## The 501(c)3 Nonprofit Corporation

The terms "nonprofit" and "501(c)3" are two designations often used to describe an organization that carries on nonprofit or charitable activities, but the two terms have some very distinct differences.

A "nonprofit" is almost always a legal entity organized under the nonprofit corporation act and statutes of any given state in the US. This legal form is most often a corporation, but may also include an association, trust or a foundation. The organization is established by filing, for a corporation, a document called Articles of Incorporation (described later). It costs around US$50 to incorporate in most states. Bylaws (described later) are drawn up and approved and corporate officers are elected. The entity generally opens a bank account and the organization is in business. Incorporating also provides a place for the donations and contributions to go that is separate from the individual, and thus the individual does not have to report that income on their personal tax return.

For most nonprofits, acquiring the US federal 501(c)3 tax exempt status involves another and bigger step. For some nonprofit corporations, the IRS grants automatic 501(c)3 status. Those organizations include churches and other nonprofits that are formed for one or more of the purposes described in Section 501(c)3 of the Internal Revenue Code and whose annual receipts generally average less than US$5,000. But for most nonprofits, a lengthy application form must be completed and submitted to the IRS for approval.

Most wildlife rehabilitators would like to be able to tell donors that their donation to help save an animal they have just rescued is in fact tax deductible. Some rehabilitators who conduct a relatively small operation and who do not foresee ever receiving more than US$5,000 per year in donations from the public, have chosen to incorporate as a nonprofit in their state, but have elected not to formally file an application for exemption with the IRS. And as long as their annual receipts average less than US$5,000, they can legitimately tell donors that the donations are tax deductible. However, many of the other benefits of being formally classified as a 501(c)3 tax exempt organization are not available unless the tax exempt application is submitted and approved.

## The Pros and Cons of the 501(c)3 Tax-exempt Status

Many significant benefits are available to the nonprofit that receives formal recognition from the IRS that it is tax exempt. This ruling from the IRS exempts the organization from having to pay US Federal corporate income tax on any donations received. Almost all states automatically grant a concurrent exemption for 501(c)3 organizations from having to pay state income tax. Most states also provide an exemption for 501(c)3 groups from having to pay sales tax on goods and merchandise purchased by the nonprofit. Wildlife rehabilitation organizations can then purchase such items as food and formula, caging materials and office supplies free from sales tax. (Note: However, a nonprofit that sells items, such as t-shirts for fundraising, must generally obtain a retail sales tax license from their state. They must then collect appropriate sales tax on items sold and periodically remit this collected tax to the state or taxing authority. Additionally, a nonprofit is not exempt from payroll related taxes if the organization has employees.)

Probably the largest benefit of obtaining the official 501(c)3 ruling from the IRS is that the organization can assure donors that contributions, donations and gifts are tax deductible. And, for those organizations desiring to pursue writing grant applications, most foundations and grant-making organizations require that a copy of the IRS letter accompany the grant request. Additionally, some local vendors may also have a policy that they make donations or give discounts only to 501(c)3 organizations formally recognized by the IRS.

A benefit that will help some wildlife rehabilitation organizations is the privilege of using non-profit bulk mailing rates. These rates can save as much as half the cost over standard first class rates. However, sorting by zip code is required as well as a minimum number of pieces of mail each time a bulk mailing is processed.

The last advantage really comes with the state incorporation. Since most nonprofit corporations provide for limited liability, Directors and Officers are usually protected from legal actions against the organization. Exceptions to this include a Director or Officer that violates statutory duties of these offices; violates the law or commits criminal acts; loans to the organization that have been personally guaranteed by an individual; and failure to report and pay any taxes due (where the Treasurer can be held personally responsible).

As suspected, all of these benefits do have a price. First, there is a fair amount of paperwork involved. This includes preparing the organizing documents, primarily the Articles of Incorporation and the corporate Bylaws (both described below). It entails keeping formal minutes to meetings and setting up and maintaining financial records (which for small operations is often like an expanded checkbook). Annual and informational reports are sometimes required by the Secretary of State and other governmental agencies.

The incorporation generally costs around US$50 in most states, and the Federal tax-exempt status application costs US$150 for smaller organizations (those that anticipate averaging less than US$10,000 annually in receipts). The fee for larger organizations is US$450.

Time and energy is involved, which can be challenging for rehabilitators who are already pressed for time with their direct animal care activities. Time must be spent on recordkeeping (financial records and minutes to meetings); conducting meetings; and fundraising activities.

While many of these activities require time, many organizations divide these tasks among individuals who have the time and skill to perform them. Volunteers as well as Board members may be enlisted to assist in performing these chores.

## Size of the Organization is not Important

A commonly heard misconception among rehabilitators is that only large operations and wildlife centers can qualify for the 501(c)3 designation and benefits. This is not true. No where in the IRS regulations dealing with tax-exempt organizations is size of the organization mentioned as a requirement. Thinking about it, most of today's large organizations most likely started out small at some point. Certainly size and scale can probably help with activities such as fundraising. But just because the size of the organization is small and just starting out does not preclude it from becoming a 501(c)3 organization.

## Is a 501(c)3 Right for Me and My Wildlife Rehabilitation Activity?

That depends. While there is no sure-fire checklist that will produce a definitive yes or no answer, the following questions may give an indication which way to go. The list is by no means exhaustive, but anyone considering establishing a nonprofit corporation and then filing for the federal 501(c)3 tax exempt status should think about and answer the following questions. If most of the answers are YES, then a 501(c)3 may be appropriate. Conversely, if more of the answers are NO, then it may not be right.

- Are you beginning to receive more donations (either in cash or as donated items) over time as you conduct your wildlife rehabilitation activity?
- Would you prefer not to report these donations as personal income?
- Would you like to receive a tax deduction for the donations you personally contribute to the wildlife rehabilitation activity?

- If your personal funding for the activity is becoming limited, would you like to be able to solicit donations from the public?
- While you may still continue to fund a major portion of the activity with your own donations, do you think you can generate at least one third of each year's total donations from the general public?
- Are you willing to spend some time in fundraising activities, asking people for donations?
- Would you prefer to purchase items at a discount and not have to pay sales tax? Or even get items donated free of cost from local merchants?
- Do you think the nature of your activity would appeal to foundations or local businesses that make grants to community service organizations?
- Are you or someone you know willing to spend time on financial and other recordkeeping?
- Do you have a few trusted friends or colleagues that might serve on a Board of Directors? Are you willing to give up some degree of control of your rehabilitation activities to that Board of Directors?

Are you comfortable with the fact that as a 501(c)3 organization, the financial affairs of the organization are open for public scrutiny?

## How do I get Started as a 501(c)3?

If you answered YES to most of the questions listed above, then pursing a state nonprofit incorporation followed by applying for the 501(c)3 tax exempt status might be right for your situation. The following list of activities is more or less in chronological order of the steps to be followed.

The first step is to incorporate as a nonprofit corporation in your state. This involves preparing and filing Articles of Incorporation (described below).

Once incorporated, corporate Bylaws (described below) should be drafted and adopted at the first meeting of the Board of Directors. At this same meeting, officers should be elected as specified in the Bylaws. This generally means electing a President, Vice-President, Secretary and Treasurer. Individuals may hold more than one office, but some states prevent the same person from concurrently holding certain offices.

Once the Directors and Officers are known, Form SS-4 (available form the IRS) should be submitted to get an Employer Identification Number (EIN) for the new corporation. This number will be necessary for several purposes, the first of which is to open a bank account for the organization. Many banks offer a "community" account for small local nonprofits, generally free of charge. All receipts and disbursements should be handled through this account, keeping all funds separate from any one individual's own personal account.

Another step that is advisable is to check with the Secretary of State to see if there are any requirements to solicit for charitable funds. As some states have enacted legislation through their "Charitable Solicitation Acts" targeted at nonprofit scams, it may place requirements and/or restrictions on all nonprofits operating within the state. Make sure all of these requirements have been complied with.

Some rehabilitators who anticipate receiving less than US$5,000 per year may stop at this point and not file for the formal 501(c)3 ruling from the IRS. For others, filing with the IRS involves preparing IRS Form 1023. This application may take from 2 weeks to 6 months to receive approval, depending somewhat on the workload of the IRS but more based on the thoroughness and completeness of preparing the application. Once the application is approved, the applicant receives an "advance ruling determination letter" stating that the organization is tax exempt and recognized by the IRS as a 501(c)3 organization. It also says that the ruling is good for five years. At which point the IRS performs a review (described below) of the income sources of the organization for each of those five years, and then makes a determination whether or not to make their earlier ruling permanent. Assuming the organization has met the public support requirements, the organization is then granted a more permanent tax-exempt status. If the organization fails this review, some or all of the income for those five years may be subject to tax and the organization could lose its tax-exempt status going forward.

## Articles of Incorporation

Filing the Articles of Incorporation for a corporation represents the act of establishing the organization as a legal entity. Filed with the Secretary of State, this gives the organization legal status under the eyes of the law and enables the organization to legally conduct business in the state. The Nonprofit Corporation Act of all states specifies minimum requirements to be included in this document. The state may even provide a fill in the blank form for such purposes. The Articles generally include the name of the corporation, the name and address of the registered agent and office, purpose of the corporation, term of existence, whether or not the corporation will have voting members, the initial directors, provisions for distribution of remaining funds upon dissolution, and the name of the incorporator.

The incorporator is the person that actually files the Articles with the Secretary of State and pays the filing fee, around US$50 in most states. Once that task has been performed, the job of the incorporator is complete.

For those who desire to eventually file with the IRS for the 501(c)3 exemption, the standard form provided by the state usually does not include all the provisions that the IRS is looking for in the Articles. This is where many rehabilitators who are not familiar with the 501(c)3 application process make a mistake. These other provisions, having to do with certain limitations and restrictions on activities, must be in the Articles as filed with the Secretary of State for the IRS to approve the application. If the original Articles did not include these provisions, they must be amended or restated and re-filed with the Secretary of State before submitted with Form 1023 to the IRS. This re-filing may cost from US$25-50 and take several days to several weeks.

## Corporate Bylaws

The Bylaws of the Corporation serves as the primary governing document for the organization. In addition to restating the purpose of the corporation (often times more detailed than in the Articles of Incorporation), the Bylaws establish the Board of Directors (how many, terms of office, responsibilities and authorities, frequency of meetings, etc.), the Officers (how many, terms of office, responsibilities and authorities, etc.), and many other governance issues affecting the corporation.

While some prefer to quickly adopt a "boilerplate" set of Bylaws, the creation of this document should be a thoughtful and deliberate process involving the key people on the Board of Directors. Not only does it serve to get the organization up and going, but also as importantly it can provide critical guidance during times of disagreement and dispute between members on the Board. While the Bylaws should not need to be changed or altered on a frequent basis, the Board should feel comfortable amending them as necessary to best conduct the affairs of the corporation.

## The IRS Review at the end of the 5 Year Advance Ruling Period

At the end of the advance ruling determination period (usually the end of the fifth year), the IRS will send a two page form to be completed and returned. The IRS will make a final ruling on the tax-exempt status of the organization based on the information provided on this form. The primary purpose of this form is to determine if the organization has met the public support requirements as specified in Section 501(c)3 of the Internal Revenue Code.

Basically the IRS is trying to determine if the activity during its first five years is being supported financially through support from the public and not just from a few individuals. The regulations specify that at least 33% of the financial support received each year should come from the general public, and not just from the Directors and Officers of the corporation or their family members, or from large gifts from only a few donors. If these tests are not satisfactorily met, the IRS may classify the organization as a private foundation, subjecting the organization to payment of taxes on income received during all or part of the five years, and may revoke the tax-exempt status going forward.

Too many people who set up a 501(c)3 are unaware of these public support requirements and the five-year review, and have realized too late they have run afoul of the IRS regulations. While this may all sound a little scary, it can be avoided with a little education up front. It is best to understand these requirements from day one, manage the sources of support to meet these requirements, and to keep financial records that will provide the level of detail and categories of information needed to complete the two page audit review form from the IRS.