

## **Setting Up a New Nonprofit Organization**

### ***Frequently Asked Questions***

#### **1. What kinds of organizations qualify for federal tax-exemption?**

Various types of organizations qualify for exemption from federal income tax under the Internal Revenue Code (“Code”). The most common type of tax-exempt organization is a 501(c)(3) charitable organization. The exempt purposes set forth in section 501(c)(3) of the Code include charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals. Notably, 501(c)(3) organizations can receive tax-deductible contributions, a key characteristic that distinguishes them from other tax-exempt organizations. 501(c)(3) organizations are further divided into two types: public charities and private foundations. Private foundations normally receive substantially all of their contributions from relatively few sources, while public charities generally receive a substantial portion of their financial support from the public. Because private foundations are generally privately funded and privately controlled, they are subject to additional requirements and restrictions that are not applicable to public charities.

In addition to 501(c)(3) organizations, many other types of organizations may qualify for tax-exemption, but may not receive tax-deductible contributions, including 501(c)(4) social welfare organizations, 501(c)(6) trade associations, and 501(c)(7) social clubs, to name a few. The IRS provides an overview of these different types of organizations [here](#).

#### **2. What steps are required to set up a new nonprofit organization?**

Typically, setting up a new nonprofit organization involves three key steps:

- (i) File your Certificate of Incorporation with the state, which should include certain language required by the IRS to qualify for the applicable tax-exempt status. To learn more about why Delaware is a common choice for incorporating a nonprofit, click [here](#).
- (ii) Adopt Bylaws, appoint initial directors and officers, adopt initial corporate resolutions, and apply for a federal Employer Identification Number (EIN).
- (iii) Prepare and file an application for federal tax-exempt status with the IRS. As of January 31, 2020, the IRS requires that Form 1023, “Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code”, be completed online and submitted through Pay.gov. Applications for tax-exempt status under other sections of the Code must still be submitted by mail.

### 3. How long does the process take to incorporate and obtain tax-exemption?

***For incorporation:*** The process for incorporating a nonprofit in most states is usually quick, and can be completed in a matter of days. For example, in Delaware, once you have submitted a signed Certificate of Incorporation with certain basic information (e.g., purposes, the name of the incorporator and/or a list of directors, and an organizational address, which can be a registered agent’s address), you can legally incorporate in approximately 24 hours. Incorporating in other states may take longer, and can take anywhere from a few days to a few weeks.

***For obtaining federal tax-exempt status:*** The IRS will initially send a letter in approximately one month confirming its receipt of the application.

Information about the status of the IRS’s review of applications based on their postmark date is available on their website [here](#). For example, as of September 23, 2020, Form 1023 applications postmarked after March 24, 2020 have not yet been assigned for review, meaning there is approximately a five-month queue before the application is assigned for review.

#### **Has my application been assigned to a specialist?**

Applications submitted after the postmark date in the chart below have not yet been assigned to an Exempt Organizations specialist. Keep checking this web page for updates and await IRS contact. **There is no need to call.**

Information on [expedite handling requests](#).

Form Number	Your application has not been assigned if postmarked after this date:
Form 1023-EZ	August 6, 2020
Form 1023	April 9, 2020
Form 1024	April 14, 2020
Form 1024-A	April 16, 2020
Form 8940	April 30, 2020

In addition, organizations whose applications are likely to require a longer review time are those that have certain organizational or operational features that require a more in-depth review to determine if the organization qualifies for tax-exempt status. Such features may include, but are not limited to: (a) engaging in a substantial amount of activities that are (or could be perceived as) commercial rather than charitable, (b) having a majority of directors, officers, or key employees that are related to one another through family or business relationships, (c) engaging in lobbying activities, and (d) actually or potentially providing significant benefits (financial or non-financial) to any person or entity.

Information how to check on the status of your application after it has been assigned to a specialist is available [here](#).

**4. I would like to start a small nonprofit organization. Is there an easier or faster way to apply for tax-exempt status?**

Yes, the IRS created the Form 1023-EZ for small organizations seeking 501(c)(3) tax-exempt status. This form has a much shorter processing time than the regular Form 1023. In our experience, Form 1023-EZ applications have typically been processed in about one month, although all IRS requests may be somewhat delayed due to the COVID-19 pandemic.

The Form 1023-EZ is a simple, three-page application. The organization must provide basic information, include a brief description of the organization's mission or most significant activities, and attest, through a checkbox response, that it has not, and will not conduct activities that violate certain prohibitions and restrictions applicable to 501(c)(3) organizations. Prior to filing this application, qualifying organizations should first consider incorporating, and should adopt Bylaws and a Conflict of Interest Policy. These documents are typically submitted to the IRS as part of the regular Form 1023 application, and are important foundational documents for the organization to have in place, even if they do not need to be submitted to the IRS with the EZ form.

Organizations can determine their eligibility for the EZ by completing the form 1023-EZ eligibility worksheet, which is available in the form [1023 EZ instructions](#), starting on page 13. The worksheet consists of 30 questions. The first three questions address financial thresholds, and are the most common indicators of whether an organization will qualify to use the EZ form. If gross receipts are expected to exceed \$50,000 per year in any of the next three years, if gross receipts have exceeded \$50,000 in any of the past three years, or if total assets have a fair market value in excess of \$250,000, the organization cannot use the EZ form. If an organization answers "yes" to any question on the worksheet, it cannot apply for exemption using the EZ form, and must file the full, standard 1023 form.

**5. Can I start soliciting donations while I am waiting for my IRS application for tax-exemption to be reviewed?**

Yes, an incorporated nonprofit organization may solicit and receive donations while it is waiting for its tax-exempt application to be reviewed. If the IRS application for tax-exempt status (Form 1023) is filed within twenty seven (27) months from the end of the month of incorporation, and the organization's status as a 501(c)(3) tax-exempt organization is granted, the organization's tax-exempt status and ability to accept tax-deductible donations will be retroactive to the date of the organization's incorporation. However, keep in mind that if the organization is seeking 501(c)(3) tax-exempt status, the Internal Revenue Code and state laws require that any solicitation materials distributed while the organization's tax-exempt status is pending must clearly disclose that the organization has not yet received 501(c)(3) tax-exempt recognition, and therefore, donations may not be deductible.

If your organization's donors need greater certainty regarding the tax-deductibility of their donations during the period in which it is waiting for the IRS to review and approve its application, you may want to consider using a fiscal sponsor to receive donations and make reimbursements or payments to vendors, contractors, and individuals. A fiscal sponsorship is a

relationship in which one organization that is tax-exempt (the fiscal sponsor) serves as the official recipient of charitable donations for another organization that is not yet recognized as tax-exempt (the sponsored organization). For more information on fiscal sponsorships, click [here](#).

## 6. What are my filing responsibilities once I receive or apply for my tax-exempt status?

***With the IRS:*** Almost all organizations are required to file a Form 990 (or 990-PF, 990-EZ, or 990-N) every year. (Exceptions include churches and their affiliated organizations, and governmental organizations, which are exempt from the 990 filing requirement). The Form 990 is an annual report filed with the IRS that provides information on the filing organization's mission, programs, and finances. The filing deadline is four and a half (4 ½) months after the end of the organization's fiscal year (although extensions can be requested). **The obligation to file a Form 990 (or 990-PF, 990-EZ, or 990-N) generally begins on the date of formation, *not* the date that the letter acknowledging tax-exempt status is issued.** The IRS Determination Letter will specify the effective date of exemption, which is the official date from which to calculate the organization's filing deadline. Failure to file Form 990 for three (3) consecutive years will result in automatic revocation of your federal tax-exempt status. For additional information on nonprofits' Form 990 filing obligations, click [here](#).

***With the State(s):*** Many states have annual filing requirements for nonprofit organizations. For example, Delaware requires all corporations incorporated in Delaware, including nonprofit corporations (which are actually "nonstock corporations" in Delaware), to file an Annual Report on or before March 1<sup>st</sup> of every year with a current fee of \$25.00 (\$125.00 if filed after March 1<sup>st</sup>). In New York, all organizations that conduct charitable activities, hold property that is used for charitable purposes, or solicit contributions in the state are required to register and file annual financial reports with the [Attorney General's Office](#). In addition, organizations may be required to register with certain states to solicit charitable contributions, even while their tax-exempt application is pending. For more information about these registration requirements, [click here](#).

## 7. What other ongoing compliance obligations should I be aware of to set up and operate a new nonprofit organization?

In order to maintain federal tax-exempt status, your organization must continue to be operated exclusively for exempt purposes. If more than an insubstantial part of the organization's activities do not further an exempt purpose, the IRS can revoke the organization's exempt status.

In particular, a 501(c)(3) tax-exempt organization must:

- not participate in [political campaigns](#) of candidates for local, state, or federal office;
- restrict its [lobbying activities](#) to an insubstantial part of its total activities;

- ensure that its earnings do not [inure](#) to the benefit of any private shareholder or individual;
- not operate for the [benefit of private interests](#) such as those of its founder or the founder's family; and
- not operate for the primary purpose of conducting a [trade or business](#) that is not related to its exempt purpose.

In addition to possible loss of the organization's section 501(c)(3) tax-exempt status, activities constituting inurement (i.e., an improper economic benefit) may result in the imposition of [penalty excise taxes](#) on individuals benefiting from excess benefit transactions, as well as organization managers.

For an overview of ongoing compliance issues for 501(c)(3) tax-exempt organizations, the IRS has prepared a [compliance guide for public charities](#) and a [compliance guide for private foundations](#).

*The information provided in this document does not constitute legal advice, and is not intended to substitute for legal counsel.*