

The following is for use by assistive readers and users who prefer a text alternative of this course.

Applying for Tax-Exempt Status Overview Course

Page 1 – Welcome to the Applying for Tax-Exempt Status Course

This course is presented by the Tax Exempt & Government Entities division's Exempt Organizations office.

Page 2 – Introduction

Leagle: I'm Leagle, the EO Eagle, and I'll guide you through the courses here at StayExempt. During this course, you'll engage in several Knowledge Checks. These questions will reinforce your learning experience.

Page 3 – Objectives

Leagle: In this course I'll talk about the lifecycle of a typical tax-exempt organization, and you'll become familiar with the benefits and responsibilities associated with achieving exempt status. You'll learn about the different types of exempt organizations and I'll discuss how to apply for tax-exempt status - then we'll talk about the rules for running an organization while under consideration for tax-exempt status.

First, let's start with the basics.

Page 4 – What is Tax-Exempt Status?

Richard: Hi, I'm Richard. I've had a passion for helping animals since I was a child. I'm considering starting an animal rescue to fulfill my life's dream of preventing cruelty to animals. I've heard it could be advantageous to obtain tax-exempt status but I am not sure what all that entails. Can you help me?

Leagle: Well it's a good thing you came to the StayExempt.IRS.Gov website. I'll be happy to help you through the process of understanding tax-exempt status. Soon, you'll understand what it takes to become a tax-exempt organization and maintain the status of your organization. First, you should know that the term 501(c)(3) refers to section 501(c)(3) of the Internal Revenue Code – where the rules and regulations governing exempt organizations are found. Tax-exempt organizations are commonly referred to as 501(c)(3)s. 501(c)(3) includes both public charities and private foundations. We'll discuss the differences later.

Richard: Wow. That's good to know. So, how do I get started?

Leagle: Well Richard, being a tax-exempt organization is **not** a static thing. It's a process with a lifecycle to it. Let's talk more about the lifecycle, and once you understand the process then we can talk about the benefits and responsibilities. After that, I can walk you through the first steps of applying for tax-exempt status and point you to some great resources for operating as a tax-exempt organization. Ready to begin?

Page 5 – Lifecycle of a Tax-Exempt Organization

Richard – Leagle, you mentioned that there is a whole process to becoming a tax-exempt. What's that like?

Leagle – There are five steps to the lifecycle of a tax-exempt organization. They include

- Starting out

- Applying for Exemption
- Required Filings
- Ongoing Compliance, and
- Significant Events

The first two steps, starting out and applying for exemption, are unique because you should only do them once for any single organization. For the purposes of this course, we're only going to concentrate on creating and maintaining one organization at a time.

What's different about the other three steps is that a single organization has to deal with each of those issues multiple times. Some required filings are annual, for example. We'll talk about each of these steps in a little more detail in a minute.

Before we move on it's important that you know there's a lot more information about the [Lifecycle on the IRS.gov Charities & Non-Profits site](#).

Page 6 – Lifecycle – Starting Out

Richard – So if I'm starting out, what's the first thing I should do?

Leagle: Well, you'll need to create an organization under your state's law. Your state will have rules that would likely make your animal rescue a non-profit, which is a state level classification. When you're creating your organization, you may need to create organizing documents based on the requirements of your state. You'll need these if you apply for tax exemption.

If you'd like to apply for tax exemption, which is a federal level status, you'll need to acquire an employer identification number, or EIN.

Richard: But I don't have any employees, so I'm not an employer.

Leagle: Even so, you still need an EIN. Your EIN is similar to your personal social security number, only it's for your business. It identifies you to the IRS.

Richard: Do I need anything else?

Leagle: Finally, you need to determine what type of tax-exempt organization you have. You'll need this information when you apply for tax-exempt status.

If you decide to apply, you'll probably need more information on the EIN step. Here's the [EIN page at IRS.gov](#).

Page 7 – Lifecycle – Applying for Exemption

- Apply to the IRS for Tax-Exempt Status
- Form 1023

Richard: So, you said the next step was applying?

Leagle: That's right. For this step, you'll need to fill out Form 1023 or Form 1023-EZ. That's a big step. Of course, there are resources to help you on the [IRS website](#). We'll be covering this step later in this training - once you decide to apply for tax-exempt status.

Richard: That sounds great. What's next?

Leagle: Now let's talk about your Required Filings.

Page 8 – Lifecycle – Required Filings

Richard: So, you said that this step is different because these are things I'll have to do regularly. What are the requirements?

Leagle: Once the IRS has granted your organization tax-exempt status, it's important that you meet the mandatory annual filing requirements. You'll need to file annual exempt-organization returns, and you could be required to file unrelated business income tax filings, and other returns and reports you'll learn about here at StayExempt. Once you have your tax-exempt status, you should look into some of the [courses designed for existing organizations](#).

The next step is ongoing compliance.

Page 9 – Lifecycle – Ongoing Compliance

Richard: All right, so I know I have annual filing requirements. What's next?

Leagle: Well, it's helpful if you understand how an organization can avoid jeopardizing its tax-exempt status. To do that, you'll need to understand employment taxes, public disclosure requirements, and other ongoing compliance issues.

There are other courses here at StayExempt that can help you with that. There's the [Maintaining Tax-Exempt Status course](#), one on [Required Disclosures](#), which tells you what information the public is entitled to see, and [Employment issues courses](#). You should go through those when you've applied for tax-exempt status.

Page 10 – Lifecycle – Significant Events

Richard: So the last step is significant events. What kinds of significant events are there?

Leagle: These significant events all have to do with your tax-exempt status. The events include, but aren't limited to

- Audits
- Private letter rulings and
- Termination proceedings

For more information on this step, go to the Life Cycle's [Significant Events page](#).

Now that you've learned about the steps in the lifecycle, let's try an exercise.

Page 11 – Knowledge Check

Leagle: Let's see how well you remember the order of events in the lifecycle. Which of the following event is listed too early. Choose only one answer.

- A) Applying to IRS – Form 1023
- B) Starting out – Organizing Documents
- C) Starting out – Employee Identification Number (EIN)
- D) Required Filings – Annual Returns
- E) Required Filings – Unrelated Business Income
- F) Ongoing Compliance – Form 990
- G) Significant Events – Private Letter Rulings
- H) Significant Events - Termination proceedings

If your answer was "A) Applying to IRS – Form 1023,) you were correct.

Before applying, you need to create your organizing documents and obtain an EIN. The "Applying to IRS – Form 1023" step should come after you create organizing documents and obtain an EIN.

Page 12 – Progress Check

Leagle: Great job! You've completed the lifecycle section of this course. Next, we'll talk more with Richard about why tax-exempt status might be right for him, and what responsibilities he'll have if he is granted tax-exempt status for his organization.

Page 13 – Benefits and Responsibilities

Richard: All right, so I'm just starting out. What steps should I take before applying?

Leagle: Before you can be sure that tax-exempt status is right for you, you'll need to understand some of the benefits and responsibilities that come with tax-exemption, the steps required to become tax-exempt, and the rules your organization must follow after you apply. As your animal rescue grows, your exempt status responsibilities will grow, too.

First, you need to learn about tax-exempt status so you can make an informed decision - and then apply. Next, we'll do an exercise together to separate the benefits from the responsibilities of tax-exempt status.

Page 14 – Activity: Benefits and Responsibilities

Leagle: Which of the following five items are benefits of tax-exempt status? Choose all the options that apply:

- Exemption from federal income tax
- Tax-deductible contributions
- Reduced postal rates
- Recordkeeping
- Annual Filings

You were correct if you chose:

- Exemption from federal income tax
- Tax-deductible contributions and
- Reduced postal rates

Page 15 – Benefits

Richard: I see that there are a lot of financial benefits.

Leagle: That's right. In addition to being exempt from federal income tax, contributions to your organization are tax deductible, you may be exempt from paying state income, sales and employment taxes, you have access to reduced postal rates, you are exempt from paying federal unemployment tax, and you can receive tax-exempt financing.

Richard: With all these great benefits, I bet there are responsibilities as well.

Leagle: Of course, and we'll go over them.

Page 16 – Responsibilities

Richard: So what are the responsibilities for a tax-exempt organization?

Leagle: These are some of the basic requirements. You'll find out more about these and other requirements here and in the other courses here at the StayExempt. These responsibilities

include recordkeeping, certain annual filing requirements, and disclosure requirements. I'll be giving you a brief overview of each of these responsibilities.

Page 17 – Recordkeeping

- Keep detailed recordkeeping
 - Financial
 - Non-financial

Richard: Okay, Leagle, the first thing you mentioned was recordkeeping. Do I have to keep a lot more records than I normally would?

Leagle: You should keep detailed records, including records you'd probably want to keep for any business. For example, you're required to keep books and records detailing all activities, both financial and nonfinancial. [Publication 4221-PC, Compliance Guide for 501\(c\)\(3\) Public Charities](#), has information on why you need to keep records, what records you should keep, and how long to keep your records.

Page 18 – Annual Filings

Annual Filings can include

- Form 990
- Form 990-EZ
- Form 990-N (Post Card)

Richard: So, how often does the IRS need to see all of these records?

Leagle: The IRS doesn't need to see all of your records on a regular basis. But the records you keep will allow you to have everything you may need to submit your required annual filings. Most public charities recognized as tax-exempt under section 501(c)(3) of the Code are required to file an annual information return: either the Form 990 or Form 990-EZ.

Certain categories of organizations are exempted from filing Form 990 or Form 990-EZ - including churches and very small organizations. However, most small organizations that aren't required to file Form 990 or 990-EZ must file an annual **electronic** notice, the Form 990-N, also known as the e-Postcard.

For more Form 990 resources, visit the [Form 990 Resources and Tools page](#) on IRS.gov.

Page 19 – Public Disclosures

Richard: Who else do I have to show these records to? Do I have to make all of my records public?

Leagle: No, Richard, not all of them. There are specific records that need to be made public upon request. Section 501(c)(3) organizations must make their exemption application and the three most recent annual information returns (your Form 990s) available to the public, upon request and without charge (except for a reasonable charge for copying). If your organization has \$1,000 or more in gross income from an **unrelated** business, it must file Form 990-T, *Exempt Organization Business Income Tax Return*, and that must be made available as well.

Richard: Where should I keep these records?

Leagle: You should make the documents available at the organization's principal office during regular business hours and requests can be made in person or in writing.

For more Form 990 resources, visit the [Public Disclosure and Availability Requirements page](#) on IRS.gov.

Page 20 – Knowledge Check

Leagle: Let's test your knowledge again. Name one responsibility of a tax-exempt organization. Pause the system to think about your answer and continue when you're done.

If you chose recordkeeping, annual filings, filings, disclosures or public disclosures, you're right! A 501(c)(3) organization is responsible for recordkeeping, annual filings and public disclosures among other things.

Page 21 – Progress Check

Leagle: Great job! You've completed the lifecycle section of this course. Next, we'll talk more with Richard about why tax-exempt status might be right for him, and what responsibilities he'll have if he receives tax-exempt status for his organization.

Page 22 – Preparing to Apply for Tax-Exempt Status

Apply for an EIN:

- Go to the IRS website or call a toll-free number (800) 829-4933 and get an EIN immediately.
- Fax Form SS-4 to the IRS and get an EIN within 4 business days
- Complete Form SS-4, Application for Employer Identification Number, and mail it to the IRS
- <https://www.irs.gov/businesses> for more information

Leagle: So, Richard, now that you know basically what it means to have a tax-exempt organization and maintain it, do you think you're ready to apply?

Richard: Yes, I can definitely see how this would benefit my organization. What do I need?

Leagle: Do you have an EIN?

Richard: No, I don't. But I remember you saying I need it whether or not I have employees. How do I get one?

Leagle: There are a number of ways you can apply for an EIN. The fastest is to go to the IRS website or call our toll-free number and get an EIN you can use immediately. You can also fax your [Form SS-4, Application for Employer Identification Number](#), and you'll receive your EIN within 4 business days. Or, you can fax it to 859-669-5987 or do it the old-fashioned way by completing Form SS-4 using the [form's instructions](#) and mailing it to:

Internal Revenue Service Center

Attn: EIN Operation

Cincinnati, OH 45999

Fax- *TIN*: 859-669-5760

Next, you'll need to gather your organizing documents.

Page 23 – Organizing Documents

- Limit the organization's purposes to one or more of the exempt purposes set forth in section 501(c)(3)
- Must not expressly empower the organization to engage in activities that are not in furtherance of its purposes
- Assets of the organization must be permanently dedicated to an exempt purpose described under section 501(c)(3)

Richard: All right, I know how to get my EIN number. What else do I need?

Leagle: An organization can't qualify for exempt status without an organizing document. To qualify for exemption under Section 501(c)(3), the organizing document must contain three provisions.

First, the organizing document must limit the organization's purposes to one or more of the exempt purposes listed in Section 501(c)(3) of the Code. These purposes include:

- Religious
- Charitable
- Scientific
- Testing for public safety
- Literary or educational
- Fostering national or international amateur sports competition, or
- Preventing cruelty to children or animals.

Second, the organizing document must not give the organization the ability or permission to engage in activities that don't advance those exempt purposes.

And third, the assets of the organization, such as the money and property of the organization, must be permanently dedicated to an exempt purpose described under Section 501(c)(3).

You can find more information including sample documents on the Charities and Non-Profits section of the IRS.gov at <http://www.irs.gov/charities-non-profits/exempt-organizations-organizing-documents>.

Page 24 – By-Laws

Richard: Leagle, I heard an exempt organization should have by-laws. Are by-laws different from the organizing documents?

Leagle: Yes, Richard, by-laws are an organization's internal operating rules. Federal tax law doesn't require specific language in the by-laws of most organizations. However, state law may require you to have by-laws, so it is a good idea to contact your state to find out the specific requirements.

Richard: My organization is in California. Do you know who I should contact there?

Leagle: In the "Life Cycle of a Public Charity" area of the IRS Charities and Non-Profits page, there's a page about [by-laws](#). You may also want to go to the website for links to appropriate state officials.

The By-Laws page link is: <https://www.irs.gov/charities-non-profits/other-non-profits/exempt-organization-bylaws>

Page 25 – Knowledge Check

Leagle: Let's test your knowledge. Which of the following are requirements for the organizational documents of charities applying for tax-exempt status? Pause your system and choose all that apply.

- A. Limit the organization's purposes to one or more exempt purposes
- B. Bar the employees from participating in activities that don't further the organization's purpose
- C. Constrain the organization to engage in activities that further its exempt purposes

- D. Define the hours of operation and location of the organization
- E. Permanently dedicate the assets of an organization to an exempt purpose

If you chose A, C and E...

- Limit the organization's purposes to one or more of the exempt purposes set forth in section 501(c)(3)
- Must not expressly empower the organization to engage in activities that are not in furtherance of its exempt purposes
- Assets of the organization must be permanently dedicated to an exempt purpose described under section 501(c)(3)

... then you are correct!

Page 26 – Types of Tax-Exempt Organizations

Richard: Leagle, you mentioned that an organization must have one or more specific purposes to qualify as tax-exempt. What are those purposes again?

Leagle: A 501(c)(3) organization (also known as a public charity) is one that is organized and operated exclusively for purposes that are:

- Religious
- Charitable
- Scientific
- Testing for public safety
- Literary or educational
- Designed to foster national or international amateur sports competition, or
- For the prevention of cruelty to children or animals.

There are many kinds of organizations that fall under these categories. For example, organizations that provide relief of the poor, distressed or underprivileged; those that lessen neighborhood tensions; or those that defend human and civil rights usually qualify as charitable organizations. Educational organizations can be schools, museums, symphony orchestras, training for the unemployed, dance classes and zoos.

You can find more information on these types of organizations on the IRS Charities & Non Profits page and in Publication 557, *Tax-Exempt Status for Your Organization*. Let's try a practice activity to help you learn which organizations might qualify for tax exemption.

Select the activity button to continue.

To learn more you can link to the IRS list of 501(c)(3) purposes at: <http://www.irs.gov/charities-non-profits/charitable-organizations/exempt-purposes-internal-revenue-code-section-501c3> or Pub 557 at: <http://www.irs.gov/pub/irs-pdf/p557.pdf>.

Page 27 – Organization Type Activity

Which of these organizations would probably qualify as a 501(c)(3) tax-exempt organization based on the exempt purposes? Pause your system after reading each example to decide.

a. Human Liberties Association – yes or no? (Pause.)

Yes, as this organization would primarily be concerned with advocating human rights.

b. Town Country Club – yes or no? (Pause.)

No. This seems like a social/recreational club, which falls under 501(c)(7).

c. One Name Church – yes or no? (Pause.)

Yes – This is a religious organization and would qualify as a 501(c)(3).

d. ABC County Citizens Group – yes or no? (Pause.)

No. This is a civic league 501(c)(4).

e. Galaxy Planetarium – yes or no? (Pause.)

Yes. Educational: fostering knowledge of the physical universe.

f. 'We are veterans' Association – yes or no? (Pause.)

No, a veterans association is usually a 501(c)(19).

g. State Chamber of Commerce – yes or no? (Pause.)

No, an organization that advances the interests of business would qualify as a 501(c)(6) business league.

h. Dalmatian Rescue Organization – yes or no? (Pause.)

Yes, the prevention of cruelty to animals is an exempt purpose under 501(c)(3).

i. Purple-Blue Orchid Society – yes or no? (Pause.)

No, in most cases, this would be a horticultural organization, which would qualify under 501(c)(5).

j. Biochemistry Researchers – yes or no? (Pause.)

Yes, this organization is dedicated to advancing the subject of biochemistry, so it qualifies as scientific.

k. Gotham City Bar Association – yes or no? (Pause.)

No, this is a professional league, so it would qualify under 501(c)(6).

Page 28 – Two-part Test for Charities – Organizational Test

Organizational Test:

- Limit its purposes to one or more of the exempt purposes listed in Code section 501(c)(3),
- Not permit the organization to engage in a nonexempt activity, and
- Assets of the organization must be permanently dedicated to an exempt purpose.

Richard: So, because I'm planning to start an organization that falls under the exempt categories, do I need to do anything else to establish that it would qualify as a 501(c)(3)?

Leagle: Yes, the Organizational and Operational tests. All types of tax-exempt organizations must meet them, but we'll focus specifically on how a prospective 501(c)(3) organization does it.

First, let's talk about the Organizational Test. This test is used to determine if the organization is properly organized. To pass this test the organization must:

- Limit its purposes to one or more of the exempt purposes listed in Code section 501(c)(3)
- Not permit the organization to engage in a nonexempt activity and
- Assets of the organization must be permanently dedicated to an exempt purpose.

Richard: This sounds really familiar.

Leagle: That's because these are provisions you need to have in your organizing documents, which we just talked about. So if you write your organizing documents correctly, this test will be easy to pass.

Next, let's talk further about the Operational Test.

Page 29 – Two-part Test for Charities – Operational Test

Operational Test:

- Principal activities further exempt purposes
- Insubstantial number of activities do not advance exempt purposes

Other Resources

- Maintaining Tax-Exempt Status Course
- Unrelated Business Income Course
- Political Campaigns and Public Charities Course
- Required Disclosures Course
- Employment Issues Course

Richard: Okay, so the Organizational Test was pretty easy. What about the Operational Test?

Leagle: Well, the operational test covers how your organization is actually operated. To pass the operational test, your organization must show that its principal activities will be to further its exempt purposes. Conversely, your organization has to limit the participation in certain kinds of activities and absolutely refrain from others.

Though this test is conducted when you're first applying for tax-exempt status, if the balance of your activities gets out of line after you receive your status, or your organization engages in prohibited activities, you can lose your tax-exempt status and be subject to both taxes and penalties.

Richard: What are the restricted and prohibited activities?

Leagle: One example is intervening in political campaigns. If your organization openly endorses a candidate, that's a prohibited activity. There are many other kinds of political (and other) activities that aren't allowed. But for the purposes of **this** discussion, we won't go into that.

If you're interested in learning more about these kinds of activities, you should start with the Maintaining Tax-Exempt Status course, which discusses how you could possibly jeopardize your tax-exempt status. There's also the *Unrelated Business Income Course*, the *Political Campaigns and Public Charities Course*, the *Required Disclosures Course*, and the *Employment Issues Course*.

Next, let's talk about the difference between a public charity and a private foundation.

Page 30 – Public Charity versus Private Foundation

Statutory Charities

- Churches
- Schools
- Organizations providing medical or hospital care (including medical education and research)

Other Public Charities

- Organizations that receive significant public support

- Organizations that provide support to other public charities

Richard: So once I pass both tests, I can be recognized as a tax-exempt charity?

Leagle: Not quite yet. When an entity qualifies as a tax-exempt organization, the IRS presumes it's a private foundation unless it can show that it's a public charity.

Richard: So, what's the difference between a public charity and a private foundation?

Leagle: The main difference is where the money comes from. Generally, a public charity has a broad base of support while a private foundation has very limited sources of support. There are also different tax rules – so, for example, public foundations are subject to excise taxes that aren't imposed on public charities. There are more differences – and you can look into on IRS.gov website under *Lifecycle of a public charity/private foundation*. There's also a course on classifying private foundations - called *The Wonderful World of Foundation Classification*.

For now, we're going to concentrate on public charities. Some organizations automatically qualify as public charities based on the Code, so they're called Statutory Public Charities. Some examples are churches, schools, and organizations providing medical or hospital care (including medical education and research). These organizations still have to pass the Operational and Organizational tests. Or, if your organization receives significant public support or it provides support to other public charities, you may qualify that way. Otherwise, you'll have to demonstrate you are a public charity by other means.

For more information, you can reference the [Lifecycle of a Public Charity/Private Foundation](#) page or take our [The Wonderful World of Foundation Classification](#) course here at StayExempt.

Page 31 – Showing Your Organization as a Public Charity

Richard: My friend Chloe is starting an organization that **could** be considered a private foundation. How can she show the IRS that her organization is actually a public charity?

Leagle: If Chloe's organization is not a statutory public charity, it may still be a public charity if it receives broad public support – and passes the Organizations and Operational tests. To have broad public support, her organization must be able to demonstrate the following:

- That it receives a substantial part of its support in the form of contributions from publicly supported organizations, governmental units and/or the general public or
- That it normally receives no more than one-third of its support from gross investment income and unrelated business income combined and gets more than one-third of its support from contributions, membership fees, and gross receipts from activities related to its exempt functions.

This is another situation where good recordkeeping can really help you.

For more information about Publication 557, Tax-Exempt Status for Your Organization, go to this link: <https://www.irs.gov/forms-pubs/about-publication-557#page=32>.

Now let's talk more about Chloe's situation.

Page 32 – After Your First Five Years

- For the first five years – Based on predicted support and treated as a public charity regardless of actual support
- From year six forward – Based on Schedule A calculated for current year, plus for previous years

Richard: Chloe's organization is still really small. I'm not sure if she can show broad public support yet.

Leagle: No problem! If she can show that her organization can reasonably expect to meet these criteria, she can still apply for tax-exempt status. If she receives the tax-exempt status, her organization will be treated as a public charity for the first five years regardless of how much public support it actually gets.

Richard: So what happens on year six?

Leagle: At that point, the IRS starts monitoring the status of all public charities based on the public support reported on Schedule A, *Public Charity Status and Public Support of your Form 990*.

Because her organization is not a statutory public charity, she'll have to show that her organization meets one of the public support tests over a five year computation period, including the current year and the four preceding years. If her organization passes one of the tests, her organization will remain a public charity for that year and the next tax year.

For more information on Schedule A, Public Charity Status and Public Support, go to this link: <https://www.irs.gov/pub/irs-pdf/f990sa.pdf>.

Why don't you try a few activities now?

Page 33 – Knowledge Check

Leagle: Let's test your knowledge. Choose the best answer to this question:

To be recognized as tax-exempt under Code section 501(c)(3), an entity must meet an organizational test and what other test?

- a) Principal
- b) Critical
- c) Operational
- d) Inspirational

Pause your system to choose an answer and then begin when you're done.

If you chose c, Operational, then you're right. To be recognized as tax-exempt under Code section 501(c)(3), then an entity must meet both organizational and operational tests.

Page 34 – Knowledge Check

Leagle: Let's test your knowledge. Choose the best answer to this question:

501(c)(3) organizations have either a public charity or a private foundation designation. An organization may qualify for public charity status by demonstrating that it can or does receive what kind of broad support?

- a) Financial
- b) Public
- c) Technical
- d) Moral

Pause your system to choose an answer and then begin when you're done.

If you chose b, Public, you are correct. An organization must be able to show that it can or does receive broad public support.

Page 35 – Progress Check

You have learned how to:

- Describe the lifecycle of a typical tax-exempt organization
- Distinguish the benefits and responsibilities associated with achieving tax-exempt status for an organization
- List the types of tax-exempt organizations

Leagle: Great job! Now you understand the different types of tax-exempt organizations. Next, we'll help Richard with the basic requirements of applying for tax-exempt status.

Page 36 – Becoming Tax-Exempt

Application process topics:

- Documents Required
- How to obtain an EIN
- User Fees
- Timeline
- Group/Church Exemptions
- Post Application Operational Guidance

Richard: Now that I understand the benefits of tax-exempt status, I think I'm ready to start the application process.

Leagle: Congratulations, Richard! Filling out the forms can be a big task, but before you start, there are a few things you need to know. First, you need to know which documents are required, how to get an employee identification number, the timeline for applying and functioning as a tax-exempt organization while you're waiting for your determination, the user fees for applying, how group and church exemptions work, and some key information for running your organization while you are waiting for tax-exempt status approval.

First, let's start with an overview of form 1023, as that is the bulk of your application.

Page 37 – Basic Application Information

Richard: What do I need to apply for tax-exempt status?

Leagle: You need three basic things: Form 1023, your Employee Identification Number, or EIN, and your user fee.

Richard: What is form 1023?

Leagle: Form 1023 is the *Application for Recognition of Exemption* document. You can download it from IRS.gov. There are some additional resources for the form there as well. You have to fill out every line. The IRS won't process an incomplete application, so answer each question. Form 1023 has instructions and checklists to help you provide the required information.

For more information on how to apply to be tax-exempt, go to this link:

<https://www.irs.gov/charities-non-profits/applying-for-tax-exempt-status>

Richard: So how do I apply for an EIN?

Leagle: Well, the quickest and easiest way is to apply online, but you can call the toll free number as well, Monday through Friday between 7am and 7pm. Otherwise, you can fill out the SS-4 form and either fax or mail it in. Here is some more information on the various ways to apply for an EIN:

- Apply for an EIN online at <http://www.irs.gov/businesses/small-businesses-self-employed/apply-for-an-employer-identification-number-ein-online>
- Call Toll free: Business & Specialty Tax Line at (800) 829-4933. 7:00 a.m. - 7:00 p.m. local time, Monday through Friday
- Fax Form SS-4
- Mail in SS-4 form that you can find at: <http://www.irs.gov/businesses/small-businesses-self-employed/how-to-apply-for-an-ein>

Richard: All right, so how much is this going to cost me?

Leagle: Well the amounts may vary a little, so you should go to the IRS.gov website and search "exempt organizations user fees" for current fees.

The user fee is based on the organization's average annual gross receipts over a four-year period. Gross receipts are the amount an organization receives from all sources before taking out any costs or expenses.

Richard: But my organization hasn't been around for four years.

Leagle: The gross receipts are based on actual funds received or funds your organization plans to receive over a four year period. There are three fee tiers. See which one is right for you.

- Gross Receipts > \$10,000 each year: \$850
- Gross Receipts < \$10,000 annually: \$400
- Group exemption: \$3,000

Page 38 – Application Timeline

Richard: Is there a deadline for me to file my form 1023?

Leagle: Good question Richard. There are time limits. For the tax-exempt status of your organization to be recognized from the day you open, you need to file form 1023 within 27 months of the end of the first month it was organized. This deadline can be extended if the organization meets certain requirements.

Within 27 months of operating, a typical non-profit can choose to apply for tax-exempt status. If you apply prior to 27 months, you can be recognized as exempt from the first day you were organized.

The IRS receives so many applications for exemption, ranging from very straightforward to extremely complex. The applications are divided into four categories as they are received: There's the no additional information needed category, the minor information needed category, those that were submitted using an obsolete form or may be missing required information mentioned in the Procedural Checklist and those that require additional development.

For the first three categories, you can expect to either receive a determination letter or a request for additional information within 90 days. The notification can be by mail, fax or phone.

If the application is very complicated, the application is assigned to an Exempt Organizations (also known as EO) specialist. This person works directly with you to get all the information needed to make a proper assessment.

Richard: So how long will it take to get my application approved if it's assigned to an EO specialist for additional development?

Leagle: Unfortunately, I can't give you the exact amount of time it'll take because it depends on the types of issues involved. That said, if you don't hear from us in 60 days, go to "Where is my Exemption Application" <https://www.irs.gov/charities-non-profits/charitable->

[organizations/wheres-my-application](#)? You'll see a chart that illustrates the application process and instructions on what to do if you haven't heard from the IRS. You can also see which month's applications are currently being processed. For instance, if the site shows "June, 2012," that means that applications received in June are being processed.

Here are some final thoughts for you. For all four categories, if the information received shows that your organization meets the requirements for exemption, the IRS will issue a determination letter recognizing your organization's exempt status - and also showing your public charity classification.

This determination letter is an important document. You should keep it with your organization's permanent records. You'll need it for any public disclosure requests.

Page 39 – Group Exemptions

Group Exemptions

- Smaller groups associated with a single central group
- Can apply as a group, no need for individual applications
- Group exemption letters have same effect as individual letters.

Richard: Okay. So what are group exemptions?

Leagle: Sometimes the IRS recognizes a group of organizations as tax-exempt if they're affiliated with a central organization. This avoids the need for each organization to apply individually. A group exemption letter has the same effect as an individual exemption letter, but it applies to more than one organization.

Richard: So if I work together with a couple of other animal rescues; can we apply as a group? We share the same overall mission but we have slightly different organizational goals. Some focus on rescuing, others want to build a location for animals that can't return to the wild. Another organization is strictly set up to promote animal rights by lobbying congress for stricter animal neglect and abuse laws.

Leagle: In principle, yes. You'd have to have one central organization that all the organizations are affiliated with. Select this link for more information. Or select the continue button to move on.

Page 40 – Church Exemptions

Richard: Do churches have an exemption too?

Leagle: Good question. Churches, including synagogues, temples and mosques, don't have to file for tax exemption, yet they're still exempt from federal income tax - and the contributions they receive are tax deductible. But, even though they aren't required to file an application, many do to receive a determination letter that proves their tax-exempt status and specifies that contributions to them are tax deductible.

Page 41 – Post Application Operational Guidance

- Recordkeeping – Keep detailed records of financial and non-financial activities
- Annual Filings – Form 990, Form 990-EZ, or Form 990-N Postcard
- Public Disclosures – Application, annual returns and Form 990-T if applicable.

Richard: So, once I'm running my organization and I've started the application process, is there anything I need to do before soliciting donations?

Leagle: Absolutely. You can operate as a tax-exempt organization while you're awaiting approval, but donors won't have assurance that contributions to your organization are tax

deductible until your application is approved. While you're waiting for approval, you have some additional responsibilities to ensure that you don't jeopardize your status before you even get it.

Remember when we talked about the responsibilities of a tax-exempt organization?

Richard: Yeah. You mentioned recordkeeping, annual filings and public disclosures.

Leagle: That's exactly right. Remember to take the *Maintaining Tax-Exempt Status* course to review all of the activities you'll need to be familiar with in order to maintain your status. When you're done, you can select the continue button to move on.

For more information, see the [Maintaining Tax-Exempt Status](#) course.

Page 42 – Charitable Solicitation

Richard: I'm anxious to start collecting funds but I'm worried I may be breaking some of the rules. What should I know first?

Leagle: First of all, each state has laws regulating fundraising - as well as how you go about soliciting donations. These include: requiring that you register your organization, special rules for when fundraising activities involve paid solicitors and fundraisers counsel, and filing financial reports.

Each state is different, so be sure to check with each state you'll be fundraising in to confirm their requirements. When you're ready, we should talk about governance next.

Page 43 – Tips for Governance

Richard: Do you have any more tips for running my organization?

Leagle: Sure! We've found that an organization is more likely to operate effectively and consistently with tax law requirements if it can clearly articulate its purpose, selects a knowledgeable and committed governing body and management team, and adopts sound management practices.

The IRS requests information about an organization's governance on the application for tax exemption - and again annually on the information return most organizations must file.

Finally, why don't you try a few activities to see how much you remember?

Page 44 – Knowledge Check

Leagle: Let's test your knowledge. So, how do you determine the user fee associated with applying for tax-exempt status?

- a) Public charity status
- b) Expenses
- c) Gross Receipts
- d) Number of employees

Pause your system to choose the best answer.

If you chose c, Gross Receipts, then you're right! The user fee is based on gross receipts for your organization for four years. You can use projections for this figure if your organization has not existed for four years at the time of your application.

Let's try another one.

Page 45 – Knowledge Check

Leagle: Here are the items from the application timeline. Think about what order they should be in.

- Minor information notification
- Application received by IRS
- Create an organization
- File Form 1023 to apply for tax-exempt status
- Case assigned to EO Specialist

Pause your system to put them in the proper order.

If you put them in this order, you were right!

- 1) Create an organization
- 2) File Form 1023 to apply for tax-exempt status
- 3) Application received by IRS
- 4) Minor information notification
- 5) Case assigned to EO Specialist

After you create your organization, you apply for tax-exempt status by filing Form 1023. Once the application is received by the IRS, they can take up to 60 days to notify you that they need more information about your application. If your application is particularly complex, the IRS will assign your case to an EO Specialist.

Page 46 – Progress Check

You have learned how to:

- Describe the lifecycle of a typical tax-exempt organization
- Distinguish the benefits and responsibilities associated with achieving tax-exempt status for an organization
- List the types of tax-exempt organizations
- Explain how to apply for tax-exempt status
- Discuss the rules for running an organization while under consideration for tax-exempt status

Leagle: Great job! Now you can explain how to apply for tax-exempt status and discuss the rules for running a tax-exempt organization.

Page 47 – Conclusion

Leagle: Thank you for taking the Tax-Exempt Overview course. We at the IRS are always happy to be of service. There were a lot of resources in this course, so feel free to go back through it. But we've also listed them here for you as well:

Resources:

- IRS.gov website for businesses
<https://www.irs.gov/businesses>
- IRS.gov website for Organizing Documents
[charities-non-profits/exempt-organizations-organizing-documents](https://www.irs.gov/charities-non-profits/exempt-organizations-organizing-documents)
- IRS Lifecycle page
<https://www.irs.gov/charities-non-profits/life-cycle-of-an-exempt-organization>
- Applying for Recognition of Exemption
<https://www.irs.gov/charities-non-profits/application-for-recognition-of-exemption>
- Publication 4220, Applying for 501(c)(3) Tax-Exempt Status
<https://www.irs.gov/pub/irs-pdf/p4220.pdf>

- Publication 4221-PC, Compliance Guide for 501(c)(3) Public Charities
<https://www.irs.gov/pub/irs-pdf/p4221pc.pdf>
- Publication 557, Tax-Exempt Status for Your Organization
<https://www.irs.gov/pub/irs-pdf/p557.pdf>
- Where is My Exemption Application?
<https://www.irs.gov/charities-non-profits/charitable-organizations/wheres-my-application>
- How to Apply to be Tax-Exempt
<https://www.irs.gov/charities-non-profits/applying-for-tax-exempt-status>
- Apply for an EIN Online
<https://www.irs.gov/businesses/small-businesses-self-employed/how-to-apply-for-an-ein>
- Mail in SS-4 Form
<http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/How-to-Apply-for-an-EIN>
- Schedule A, Public Charity Status and Public Support
<http://www.irs.gov/pub/irs-pdf/f990sa.pdf>
- IRS List of 501(c)(3) Purposes
<http://www.irs.gov/charities-non-profits/charitable-organizations/exempt-purposes-internal-revenue-code-section-501c3>
- By-laws
<http://www.irs.gov/Charities-&Non-Profits/Other-Non-Profits/Exempt-Organization---Bylaws>
- Information on Public Disclosures
<https://www.irs.gov/charities-non-profits/exempt-organization-public-disclosure-and-availability-requirements>
- Form 990
<https://www.irs.gov/charities-non-profits/form-990-resources-and-tools>
- Information on Required Filings
<https://www.irs.gov/charities-non-profits/exempt-organizations-required-filings>