

501(c)(3) Tax Exempt Status: Do You Need It?

By Carol Topp, CPA

Perhaps your nonprofit organization is thinking about being officially recognized by the federal government. You've heard terms like non-profit, tax-exempt and 501(c)(3). You wonder what government recognition might mean for your group. What are the benefits? What will it cost in dollars and time?

The IRS Grants Tax Exempt Status

The IRS grants a "qualified charity" status to nonprofit organizations. The IRS is seeking to discover if a charity is legitimate and they will check for a Board of Directors, bylaws, a mission statement and a budget that does not seek personal gain for the founders. The tool the IRS uses is a 28-page application called Form 1023. The IRS also requires a \$300-\$750 application fee based on the size of the organization and annual reporting, again based on the size of the organization. It is frequently suggested that organizations get legal and accounting assistance in preparing the Form 1023 application. Becoming a formally recognized not-for-profit organization involves a lot of government paperwork, so an organization must ask if they desire the benefits of 501(c)(3) status and if they are prepared to carry out the responsibilities.

Benefits of 501c3 status

Tax exemption

If your organization has a financial surplus (and I recommend that you do have a surplus for emergencies), that "profit" will be subject to tax unless you file for and receive tax exempt status from the IRS. Tax exemption is not automatic simply because you are a nonprofit; it must be applied for and granted by the IRS.

Contributions

One of the greatest benefits of 501(c)(3) status is not for the charity, but for its donors. Any contributions of cash or property to a qualified charity are tax-deductible. This is an such important benefit that many organizations pursue the paperwork of 501(c)(3) status simply to receive more donations. If your group is not receiving donations (i.e., if you are funded by member fees), you may not need to pursue the 501(c)(3) status. But if you have individuals or businesses that wish to make donations, but will not unless they are tax deductible, you'll need the IRS's coveted "qualified charity" status. Also, if you are seeking government or charitable foundation grants, you will need 501(c)(3) status. And, finally, some fund raisers are only open to 501(c)(3) organizations.

Discounts

There are other benefits of 501(c)(3) status including special discounts on postage and some discounts for rent or equipment offered to charities by businesses. Some states offer special status to non-profits such as sales-tax exemptions on purchases made by the nonprofit or property tax exemptions.

Check with your state's Attorney General's Office to see if they grant special benefits to 501(c)(3) organizations.

Prestige

One intangible benefit of the 501(c)(3) status is the prestige. A 501(c)(3) non-profit organization is serious in their mission, expect to be around awhile and they went to extra effort to be accountable. 501(c)(3) status gives donors assurance that the nonprofit is trying to run a responsible organization.

Here's a quiz to see if you would benefit from 501(c)(3) Status:

Do you consistently make a **financial surplus** (i.e. a profit)?

File for tax exempt status so the government does not try to tax your "profit." Tax exemption is not automatically granted because you are a nonprofit; it must be applied for and granted by the IRS. State governments will also exempt nonprofits from state taxes when they are recognized 501(c)(3) organizations.

Do you have **donors who want a tax deduction**?

Only organizations that have been approved by the IRS can tell donors that their gifts are tax deductible. The coveted 501(c)(3) status granted by the IRS is essential if you begin accepting donations and someone asks for a receipt. Getting a 501(c)(3) status is a lengthy, time-consuming process, but may be worth your efforts if it increases donations.

Does your group wish to **apply for or receive grants**?

Granting organizations whether private foundations, corporations or government agencies almost always require 501(c)(3) status.

Does a **fundraising program require 501(c)(3)** status?

Some programs like local grocery "Rewards Programs" require that a group be a 501(c)(3) tax exempt organization. These reward programs are a great and easy fundraiser, and many nonprofit groups wish to take part. You will need to file for tax exempt status to participate.

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