Starting a Nonprofit Organization:

A Guide to Tax-Exempt Status

Starting a nonprofit organization can be an exciting and rewarding endeavor, but it requires careful planning and compliance with legal and tax regulations. From choosing the right structure to obtaining tax-exempt status, there are several important steps to take before launching your mission-driven organization. This guide outlines the key considerations and requirements for establishing a nonprofit, helping you navigate the process with confidence.

CHOOSING THE RIGHT STRUCTURE FOR YOUR ORGANIZATION

The first step in establishing a nonprofit organization is determining its legal structure. Organizations can be set up as an unincorporated association, a Limited Liability Company (LLC), or a corporation. In Pennsylvania, you may consider structuring your organization as a corporation.

A corporation provides:

- **Limited personal liability protection** for members.
- **Perpetual existence**, ensuring continuity beyond the original founders.
- **A formal structure** that is beneficial for governance and compliance.

An attorney can assist with drafting the articles of incorporation and developing a set of bylaws, which are essential documents for any nonprofit.

STEPS BEYOND INCORPORATION

Incorporation alone does not grant nonprofit status. A more accurate term for a nonprofit is a **tax-exempt entity**, as the designation involves securing tax exemption at the federal and state.

Key steps include:

1. **Filing for tax exemption** with the IRS using either Form 1023 (for public charities) or Form 1024 (for other tax-exempt entities).
2. **Obtaining an Employer Identification Number (EIN)** for tax and banking purposes.
3. **Registering for state-specific exemptions**, such as sales and use tax exemptions, which require separate applications.

UNDERSTANDING DIFFERENT TYPES OF TAX-EXEMPT ORGANIZATIONS

While 501(c)(3) organizations are the most well-known, other types of tax-exempt entities exist, including:

- **501(c)(6) organizations:** Chambers of Commerce and business leagues.
- **501(c)(7) organizations:** Social or recreational organizations like country clubs.

For this guide, the focus remains on 501(c)(3) public charities, as they allow for tax-deductible donations and grant eligibility.

BENEFITS OF 501(C)(3) STATUS

- **Tax-deductible donations** for donors.
- **Exemption from federal unemployment tax**.
- **Potential exemption from state unemployment compensation tax**.
- **Eligibility for state sales tax exemptions** (subject to separate state approval).

APPLYING FOR 501(C)(3) STATUS

1. **Draft Articles of Incorporation and Bylaws** - These must contain IRS-required language regarding asset distribution upon dissolution and operational compliance with 501(c)(3) rules.
2. **Obtain an EIN** - This is necessary for tax filings and banking.
3. **Complete IRS Form 1023** - The application must be filed online at Pay.gov.
    - **Form 1023-EZ** - Available as an option for small, straightforward organizations.
    - **Standard Form 1023** - Requires a detailed budget for the current and next two years, mission statements, and financial projections.

TIMELINE FOR APPROVAL AND COST

- **Processing time:** 6-8 months, depending on IRS backlog.
- **Fees:**
    - Form 1023-EZ: $275
    - Standard Form 1023: $600
    - *Note: The above amounts are accurate at the time of this publication and are subject to change; the IRS publishes the latest user fee information at IRS.gov, keyword "1023 user fee."*

SOLICITING DONATIONS BEFORE IRS APPROVAL

Organizations may solicit donations while their application is pending. However, if tax-exempt status is denied, donors must be informed that their contributions are not tax-deductible. Many foundations and large donors prefer to wait until IRS approval before contributing.

ANNUAL COMPLIANCE AND FILINGS

Once approved, a nonprofit organization must file an annual return with the IRS:

- **Form 990-N:** For gross receipts of less than or equal to $50,000.
- **Form 990-EZ:** For gross receipts between $50,000 and $200,000 and total assets under $500,000.
- **Full Form 990:** For gross receipts over $200,000 or total assets equal to or greater than $500,000.

ADDITIONAL REPORTING REQUIREMENTS

- **State solicitation filings:** Pennsylvania's Solicitation of Funds for Charitable Purposes Act requires registration for organizations soliciting over $25,000 annually.
- **Payroll and tax reporting:** Organizations with employees must file payroll tax returns, W-2s, and Form 1099s for independent contractors.
- **Financial reporting:** Depending on gross receipts, organizations may need to provide compiled, reviewed, or audited financial statements by a Certified Public Accountant (CPA).

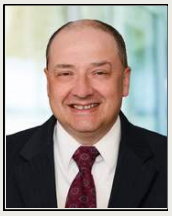
FINAL THOUGHTS

Starting a nonprofit involves multiple legal and tax considerations. Consulting with legal and financial professionals ensures compliance and sets the organization up for long-term success. Our team is available to guide you through the financial aspects of setting up your nonprofit and maintaining ongoing compliance.

Starting a Nonprofit Organization:

Determining the right level of assurance for your nonprofit can be complex, and the need for an audit is not always immediately clear. If your organization is unsure about its assurance requirements or needs guidance in navigating state and federal regulations, our team is here to help.

Learn more on our website or contact one of our nonprofit team leaders below to discuss your specific needs today. We are here to provide expert guidance and tailored solutions for your nonprofit's unique situation, ensuring compliance and maximizing your resources.



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