

QUICK FACTS FOR COMMUNITY GROUPS ABOUT 501(c)(3) STATUS

This publication is for general information only and cannot substitute for legal advice. Different organizations will have different needs and problems resulting in different legal consequences. Every issue discussed is complex, so always consult an attorney for advice on specific situations.

Community groups seeking funding are often asked if they are “501(c)(3).” In most cases before a community group can be a 501(c)(3) organization it must organize itself as a nonprofit corporation (or unincorporated nonprofit association meeting certain federal and state law requirements). Here are a few quick introductory facts about nonprofit corporations and 501(c)(3) status.

1. How are nonprofit corporations formed?

In Kentucky, nonprofit corporations form by filing “Articles of Incorporation” containing legally required information with the Kentucky Secretary of State. The one-page “Articles of Incorporation” form on the Kentucky Secretary of State website is not sufficient for groups aspiring to 501(c)(3) status, as the Internal Revenue Service requires additional provisions.

2. What does it mean to be a nonprofit corporation?

Being a corporation allows a group to be treated as a legal entity in and of itself, rather than simply as a collection of individuals. For example, a corporation can own property and enter into contracts in its own name, and members/directors/officers may be protected against personal liability for the acts and debts of the corporation. Being a *nonprofit* corporation means that the income and profits go back into the corporation to further its nonprofit purposes, rather than being distributed to its members, officers or directors. In contrast, a for-profit corporation exists to make money for its owners and shareholders.

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3. Who owns a nonprofit corporation?

By law, no individual – not even a founder – owns or controls a nonprofit corporation. The affairs of a nonprofit corporation are managed by a board of directors acting as a group and following the organization’s bylaws, which must comply with the KY Nonprofit Corporations Acts.

4. What does it mean to be a 501(c)(3) organization?

“501(c)(3)” refers to a section of the U.S. Internal Revenue Code that allows organizations meeting conditions in the law to enjoy certain tax benefits. Only organizations that are organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, or to do testing for public safety, foster amateur sports competition or prevent cruelty to children or animals may qualify. Further, to qualify an organization (1) may not be organized or operated for the benefit of private interests; (2) may not allow its earnings to inure to any private shareholder or individual; (3) may not attempt to influence legislation as a substantial part of its activities; and (4) may not participate in any campaign activity for or against political candidates.

5. What are the main benefits of 501(c)(3) status?

A 501(c)(3) organization is exempt from paying federal income tax on most types of income. In Kentucky, 501(c)(3) organizations are also exempt from state income tax and most Louisville Metro net profits taxes and may apply to be exempt from sales and property taxes. Further, donations made to a 501(c)(3) organization are tax deductible, meaning that individuals who itemize and businesses that donate money or goods can take a deduction to the extent permitted by law when they file their income tax returns. In addition, government entities, foundations and businesses often require the organizations they support to have 501(c)(3) status.

6. What are the main drawbacks of 501(c)(3) status?

Because of the tax advantages they enjoy, 501(c)(3) organizations are highly regulated. Members of the board of directors must learn about and comply with the many legal requirements that apply to 501(c)(3) organizations. The IRS requires 501(c)(3) organizations to keep detailed records showing proper expenditures and operations and legal compliance with

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IRS rules, and (except for churches and some church-affiliated organizations) to file annual information returns,

There are also strict prohibitions against insiders improperly benefitting from their relationship with the organization, and severe financial penalties for the organization and the individual when these rules are violated.

7. How is a nonprofit corporation approved for 501(c)(3) status?

A nonprofit corporation that believes it qualifies for 501(c)(3) status may file an "Application for Recognition of 501(c)(3) Status" with the IRS. The type, length and complexity of the application, as well as the filing fee, will depend upon the organization's particular circumstances. As of January 1, 2022, filing fees are either \$275 or \$600. Churches, some church-affiliated organizations and some organizations that do not normally have annual gross receipts over \$5,000 may enjoy 501(c)(3) status without filing an application, provided they otherwise qualify as a 501(c)(3).

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