If any of the Form 1023 schedules applies to the activities of your organization, be sure to review the applicable schedule so that you can gather all of the required information.

Tips for Completing Form 1023

General Considerations

Throughout Form 1023, if the form does not permit enough space to answer the question posed, you may write "Please See Attachment" or "Please See Exhibit Attached" and attach a copy of the referenced document. Be sure to insert the document in the appropriate spot within the pages of the application itself (i.e., behind the page of the application that references the attachment.) This will make it easy for the IRS agent to find your attachments. Be sure to label each attachment with the organization's name, employer identification number, and the question number to which the attachment relates.

It is important to be as transparent as possible regarding the organization's activities, finances, etc. If you feel you have already provided information requested in one part of the application in response to a question elsewhere in the application, you may find it

convenient to cross-reference such information rather than repeating it. For example, if an organization intends to make grants to support foreign charitable organizations, it might describe this activity in detail in its narrative description of activities under Part IV. The organization's responses to Part VIII, questions 13 and 14, might then cross-reference "Attachment 1, responses to Part IV."

Tricky Questions: Form 1023

Page 2—Part IV: Narrative Description of Activities

The narrative portion of Form 1023 is the core of the application. This section can make or break an organization's chance at receiving tax-exempt status. One approach is to start with this formula:

[Name of organization] is organized exclusively for [religious, charitable, scientific, literary or educational (choose one or more)] purpose(s) within the meaning of § 501(c)(3) of the Code. Specifically, [Name of organization] (describe in one or two sentences what the organization does).

In succeeding paragraphs, define the problem the organization hopes to solve, using specific data or statistics if available. Try to cover WHO, WHAT, WHEN, WHERE, HOW, etc. Examples:

- Who are the organization's members, clients, and patrons?
- Who will carry out the activities of the organization?
- What will the organization offer to these individuals or entities?
- What will the organization charge for its programs?
- What will take place at a typical meeting or event of the Organization?
- When did the organization's founders begin working to further the organization's purposes?
- When will the organization be fully operational?
- When will regular meetings, events, or other program activities be held?
- Where will the organization be based?
- Where will the organization obtain its funding?
- How will members, clients, and patrons hear about the organization's activities?
- How many members, clients, and patrons does the organization expect to serve?
- How is the organization distinguishable from for-profit entities, if any, with similar activities?

Page 3—Part V: Compensation and Other Financial Arrangements With Your Officers, Directors, Trustees, Employees, and Independent Contractors

Questions 1b and 1c:

If no employee or independent contractor is expected to receive more than \$50,000 per year, simply insert a statement to that effect in the provided space for both 1b and 1c.

Page 3—Part V, Question 3b:

If any of the listed officers, directors, trustees, highest compensated employees, or highest compensated independent contractors receive money from an entity that is connected to the organization through common control, you must check “yes” and explain the nature of the arrangement in a complete and transparent manner.

Common Control—You and one or more other organizations have:

- A majority of your governing boards or officers appointed or elected by the same organization(s);
- A majority of your governing boards or officers consist of the same individuals;
- A majority ownership interest in a corporation, partnership, or trust.

Page 3—Part V, Question 4

The Form 1023 indicates that the practices regarding compensation for officers, directors, trustees, and highly compensated employees and independent contractors reflected in this question are recommended, but not required. However, answering “no” to any of these questions is likely to raise a flag for the IRS agent reviewing your application. If you do answer “no” to any of these questions, be ready to provide complete and transparent information describing why the organization has not adopted a particular practice and what other safeguards it has put in place to ensure that compensation paid to officers, directors, trustees, highly compensated employees, and independent contractors is no more than is reasonable.

Page 4—Part V, Question 6

While tax-exempt organizations are not prohibited from compensating individuals through non-fixed payments, such as discretionary bonuses or revenue-based payments, these arrangements must be carefully designed in a way that results in reasonable compensation consistent with the rules set forth for 501(c)(3) organizations. It would be advisable to seek advice from a lawyer to be sure your compensation arrangements are within regulations.

Page 4—Part V, Question 7

It is in the organizations best interest if you can truthfully answer “no” to both parts of question 7. Answering “yes” will likely raise a flag with the IRS. You do not need to answer yes simply because directors, officers or other persons described in this question can purchase goods or services from the organization on the same terms as the general public. The purpose of this question is to ensure that any business

conducted between the organization and its officers, directors, trustees, or highly paid individuals that are in a position to influence the organizations activities (outside the normal course of operation and not available to the general public) is conducted in a way that does not unfairly compensate a particular person associated with the organization. Being able to show that any business between the organization and the individual has been noted in the conflict interest policy, conducted at *arms length*, approved consistent with the rebuttable presumption set out under the intermediate sanctions regulations, and vetted to be sure the product or service is being offered at *fair market* price may help alleviate the concerns of the IRS.

Page 4—Part V, Questions 8 and 9

See above explanation.

Page 5—Part VI: Members and Other Individuals, and Organizations That Receive Benefits From You

Question 1a and 1b: Benefits to Individuals and Organizations

Answer “yes” if your organization provides goods or services to individuals/ organizations (e.g., educational programs for youth or food to homeless people). The IRS wants to see that the goods or services you provide serves a charitable class, rather than a small, identifiable group of individuals or particular organization. If you intend to sell goods or services, make sure to show that your activities are structured in a manner that is different from the way a for-profit entity would operate. Do not say that the organization’s charges are based on cost. In the real world, of course, everyone must consider costs, but for the IRS, using cost as the sole basis for fees or charges may be a hallmark of a for-profit organization. Instead, survey what other nonprofits offering similar goods or services charge and base your fees on that; set your fees at a level that most people likely to need your services can afford; set your fees as low as you feasibly can, with the difference to be made up by donations; or establish a sliding scale for fees based on income and family size.

Page 5—Part VI, Question 2:

If the answer to this question is “yes,” you will want to be sure that the class of individuals to whom the organization provides services is a large and indefinite group (e.g., homeless people, youth), rather than a small, identifiable group (e.g., the organization’s members, residents of a single neighborhood, employees of a small company).

Page 5—Part VI, Question 3

Generally, the answer to this question should be “no.” If the answer is “yes” (for example, because you are starting a community orchestra and you expect that relatives of your directors and officers will be among the members of the general public that will attend performances), you should explain that goods or services will be

provided to such individuals only on the same terms as they are provided to the general public.

Page 5—Part VIII: Your Specific Activities

Question 2

If it is within your organization’s mission to actively influence specific legislation it is in your best interest to be transparent about the extent of your activities. If the answer to this question is “yes,” provide enough information about your organization’s activities to make the IRS comfortable that you will comply with the limitations on lobbying activity applicable to 501(c)(3) organizations. Also, if the answer to Question 2a is “yes,” the IRS will almost surely want the organization to make the § 501(h) election (meaning that the answer to Question 2b also should be “yes”) and you should fill out Form 5768.

Page 5—Part VIII, Question 3

If the answer to this question is “yes,” you will need to review IRS Publication 3079 and likely seek advice from a nonprofit lawyer or accountant.

Page 6—Part VIII, Question 4b

If the answer to this question is “yes”, the IRS will want enough information to assure itself that any compensation paid to the organization’s fundraisers is reasonable. It is best to avoid arrangements pursuant to which the fundraisers’ compensation is a percentage (i.e. *non-fixed payments*, See *pg. 4—Part V, Question 6a*) of the funds raised for the organization.

Page 6—Part VIII, Question 4e

If the answer to this question is “yes,” you may wish to seek advice from a lawyer or accountant to be sure that you understand and can comply with the complex rules applicable to *donor-advised funds*. If your organization intends to act as a sponsoring organization, the language must be included in the organizing documents.

Page 6—Part VIII, Question 6a

If the answer to this question is “yes,” you may wish to seek advice from an attorney. While 501(c)(3) organizations may engage in economic development activities, the IRS will want to be sure that such activities are sufficiently circumscribed so as to be consistent with 501(c)(3) status. The instructions to this question give you a helpful summary of the facts and circumstances in which the IRS may find it acceptable for a 501(c)(3) organization to engage in economic development activities.

Page 6—Part VIII, Question 7

Generally, the answer to questions 7a and 7b probably will be “no.” If the answer to either one is “yes,” you will want to provide the IRS with sufficient information to show that the arrangement does not result in undue benefit being provided to private

interests and that your organization retains sufficient control over its assets. If you need to provide information in response to question 7c, you will want to establish that any such arrangements are approved pursuant to the organization's conflict of interest policy.

Page 6—Part VIII, Question 10

If the answer to question 10 is "yes," the organization generally should be the owner of the intellectual property. If the organization will not own intellectual property that it produces, this may raise concern for the IRS, and you may wish to consult with an attorney. The IRS is mainly interested in the marketing or selling of intellectual property.

Page 7—Part VIII, Question 11

If the answer is "yes," you will likely want to seek advice from an attorney.

Page 7—Part VIII, Question 13a

If the answer is "yes," the IRS will want to be sure that appropriate safeguards are in place to ensure that the funds you grant to other organizations will be used only in furtherance of 501(c)(3) purposes. If you make grants only to other 501(c)(3) organizations, the IRS will not require the same safeguards (e.g., applications, grant agreements and detailed record-keeping) that it expects if you make grants to non-501(c)(3) organizations. If you are a private foundation, grants to non-501(c)(3) organizations will be taxable expenditures that trigger excise tax penalties under § 4945 unless you comply with certain additional administrative requirements (e.g., expenditure responsibility or equivalency determination procedures). Thus, if your organization is a private foundation that intends to make grants to non-501(c)(3) organizations, you may wish to consult an attorney.

Page 7—Part VIII, Question 14a

If the answer to question 14a is "yes," the answer to question 14c should be "no" and the answers to questions 14d through 14f should be yes.

Page 9—Part IX-A, Statement of Revenues and Expenses

The IRS usually requires both actual financial information to date and a two-year projected budget. Many organizations feel it is difficult to predict what the financial future holds; however, the IRS will, of course, require a projected budget even if you find it difficult to prepare. Just remember that you do not have to become a fortuneteller—a goodfaith estimate of future revenues and expenses is sufficient. Some organizations find that it works best to start with the goals the group wants to accomplish, estimating, goal by goal, what the planned activities will cost, and then creating a strategy to come up with the necessary income. For other organizations, it makes more sense to start with projected income when budgeting. For instance, a membership group can estimate the number of people who might join, as well as the

amount of dues members might be willing to pay, and then decide how much of the available money will be spent on each of the organization's planned programs. Make sure that the description of the organization's programs in Part II is consistent with the financial information presented here. When you are completing the statement of revenues and expenses, be sure to watch for the lines that request schedules and to provide such schedules as attachments.

Page 10—Part IX-B Balance Sheet

The statement of revenues and expenses is a summary of the organization's financial activity over a period of time, while the balance sheet is a snapshot of what the organization owns and owes on a particular given date. The IRS prefers that an organization's balance sheet reflect its assets and liabilities as of the end of its most recently completed tax year. If the organization has not completed a tax year, provide information that is effective as of the last day of the most recent month before filing the Form 1023 with the IRS.

Page 10—Part X, Question 2—Private Operating Foundation

True "private operating foundations" are rare. An organization that believes it is a private operating foundation should probably have its application professionally prepared.

Page 11—Part X, Question 6—Advance Ruling

Advance rulings are no longer given. Therefore, this question should not be answered.

Assembling Your Application

After you have completed your Form 1023 and relevant attachments, refer to "Form 1023 checklist" (the last two pages of Form 1023). This checklist describes the order in which Form 1023 and documents that accompany it should be compiled for submission and provides the address to which your application should be submitted. Before submitting your application, make certain that all applicable parts of the form are completed, including any required schedules. As previously mentioned, attachments should be inserted in the appropriate spot within the pages of the application itself (i.e., behind the page of the application that references the attachment) to facilitate IRS review. Each attachment should be labeled with the organization's name, employer identification number, and the question number to which the attachment relates. All other attachments, including articles of incorporation, bylaws, brochures and conflicts of interest policies, should be labeled with the organization's name and EIN. **Be sure to place your check or money order, payable to the United States Treasury, in an envelope on top of the checklist.**

An authorized person, usually the president of the board of directors or other officer, rather than the executive director, must sign the form. Part XI of the application inquires about the organization's gross annual receipts, which determines the amount of User Fee required. Following the User Fee determination, an authorized person (i.e., an officer of the organization) must sign the declaration portion of the Form. The declaration is a statement that the application is true, correct and complete.

Obtaining Recognition for a Publicly Supported Charity

A new organization will be classified as a public charity by virtue of its public support if it can show on its Form 1023 that it reasonably can be expected to meet the applicable public support test. During the first five years of operation, the organization retains its status as a publicly supported organization without regard to the calculation of the "public support test" on Schedule A of the Form 990. Beginning with the organization's sixth taxable year, the organization must show that it meets the public support test based on prior years' public support in order to remain classified as a publicly supported organization.

ABOUT THE CENTER

Since 1981, our state's charitable organizations have received vital capacity building services and support from the OKLAHOMA CENTER FOR NONPROFITS. Dedicated to building better communities through effective nonprofits, our training, consultation, advocacy and recognition programs have propelled Oklahoma's nearly 18,000 organizations to better implement their missions and help the people of our state thrive.

Through the investments of dozens of corporations, foundations and individuals, Oklahoma nonprofits receive the latest, state-of-the-art assistance with a special brand of personal touch. Recognized as a national leader among statewide service organizations, the OKLAHOMA CENTER FOR NONPROFITS prides itself on providing cutting-edge services statewide.

The Center's programs provide professional training to nonprofits comprising:

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The Center also helps nonprofits from across the state network and share information, and we are the voice of the nonprofit sector for advocacy and public policy. When nonprofits need to be heard collectively, they turn to the Center. Finally, we recognize great nonprofit leadership and operations through our "Visions Awards" and "Oklahoma Nonprofit Excellence" Awards. To date, we have given nonprofits and their leaders more than a million dollars in mini-grants as recognition for excellence in the sector.

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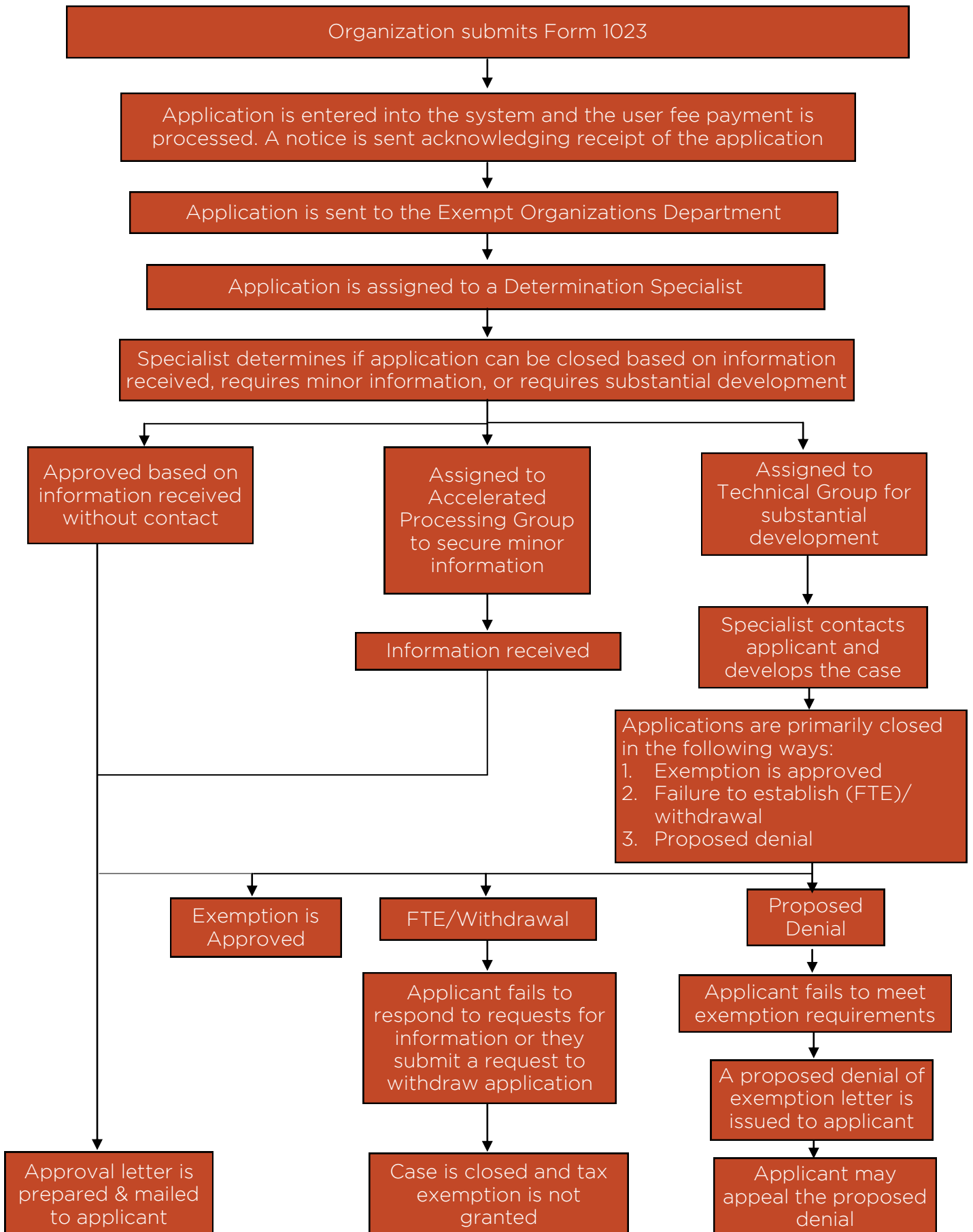
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Exempt Organization Determination Process



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