

# 501c3 IN 12 STEPS

For Public Charity  
Organizations

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Includes 2012 IRS Updates



**Sneak-A-Peek Edition**

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**501(c)(3) In 12 Steps**

**For Public Charity Organizations  
By Tanisha Williams**

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## **Introduction**

Most start-up nonprofits seek to fulfill their organization's mission on a skeletal budget; and they rely on the financial generosity of others in a struggle to sustain operations. The overwhelming financial responsibilities can drain organizational resources, leaving little to no funding to employ the task of applying for a "vital" 501(c)(3) tax-exempt status. If this sounds familiar, do not despair, there is hope!

My 12 years of experience auditing nonprofit organizations for the County of Los Angeles, Department of Public Health, has provided me a great deal of insight into the financial operations of the nonprofit business sector. In addition, my Bachelor of Arts degree in the field of Accounting has equipped me with the technical training necessary for applying accounting principles to nonprofit funder requirements. However, neither my auditing experience nor my accounting degree were key factors in developing this "how to" process of applying for federal tax-exempt status. The knowledge and experience on which I've based the information outlined in this book is my own "hands-on" personal success.

Several years ago my husband and I formed a public charity nonprofit organization. Our mission was to provide outreach programs to assist bereaved families (co-victims) as they went through the grief process that occurs when another person intentionally or recklessly takes the life of someone they love. We knew that obtaining a 501(c)(3) status would be our best resource for securing grants and soliciting donations; however, as a start-up organization we didn't have the fees that consultants were charging to file the necessary paperwork. After managing to scrape together the tax-exemption user fee, we decided to go it alone. Within a few months of document exchanges between me, the California Secretary of State, and the Internal Revenue Service, contributions to our nonprofit were finally tax

deductible, and revenues were received tax free.

This book is a written attempt to simplify the process of applying for federal tax exemption into 12-steps. The “**Sneak-A-Peek Edition**” (SAP) allows you to peek at a few of the documents I submitted to the IRS when applying for my nonprofit’s tax exempt status. There is a 99% chance that my nonprofit’s objectives were very different from the mission and goals of your organization, so I don’t expect you to be able to copy and paste. I’m hoping instead that you’ll gain some insight by focusing on the amount of detail as opposed to the substance of the detail itself. At the very least, you can use “sneak-a-peek” as a guide for determining how much or how little information to include in your supporting attachments.

I do realize that it is practical and sometimes necessary to seek the advice/guidance of a legal advisor; so this book does not advocate against doing so. My goal is to provide individuals an alternative to obtaining federal tax-exemption for a start-up organization, without having to pay the fees associated with hiring a consultant. The bottom line is.....I did it myself, and so can you!

## ***What Is A 501(c)(3)***

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Section 501(c)(3) is the section of the Internal Revenue Code (IRC) that describes educational, literary, religious, scientific and other charitable organizations that are exempt from federal income taxes (not required by law to pay federal taxes on any income generated by the organization). Nonprofit organizations that want to be recognized as exempt from federal income taxes must apply to the Internal Revenue Service (IRS) for tax-exempt status under section 501(c)(3).

There are two classifications under section 501(c)(3) that are eligible to receive federal tax benefits: (1) private foundations, and (2) public

charities. Broadly defined, private foundations receive contributions from a few donors, while public charities rely on many donors for support. Three main distinctions between the two make a public charity classification more favorable: (a) private foundations are subject to more extensive reporting requirements than public charities; (b) the tax deductions for contributions made to private foundations are more restricted than the contributions made to public charities; and (c) public charities are not subject to the same excise taxes that are imposed on private foundations.

Initially, every organization that qualifies for tax exemption under section 501(c)(3) is presumed by the IRS to be a private foundation. In order to be considered a public charity, you have to show the IRS that your organization falls under one of the following “exceptions” referred to in section 509(a) of the IRC (see Table 1 below):

| <b>Table 1</b>   |
|--|
| (1) 509(a)(1) ... (Sections a-f show six different classifications “within the meaning” of 509(a)(1)) <ul style="list-style-type: none"><li>a. 170(b)(1)(A)(i) - A church or a convention or association of churches</li><li>b. 170(b)(1)(A)(ii) - An educational organization (school or college)</li><li>c. 170(b)(1)(A)(iii) - A hospital or medical research organization</li><li>d. 170(b)(1)(A)(iv) - Endowment funds operated for the benefit of state and municipal colleges</li><li>e. 170(b)(1)(A)(v) - A governmental unit</li><li><b>f. 170(b)(1)(A)(vi) - A “donation-based” publicly supported charity</b></li></ul> |
| (2) <b>509(a)(2) - An “earning-based” publicly supported charity</b>   |
| (3) 509(a)(3) - An organization that provides support to another publicly supported charity  |
| (4) 509(a)(4) - An organization that conducts product safety research  |

## ***Who This Book Is For***

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This book is intended for individuals applying for a 501(c)(3) tax exempt status under section 509(a)(1) within the meaning of 170(b)(1)(A)(vi), or under section 509(a)(2) (*both italicized and bolded in Table 1*). For simplicity and distinction, throughout the remainder of this book I'll refer to section 170(b)(1)(A)(vi) as a “donation-based” publicly supported charity, and section 509(a)(2) as an “earning-based” publicly supported charity. In general, “donation-based” charities receive most of their support from individual contributions, grants, government, or other public sources; and “earning-based” charities receive a substantial amount of their income from membership dues or activities related to their tax-exempt function. Donation-based and earning-based charities are the broadest forms of a nonprofit organization, and they are the most commonly sought out classifications when applying for federal tax exemption.

## ***Basic Assumptions***

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In this book you'll be exposed to many of the technical rules imbedded in the IRC for determining your tax-exemption qualification. If I attempted to address every possible “what-if” scenario throughout the entire application process, this book would resemble the complexities of the IRC. So in sticking to my goal of “simplicity”, I've made some basic assumptions about your organization. If any one of these assumptions does not apply to your organization, you may still use this book as a guide for applying for tax exemption. However, situations outside of the assumptions may involve filing additional schedules or require additional information that will not be covered in this book.

- (1) Your organization is required to file Form 1023** – I've made this assumption because the following organizations are automatically exempt from paying federal income taxes, and therefore do not need

to file Form 1023: Churches, integrated auxiliaries, religious schools, and organizations having gross receipts in each taxable year of not more than \$5,000. Also, there are special rules that apply to some foreign organizations (organizations created in countries other than the United States, its territories, or its possessions) which are outlined in the Instructions for Form 1023 under “Foreign Organizations in General”.

- (2) **You’re requesting tax-exemption under a corporation** – I’ve made this assumption because a corporation is the most commonly used structure when forming a nonprofit. However, tax-exemption can also be granted under a limited liability company, an unincorporated association, or a trust; but you may want to seek the advice of a professional if applying under one of these structures.
- (3) **Your nonprofit is organized, operated and qualifies as a publicly supported charity under the IRC.** (See “Who This Book Is For”).
- (4) **You are not applying for retroactive tax-exemption if you missed the 27-month deadline.** (See “Important Note” under Step I).
- (5) **Your organization will not participate in any political activity or attempt to influence legislation** – This assumption was made because 501(c)(3) organizations are prohibited from participating in political activities and may only engage in limited lobbying. If your organization plans to engage in lobbying activities, there are special guidelines that must be followed and may require the advice of a professional.
- (6) **Your organization does not plan to operate in a foreign country; nor will it make grants, loans or other distributions to organizations outside of the United States** – This assumption was made because there are special tax-exemption rules for organizations that plan to operate in foreign countries or make grants/loans to foreign organizations. Also, foreign-based nonprofits may provoke

IRS concerns regarding the participation in terrorist activities; therefore, if your organization plans to operate in a foreign country or fund foreign organizations, you should seek the advice of a professional.

## ***What You Will Need***

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- (1) Form 1023 – As of the date of this book, the latest Form 1023 version is 2006; but make sure to check for the most recent version as of your application date.
- (2) 1023 Checklist – The checklist is included with Form 1023.
- (3) A copy of your organization’s organizing document (articles of incorporation) – The document must be signed by a principal officer, or accompanied by a written declaration (signed by an authorized individual) stating that it is a complete copy and was filed and approved by the state.
- (4) A copy of any amendments to your organization’s organizing document *if applicable*.
- (5) A copy of your organization’s bylaws *if applicable*.
- (6) User Fee – As of June 2012, the fees are: (a) \$400 for organizations with annual gross receipts less than or equal to \$10,000 during the preceding 4 years; or (b) \$850 for organizations with annual gross receipts greater than \$10,000 during the preceding 4 years. Again, you should check the IRS website for the most current fee rates.
- (7) Employer Identification Number (EIN) – In order to submit your application, you will need an EIN whether or not your organization has employees. If you do not have an EIN, click on the link <https://sa1.www4.irs.gov/modiein/individual/index.jsp> and fill out the application. You’ll be issued an EIN immediately upon completion.
- (8) Publication 557 and Instructions for Form 1023 - You may want to

print these forms for easy access as I refer to them throughout the book. As with the application, check for the most recent versions.

**(9)** Snacks, water (you may prefer caffeine), and lots of Patience!