



# Incorporation & Tax Exemption

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# Presenter bios

## ***Ciarra A. Chavarria, Senior Staff Attorney, Quality Education***

*Ciarra Chavarria is the Senior Staff Attorney responsible for Lawyers Alliance's Quality Education program area, which focuses on providing business and transactional legal services to nonprofits that support, deliver, and improve education and increase access to educational opportunities for low-income New Yorkers. Prior to joining Lawyers Alliance in 2017, Ciarra was a senior associate at Covington & Burling LLP; and Dewey & LeBeouf LLP. She is also a former Lawyers Alliance extern. Ciarra received a J.D. from the University of Chicago Law School and a B.A. in English Literature from Austin College.*

## ***Elizabeth Wytock, Staff Attorney, Community Arts***

*Elizabeth Wytock is a Staff Attorney responsible for the Community Arts program area. Before initially joining Lawyers Alliance as a Legal Fellow sponsored by the National Center on Philanthropy and the Law at New York University School of Law, Liz worked as a tax associate at Proskauer Rose LLP. She graduated from the University of Virginia School of Law in 2018, where she served as executive editor of the Virginia Law Review. She also participated in the UVA Law Nonprofit Clinic and interned for the Honorable Nancy Atlas and the Honorable Mary Milloy at the U.S. District Court for the Southern District of Texas. Prior to law school, Liz worked as a health policy program assistant at the National Academy of Sciences in Washington, D.C. She graduated from Georgetown University in 2012 with a B.A. in Art History and Psychology.*



## Disclaimer

**Please note:** Today's presentation is informational only and is not intended to constitute legal advice. This presentation references both federal and state laws and regulations but primarily focuses on New York law. Please consult with appropriate counsel for guidance pertinent to your organization or situation.



## Q: Why are you interested in this webinar?

**A**

I'm thinking about forming my own nonprofit.

**B**

I've incorporated a nonprofit but have questions about getting tax exemption.

**C**

I'm not sure... it sounded interesting!



# The Process of Incorporation and Tax Exemption





# Planning





## Planning: Determining Form

- **Unincorporated association** – informal vehicle for carrying out charitable activities
- **Fiscal Sponsorship** – contractual relationship between a 501(c)(3) sponsoring organization and a group carrying out a charitable activity
- **Corporation** – formal, legally recognized entity with limited liability protection



# Planning: Fiscal Sponsorship

- Groups without tax-exemption can receive tax-deductible donations through another 501c3
- Contractual relationship

## Advantages

- May be ideal for short-term projects
- Can test out new ideas before expending significant time and resources

## Considerations

- Mission match
- Financial stability of sponsoring organization
- Fees





# Planning: Corporation

## Advantages

- Limited liability for directors, officers, and members
- Facilitates process of applying for tax exemption
- May help generate revenues
- Perpetual existence

## Disadvantages

- Restrictions on use of assets
- Time-consuming and relatively expensive
- Less control for founders
- Does not automatically generate revenues
- May be difficult to dissolve



# Planning: Where to Incorporate?

## New York

- Governed by the New York Not-for-Profit Corporation Law (NPCL)
- Generally stricter and more burdensome than Delaware
- Must have at least three directors

## Delaware

- Governed by the Delaware General Corporation Law (no specific nonprofit corporation law)
- Simpler and quicker incorporation process with less oversight for major corporate actions
- Can operate with one director



# Planning: New York Nonprofit Corporations

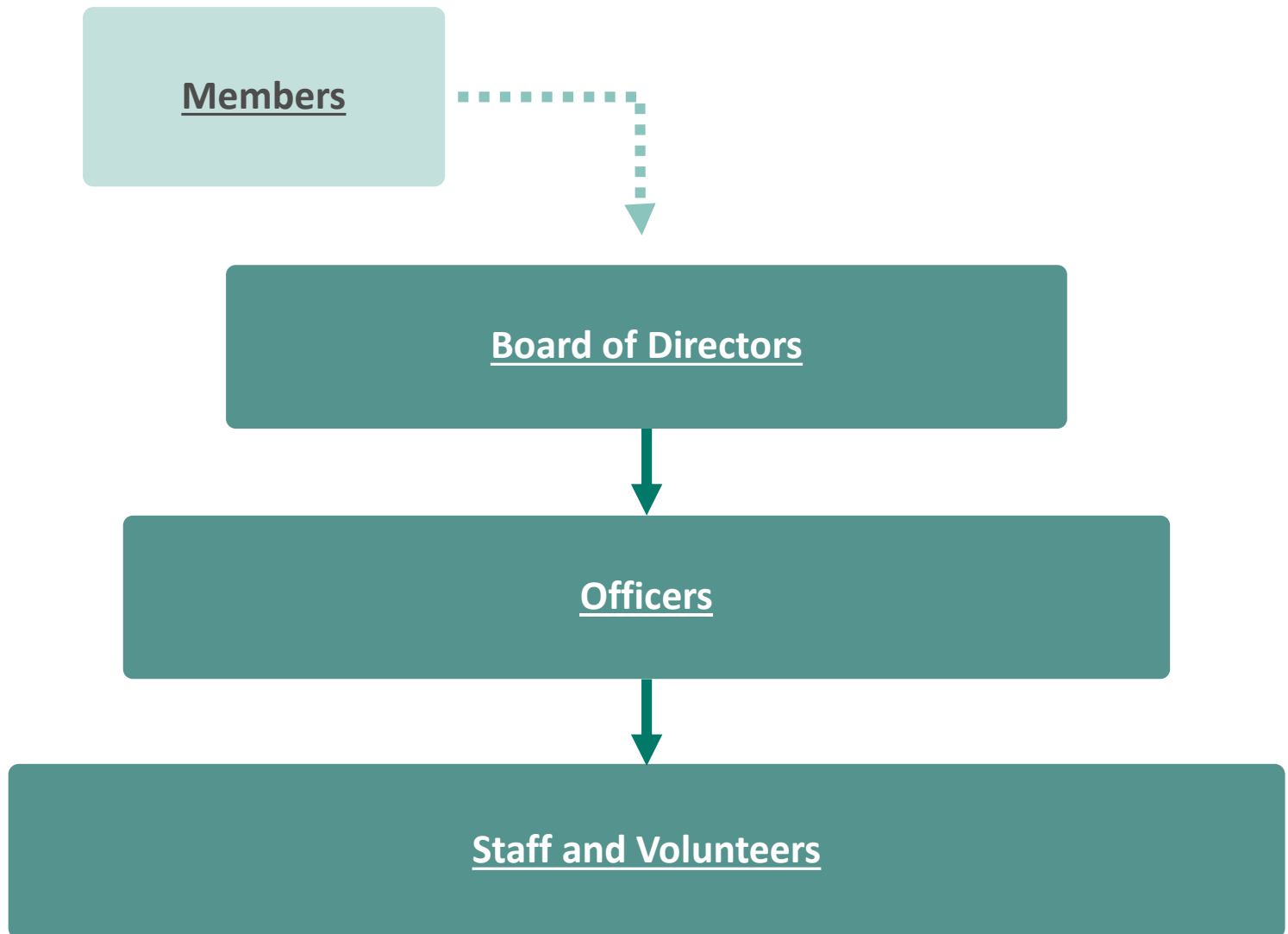
## “Charitable”

- Must be formed for “charitable” purposes as defined in the NPCL
- Generally qualify as tax-exempt under 501(c)(3)

## “Non-Charitable”

- Formed for other non-pecuniary purpose
- Must have members
- Usually tax-exempt under other provision of the Internal Revenue Code

# Planning: Structure of Nonprofits



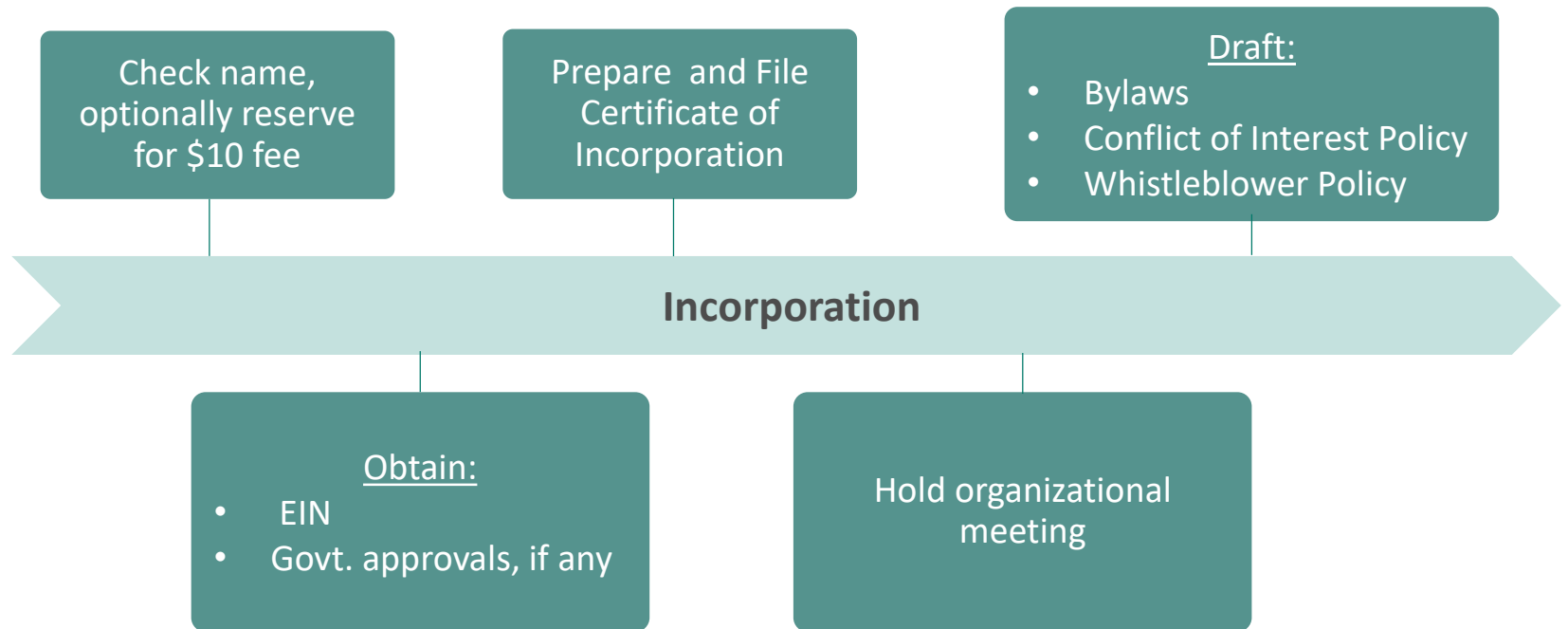


# Incorporation





# Incorporation: Timeline





# Incorporation: Certificate of Incorporation

- Purpose clause:
  - only required to state whether nonprofit is formed for charitable or non-charitable purposes
  - often includes more detailed purposes and/or activities
- Must have three board members and their addresses
- Be sure to include language required by the IRS

# Incorporation: Employer Identification Number (EIN)

- EIN required (even without employees) for:
  - Opening a bank account for organization
  - Filing Form 1023 (Application for Tax-Exempt Status)
- “Responsible Party” files Form SS-4 with IRS

<b>Form SS-4</b> (Rev. December 2019) Department of the Treasury Internal Revenue Service		<b>Application for Employer Identification Number</b> (For use by employers, corporations, partnerships, trusts, estates, churches, government agencies, Indian tribal entities, certain individuals, and others.) ▶ Go to <a href="https://www.irs.gov/FormSS4">www.irs.gov/FormSS4</a> for instructions and the latest information. ▶ See separate instructions for each line. ▶ Keep a copy for your records.		OMB No. 1545-0003
		<b>EIN</b>		
<b>1</b> Legal name of entity (or individual) for whom the EIN is being requested				
<b>or print clearly.</b>	<b>2</b> Trade name of business (if different from name on line 1)		<b>3</b> Executor, administrator, trustee, "care of" name	
	<b>4a</b> Mailing address (room, apt., suite no. and street, or P.O. box)		<b>5a</b> Street address (if different) (Don't enter a P.O. box.)	
	<b>4b</b> City, state, and ZIP code (if foreign, see instructions)		<b>5b</b> City, state, and ZIP code (if foreign, see instructions)	

- May also apply online: <https://www.irs.gov/businesses>

**Note:** Applying for EIN starts three-year clock for IRS Form 990 filing requirement!

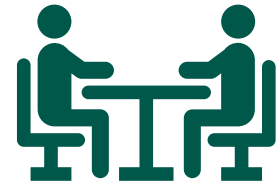




# Incorporation: Organizational Meeting

Initial directors meet to:

- Elect officers and directors
- Adopt bylaws and other key policies
- Conduct other initial business
- Authorize who will sign the Form 1023



May act by unanimous written consent





## Incorporation: Bylaws

- Agreed-upon rules and procedures for operations of a nonprofit
- Should provide clear direction and accurately reflect the practices of the organization, but provide **flexibility**
- Legal framework and minimum standards for bylaws are set forth in the NPCL



## Incorporation: Conflict of Interest Policy

- Required by the NPCL for *all* New York nonprofit corporations
- Ensures that transactions with insiders are reviewed by uninterested directors and are fair, reasonable, and in the best interest of the organization
- Sets forth procedures for the Board to:
  - determine if a conflict of interest exists within a proposed transaction, and
  - address transactions when a conflict arises



# Incorporation: Conflicts of Interest Disclosure Obligations

Before a director is initially elected, **and annually thereafter**, each director must complete, sign and submit a written statement identifying:

- Any entity of which the director is an officer, director, trustee, member, owner, or employee and with which the corporation has a relationship, and
- Any transaction in which the corporation is a participant and in which the director might have a conflicting interest



Directors should disclose new conflicts (or potential conflicts) as they arise, even outside of the annual disclosure questionnaire process

Copies of all statements should be submitted to chair of audit committee or Board chair





# Incorporation: Whistleblower Policy

\*Required for nonprofits with 20 or more employees and annual revenue of over \$1 million

- Under NPCL, policy must **prohibit retaliation** against any director, trustee, officer, employee or volunteer reporting in good faith any action or suspected action, taken by or within the organization that is **illegal, fraudulent or in violation of any adopted policy**
- Under new NY Labor Law, whistleblower protections expanded to former employees and independent contractors and covers **suspected violations of law, regulations, etc.** or activities/policies that **pose a substantial and specific danger to public health or safety**



## Q: What happens after you've filed your certificate of incorporation with the DOS?

**A**

I've formed a New York not-for-profit corporation and now I'm done!

**B**

I've created a 501(c)(3) organization, time to start fundraising!

**C**

Until I apply for tax exemption with the IRS, any money raised or generated by my organization is taxable.

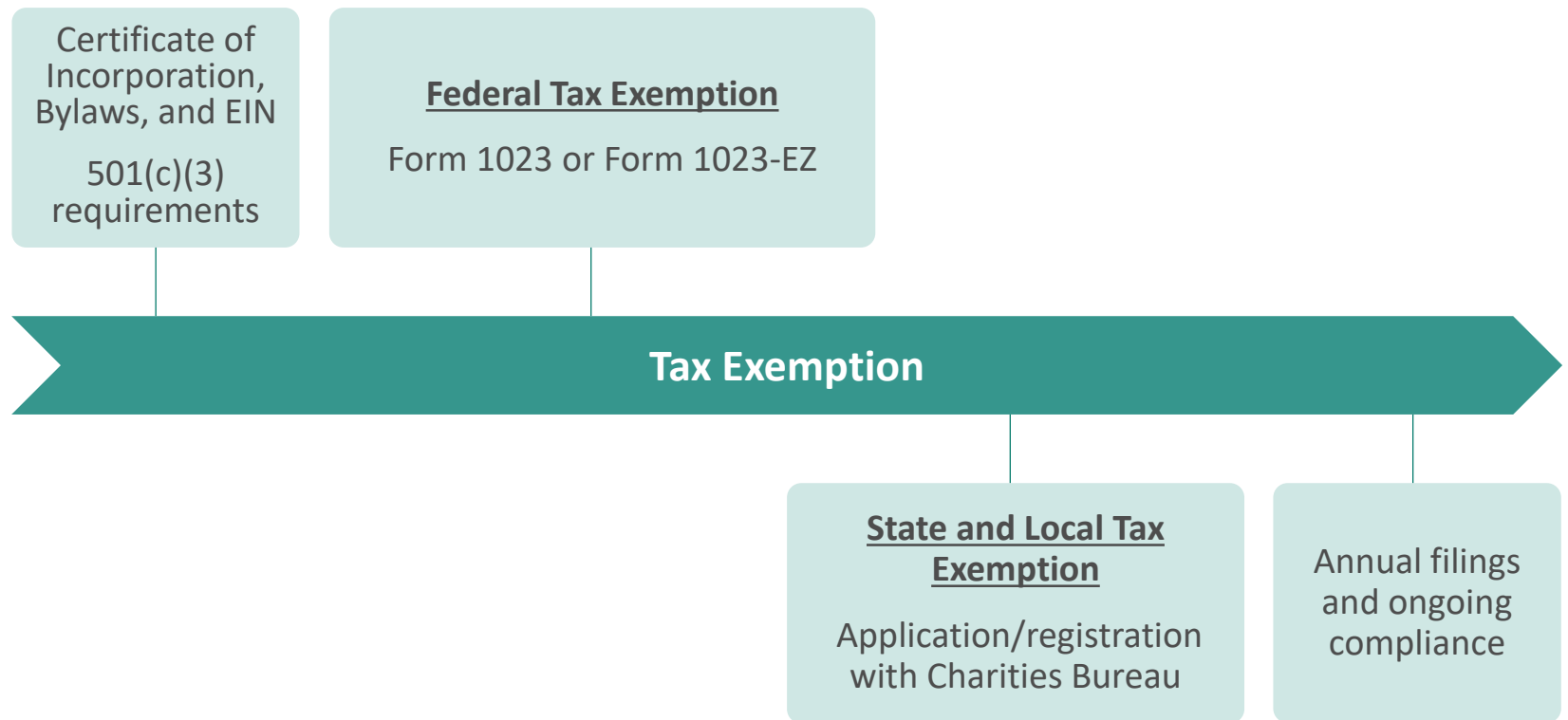


# Tax Exemption





# Tax Exemption: Timeline







# Tax Exemption: Eligibility Under IRC 501(c)(3)

**Donations to 501(c)(3) organizations are tax deductible**

- Must be organized and operated exclusively for charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, or preventing cruelty to children or animals
- Must serve the public at large rather than benefit any private individuals or companies
- Program limitations:
  - No partisan political activity
  - Only limited amounts of lobbying (i.e., influencing legislation)



## Tax Exemption: Limitations on Lobbying

- If an organization wants to participate in lobbying, two options can help you determine how much you can do:
  - **Substantial Part Test (Default):**
    - Facts and circumstances test reviewed by IRS. Loss of tax-exempt status possible if organization has engaged in substantial lobbying.
  - **501(h) Election:**
    - Establishes bright-line dollar amount an organization can spend on lobbying without jeopardizing tax-exempt status. Opt-in by filing Form 5768.



# Tax Exemption: Lobbying and the 501(h) Election

Exempt Purpose Expenditures	Non-Taxable Lobbying Allowance under 501(h)
≤\$500,000	<u>20%</u> (i.e. \$100,000 max)
>\$500,000 but ≤\$1 million	\$100,000 plus <u>15%</u> of excess over \$500,000
>\$1 million but ≤\$1.5 million	\$175,000 plus <u>10%</u> of excess over \$1 million
>\$1.5 million but ≤\$17 million	\$225,000 plus <u>5%</u> of excess over \$1.5 million
>\$17 million	\$1 million



# Tax Exemption: Public Charity vs. Private Foundation

- Classification depends on source of organization's financial support
- To be classified as public charity, must demonstrate that a significant portion of revenues (normally at least  $\frac{1}{3}$  of the total, but sometimes as little as 10%) comes from gifts or contributions from the public
  - Public support includes government contracts
- Important because private foundations:
  - are prohibited from **any** lobbying
  - are subject to 1-2% tax on investment income
  - cannot compensate any directors or officers
  - must make a certain % of distributions each year

# Tax Exemption: Form 1023 Overview

- Most questions (and most work for applicants) focuses on narrative description of activities and financial information
- Must have Certificate of Incorporation, bylaws, and EIN prior to submission

<b>Form 1023</b> (Rev. December 2017) Department of the Treasury Internal Revenue Service		<b>Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code</b> ▶ Do not enter social security numbers on this form as it may be made public. ▶ Go to <a href="http://www.irs.gov/Form1023">www.irs.gov/Form1023</a> for instructions and the latest information.		OMB No. 1545-0056 <b>Note:</b> If exempt status is approved, this application will be open for public inspection.
<i>Use the instructions to complete this application and for a definition of all <b>bold</b> items. For additional help, call IRS Exempt Organizations Customer Account Services toll-free at 1-877-829-5500. Visit our website at <a href="http://www.irs.gov">www.irs.gov</a> for forms and publications. If the required information and documents are not submitted with payment of the appropriate user fee, the application may be returned to you.</i>				
<i>Attach additional sheets to this application if you need more space to answer fully. Put your name and EIN on each sheet and identify each answer by Part and line number. Complete Parts I – XI of Form 1023 and submit only those Schedules (A through H) that apply to you.</i>				
<b>Part I Identification of Applicant</b>				
<b>1</b> Full name of organization (exactly as it appears in your <b>organizing document</b> )		<b>2</b> c/o Name (if applicable)		
<b>3</b> <b>Mailing address</b> (Number and street) (see instructions)		Room/Suite	<b>4</b> Employer Identification Number (EIN)	
City or town, state or country, and ZIP + 4		<b>5</b> Month the annual accounting period ends (01 – 12)		

Provide as much detail as possible!



# Tax Exemption: Form 1023 Filing Details

- **Timing:**
  - As of Jan . 16, 2024, the IRS was still assigning applications submitted after May 10, 2023; around 8 months
  - Effective date of tax-exempt status:
    - Applications filed within 27 months of incorporation: tax-exempt status retroactive to the date of incorporation
    - Applications filed more than 27 months after incorporation: tax-exempt status retroactive to the date of filing Form 1023
- **Application:** Must be filed online at Pay.gov
- **Fee:** \$600



# Tax Exemption: Streamlined Form 1023-EZ

Available to nonprofits who:

- Received less than \$50,000 in revenue for each of the past 3 years; and
- Project less than \$50,000 in revenue for each of the next 3 years; and
- Do not have assets whose value exceeds \$250,000

*Other exceptions apply, so consult the worksheet in the Form 1023-EZ instructions for more information*

- **Timing:** As of Jan. 16, 2024, IRS was assigning applications submitted Dec. 27, 2023; ~3 weeks
- **Application:** Must be filed online at Pay.gov
- **Fee:** \$275



# Tax Exemption: State and Local Exemptions and Registration

- Federal tax exemption isn't the end. Don't forget:

- State Franchise Tax
- State and Local Sales Taxes
- NYC Business Corporation Tax
- Real Property Tax (if applicable)

- Register with NY State Attorney General Charities Bureau (online at [www.charitiesnys.com](http://www.charitiesnys.com)):
  - Prior to beginning soliciting contributions; **or**
  - Within 6 months of receiving property in New York





# Annual Filings





# Annual Filings: Overview

## Federal

- IRS Form 990

## NY State

- CHAR500
- Annual financial reports and audits (depending on size)

# Annual Filings: Form 990

- Form must be filed by the 15th day of the 5th month following the end of the organization's fiscal year
- Public relies on information contained in Form 990
- Option to use Form 990 to report organizational changes (name change, purpose change)
- If no Form 990 is filed for three consecutive years, the IRS will automatically revoke tax-exempt status

<b>Form 990</b>		<b>Return of Organization Exempt From Income Tax</b>		OMB No. 1545-0047	
Department of the Treasury Internal Revenue Service		<b>2021</b> <b>Open to Public Inspection</b>			
Under section 501(c), 527, or 4947(a)(1) of the Internal Revenue Code (except private foundations)					
▶ Do not enter social security numbers on this form as it may be made public. ▶ Go to <a href="http://www.irs.gov/Form990">www.irs.gov/Form990</a> for instructions and the latest information.					
<b>A</b> For the 2021 calendar year, or tax year beginning , 2021, and ending , 20					
<b>B</b> Check if applicable:		<b>C</b> Name of organization		<b>D</b> Employer identification number	
<input type="checkbox"/> Address change		Doing business as			
<input type="checkbox"/> Name change		Number and street (or P.O. box if mail is not delivered to street address)		Room/suite	<b>E</b> Telephone number
<input type="checkbox"/> Initial return					
<input type="checkbox"/> Final return/terminated		City or town, state or province, country, and ZIP or foreign postal code			
<input type="checkbox"/> Amended return				<b>G</b> Gross receipts \$	



## Annual Filings: Form 990 Filing Options

- Form 990 should be filed if an organization plans to file for tax exemption, but is not yet exempt or if Form 1023 pending
- If Form 1023-EZ is pending, call IRS to be entered into database so organization can file the Form 990-N online

Gross Receipts <\$50k	<b>Form 990-N</b> (or, may choose to file Form 990-EZ or Form 990)
Gross Receipts <\$200k and total assets <\$500k	<b>Form 990-EZ</b> (or, may choose to file Form 990)
Gross Receipts ≥\$200k, or total assets ≥\$500k	<b>Form 990</b>



# Annual Filings: NYS Charities Bureau CHAR 500 and Audits

- Annual report (CHAR500) required by the New York State Attorney General's Charities Bureau
- Must be submitted via online portal within 4 ½ months after the end of the organization's fiscal year
  - Documents filed with Charities Bureau (including certificate of incorporation, bylaws, Form 1023) are made publicly available on the Charities Bureau website
- Additional required financial filings with Charities Bureau depend on organization's income

Annual Gross Revenue and Support	
\$250,000 or less	Unaudited financial report
>\$250,000 to \$1,000,000	Independent CPA review report
More than \$1,000,000	Independent CPA audit report



**Q: Do you need to file a Form 990 with the IRS every year?**

**A**

No, only once every three years.

**B**

Yes, but only if you have revenue greater than \$50k per year.

**C**

If you file your CHAR-500 with NY State, you do not need to also file the Form 990 that year.

**D**

Yes, every year.

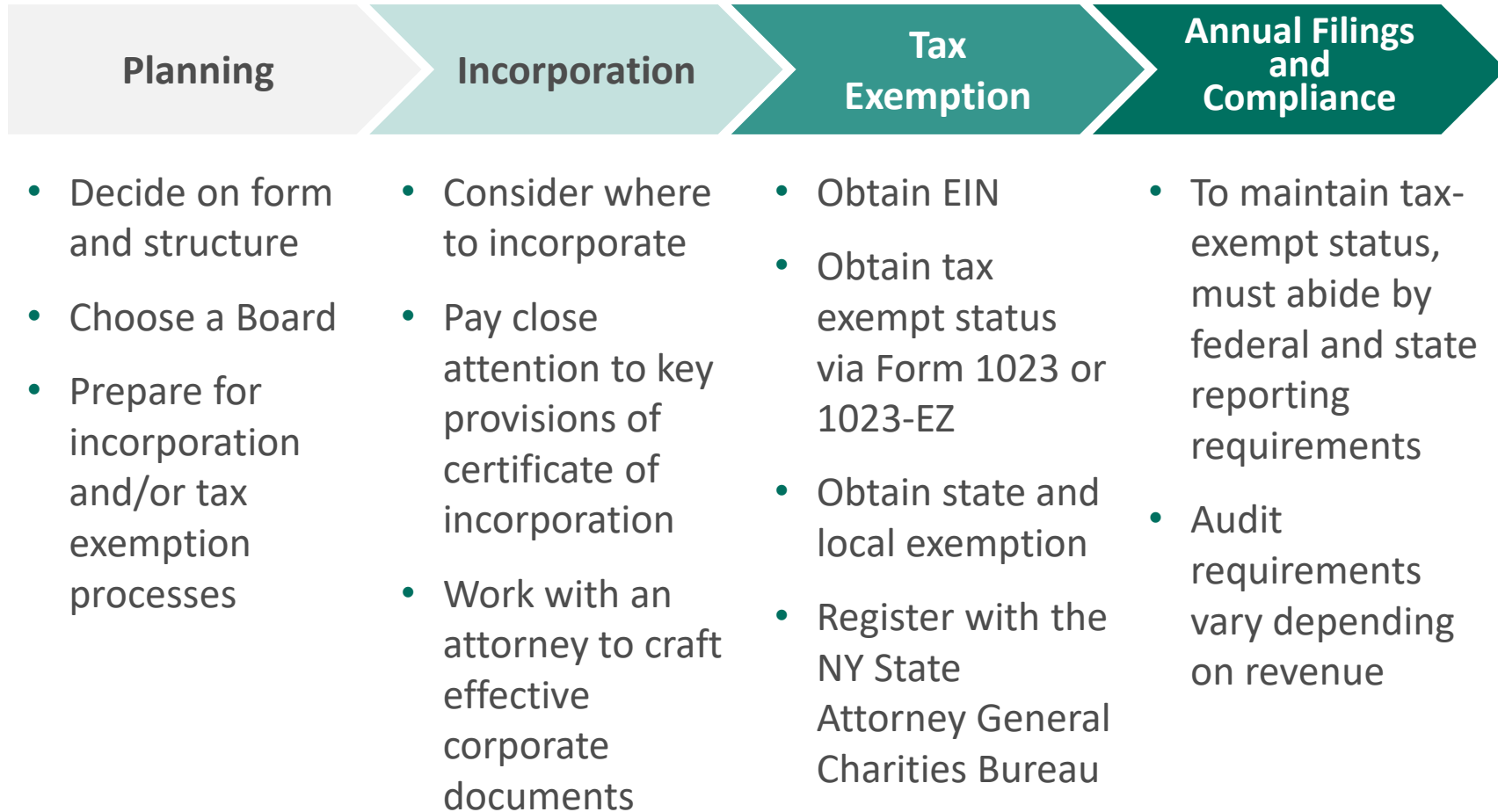
# Unrelated Business Income Tax (“UBIT”)

- Exempt organizations must consider whether they will generate revenue
- An exempt organization can be subject to tax on income if it:
  - Carries on a **trade or business**
  - **Regularly** practiced
  - That is **not substantially related** to its exempt purpose
- Even if substantially related to exempt purpose, may still be taxed if “overly commercial” in nature
- Form 990-T used to report unrelated business income to IRS

Form <b>990-T</b>  Department of the Treasury Internal Revenue Service	<b>Exempt Organization Business Income Tax Return</b> <b>(and proxy tax under section 6033(e))</b>		OMB No. 1545-0047
	For calendar year 2021 or other tax year beginning _____, 2021, and ending _____, 20____		<b>2021</b>
	▶ Go to <a href="http://www.irs.gov/Form990T">www.irs.gov/Form990T</a> for instructions and the latest information. ▶ Do not enter SSN numbers on this form as it may be made public if your organization is a 501(c)(3).		<b>Open to Public Inspection for 501(c)(3) Organizations Only</b>
A <input type="checkbox"/> Check box if address changed.	Name of organization ( <input type="checkbox"/> Check box if name changed and see instructions.)	D Employer identification number	
Print			



# Summary







# Thank You!

Don't forget to join us for our upcoming webinars:

- *Negotiating and Understanding Fiscal Sponsorship Agreements* on January 31
- *Understanding Leave Laws and Accommodations in New York: A Comprehensive Guide for Charter Schools* on February 1
- *Ways to Reduce Costs in Challenging Times - Subleasing and Desk Rentals for Nonprofits* on February 28
- *Data Protection for Nonprofits* on March 1
- *Connecting Corporate Dollars to Your Cause: Cause-related Marketing* on March 13

Register now at [lawyersalliance.org](http://lawyersalliance.org)!

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