Neighborhood Networks
Consortia Development Services

Maintaining a 501(c)(3)

Compliance with federal and state law is a responsibility of 501 (c)(3) status. An organization's size, in terms of income, assets, and expenses, determines its level of complication for compliance. Aside from its finances, an organization must adhere to the rationales for exemption, as stated in its bylaws and articles of incorporation. For example, if an organization's purpose is to provide job training, but it instead provides afterschool service, the organization is not in compliance with the law. Additionally, an organization is only allowed to engage in activities that promote its tax exemption, such as applying for grants to operate its programs. Failure to adhere to these rules places an organization at risk of losing its 501(c)(3) status.

It is important to note that as long as an organization maintains organized records, complies with state and federal tax law, and conducts itself in good faith, maintaining the 501(c)(3) status is a straightforward process.

The two types of 501(c)(3) tax-exempt status

When an organization first establishes its 501(c)(3) status, its first designation is private foundation unless it can demonstrate that it is a public charity. The difference between the two designations is based on the source of financial support. A private foundation has a single source of support and tends to be an organization that awards grants. A public charity has a broad base of financial support stemming from active fundraising programs.

What does maintaining a 501(c)(3) involve?

Once an organization has its 501(c)(3) status, it can apply for grants, conduct fundraising activities, obtain donations, and manage programs. Donated income and/or materials, which have value, must be used toward the programs, activities, or salaries. An organization is responsible for keeping track of this information as well as reporting it to the Internal Revenue Service (IRS) and the state where the organization is located.

Record keeping

The purpose of recordkeeping is to: ensure transparency, compliance with the IRS and state law, and establish credibility of the organization's 501(c)(3) status.

First, it is important that a 501(c)(3) organization always keep the following records:

- A copy of the organization's application form to the IRS for tax-exempt status (Form 1023);
- A copy of the organization's letter determining its 501(c)(3) status;
- Organizational documents, especially the articles of incorporation, bylaws, and any amendments;
- The organization's Tax Identification Number;
- Descriptions and summaries of the organization's programs;
- Minutes of the governing body's meetings;
- Employment records, such as W-2 forms; and
- Financial records documenting the organization's income, expenses, and assets; essentially, the organization's books.

Well-maintained financial records assist the organization in filing federal and state taxes. Tax law does not specify how an organization should keep its records. Listed below are some helpful tips:

- Track all income, expenses, and assets for each program. The organization must use this method to report its financial records to the IRS and the state.
- Include a summary of all transactions. This summary should note all payments, sources of income, and donations. For small organizations (those with incomes of $25,000 or less) a well-maintained checkbook will suffice. Larger organizations more than $25,000 in income should maintain an official journal or accounting ledger.
- Finally, the organization's finances should be aligned with a specified period of time. There are two options: 1) the calendar year, which runs from Jan 1 to Dec 31 or 2) the fiscal year, which runs for 12 consecutive months and ends on the last day of any month except for December.

Complying with the IRS Tax Exempt Law

Organizations must file paperwork with the IRS and state to maintain their 501(c)(3) status. While all 501(c)(3)'s must follow the same federal laws for filing with the IRS, each state's laws vary. State-by-state filing and compliance can be found at: http://www.hurwitassociates.com/siteindex.html.

The IRS has a few forms and rules for submitting records to verify an organization's tax exempt status. Under law, a 501(c)(3)'s tax records are open to public inspection as are its bylaws, articles of incorporation, and Form 1023.

There are a few forms that a 501(c)(3) organization is required to file. Below is a summary of each:

- <u>Form 990-N</u>: Starting in 2008, the IRS is requiring all organizations with gross receipts averaging less than $25,000 over a three-year period to file this form.

- Form 990: This form is the main form that verifies compliance with tax-exempt status. Organizations with gross receipts averaging $25,000 or more during the past three years must file this form.
- Form 990-EZ: This form is used for organizations with gross receipts during the most recent year that were less than $100,000 and with total assets at the end of the year of less than $250,000.

What puts a 501(c)(3) status in jeopardy?

When a 501(c)(3) does not file paperwork with the IRS and/or state or misstates its records intentionally, its tax-exempt status can be jeopardized. Additionally, 501(c)(3) organizations cannot engage in the following activities:

- Conducting extensive lobbying;
- Donating a substantial private benefit to individuals or other organizations for uses not aligned with the organization's 501(c)(3) purpose;
- Providing outsiders or insiders with personal benefits;
- Engaging in any political activity; and
- Having excessive unrelated business income (UBI).

Additional information about maintaining an organization's 501(c)(3) status can be found on the following Web sites:

www.stayexempt.org
http://www.managementhelp.org/legal/lgl_need.htm
http://law.richmond.edu/nonprofit/HowToFormANonprofit_1st_ed-Chapter3.pdf
http://www.irs.gov/charities/charitable/article/0,,id=136459,00.html
http://www.hurwitassociates.com/siteindex.html
http://www.legalzoom.com/law_library/non-profit/Operating-a-Non-Profit-Corporation.html