

## **Setting Up a New Nonprofit Organization**

### ***Frequently Asked Questions***

The following provides answers to some of the most frequently asked questions about the process for setting up a new nonprofit organization in the U.S.

#### **1. What kinds of organizations qualify for federal tax-exemption?**

Various types of organizations qualify for exemption from federal income tax under the Internal Revenue Code (“Code”). The most common type of tax-exempt organization is a 501(c)(3) charitable organization. The exempt purposes set forth in section 501(c)(3) of the Code include charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals.

Notably, 501(c)(3) organizations can receive tax-deductible contributions, a key characteristic that distinguishes them from other tax-exempt organizations. 501(c)(3) organizations are further divided into two types: public charities and private foundations. Private foundations normally receive substantially all of their contributions from relatively few sources, while public charities generally receive a substantial portion of their financial support from the public. Because private foundations are generally privately funded and privately controlled, they are subject to additional requirements and restrictions that are not applicable to public charities.

In addition to 501(c)(3) organizations, many other types of organizations may qualify for tax-exemption, but may not receive tax-deductible contributions, including 501(c)(4) social welfare organizations, 501(c)(6) trade associations, and 501(c)(7) social clubs, to name a few. The IRS provides an overview of these different types of organizations [here](#).

#### **2. What steps are required to set up a new nonprofit organization?**

Typically, setting up a new nonprofit organization involves three key steps:

- (i) File your Certificate of Incorporation with the state, which should include certain language required by the IRS to qualify for the applicable tax-exempt status.
- (ii) Adopt Bylaws, appoint initial directors and officers, adopt initial corporate resolutions, and apply for a federal Employer Identification Number (EIN).
- (iii) Prepare and file an application for federal tax-exempt status with the IRS.

### **3. How long does the process take to incorporate and obtain tax-exemption?**

***For incorporation:*** The process for incorporating a nonprofit in most states is usually quick, and can be completed in a matter of days. For example, in Delaware, once you have submitted a signed Certificate of Incorporation with certain basic information (e.g., purposes, the name of the incorporator and/or a list of directors, and an organizational address, which can be a registered agent's address), you can legally incorporate in approximately 24 hours. Incorporating in New York usually takes longer, based on our past experience, and can take anywhere from a few days to a few weeks.

***For obtaining federal tax-exempt status:*** Currently, the IRS takes approximately six to eight months to review and approve applications for tax-exempt status. However, some applications may take longer if there are questions from the Examiner. When your application is received, the IRS will send a letter confirming its receipt of the application. Once an application is assigned, applicants can typically expect to hear back from the IRS within 4-6 weeks. The IRS publishes on their [website](#) the postmark date of applications that have not yet been assigned for review, which provides applicants with an indication of approximately when a submitted application will be reviewed. If your application was submitted before the published postmark date, you can call the IRS at 877-829-5500 to request a status update.

### **4. Can I start soliciting donations while I am waiting for my IRS application for tax-exemption to be reviewed?**

Yes, an incorporated nonprofit organization may solicit and receive donations while it is waiting for its tax-exempt application to be reviewed. If the IRS application for tax-exempt status (Form 1023) is filed within twenty-seven (27) months from the end of the month of incorporation, and the organization's status as a 501(c)(3) tax-exempt organization is granted, the organization's tax-exempt status and ability to accept tax-deductible donations will be retroactive to the date of the organization's incorporation. However, keep in mind that if the organization is seeking 501(c)(3) tax-exempt status, the Internal Revenue Code and state laws require that any solicitation materials distributed while the organization's tax-exempt status is pending must clearly disclose that the organization has not yet received 501(c)(3) tax-exempt recognition, and therefore, donations may not be deductible.

If your organization's donors need greater certainty regarding the tax-deductibility of their donations during the period in which it is waiting for the IRS to review and approve its application, you may want to consider using a fiscal sponsor to receive donations and make reimbursements or payments to vendors, contractors, and individuals. A fiscal sponsorship is a relationship in which one organization that is tax-exempt (the fiscal sponsor) serves as the official recipient of charitable donations for another organization that is not yet recognized as tax-exempt (the sponsored organization). For more information on fiscal sponsorships, click [here](#).

Keep in mind that organizations soliciting charitable contributions must register to solicit in the applicable states. For more information, click [here](#).

## 5. What are my filing responsibilities once I receive or apply for my tax-exempt status?

***With the IRS:*** Almost all organizations are required to file a Form 990 (or 990-PF, 990-EZ, or 990-N) every year. (Exceptions include churches and their affiliated organizations, and governmental organizations, which are exempt from the Form 990 filing requirement). The Form 990 is an annual report filed with the IRS that provides information on the filing organization's mission, programs, and finances. The filing deadline is four and a half (4 ½) months after the end of the organization's fiscal year (although extensions can be requested). **The obligation to file a Form 990 (or 990-PF, 990-EZ, or 990-N) generally begins on the date of formation, *not* the date that the letter acknowledging tax-exempt status is issued.** The IRS Determination Letter will specify the effective date of exemption, which is the official date from which to calculate the organization's filing deadline. Failure to file Form 990 for three (3) consecutive years will result in automatic revocation of your federal tax-exempt status. If you would like references of accountants who are experienced in nonprofit accounting and tax issues, please let us know. For additional information on nonprofits' Form 990 filing obligations, visit the [IRS website](#).

***With the State(s):*** Many states have annual filing requirements for nonprofit organizations. For example, Delaware requires all corporations incorporated in Delaware, including nonprofit corporations, to file an Annual Report on or before March 1<sup>st</sup> of every year with a current fee of \$25.00 (\$125.00 if filed after March 1<sup>st</sup>). In New York, all charitable organizations operating in the state are required to register and file annual financial reports with the [Attorney General's Office](#), including any organization that conducts charitable activities, holds property that is used for charitable purposes, or solicits financial or other contributions. If you plan to begin soliciting nationally or in multiple states, you may need to register in each of the states before you begin your solicitation activities. For more information, click [here](#).

## 6. What other ongoing compliance obligations should I be aware of?

In order to maintain federal tax-exempt status, your organization must continue to be operated exclusively for exempt purposes. If more than an insubstantial part of the organization's activities does not further an exempt purpose, the IRS can revoke the organization's exempt status.

In particular, a 501(c)(3) tax-exempt organization must:

- not participate in [political campaigns](#) of candidates for local, state, or federal office;

- restrict its [lobbying activities](#) to an insubstantial part of its total activities;
- ensure that its earnings do not [inure](#) to the benefit of any private shareholder or individual;
- not operate for the [benefit of private interests](#) such as those of its founder or the founder's family; and
- not operate for the primary purpose of conducting a [trade or business](#) that is not related to its exempt purpose.

In addition to possible loss of the organization's section 501(c)(3) tax-exempt status, activities constituting inurement (i.e., an improper economic benefit) may result in the imposition of [penalty excise taxes](#) on individuals benefiting from excess benefit transactions.

For an overview of ongoing compliance issues for 501(c)(3) tax-exempt organizations, the IRS has prepared a [compliance guide for public charities](#) and a [compliance guide for private foundations](#).

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