

Nonprofit Tax Exempt Organizations

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Most of us have "causes" we would like to pursue and support for the good of our community, to help others or just to be good citizens. There are important advantages to be secured by establishing a nonprofit tax exempt organization to pursue the cause. The principal advantage, of course, is that contributions to such an organization are tax deductible. Also, grants from government and from private foundations are generally only available to nonprofit tax exempt organizations. Finally, such organizations as a general matter are eligible for certain exemptions from income tax, sales tax and property tax. (Important to note that they are not exempt from all taxes, for instance, charities generally have to pay sales taxes on their purchases.)

What sorts of organizations are eligible for tax exempt status?

Only organizations which pursue certain specified purposes are entitled to tax exempt status. These exempt purposes are:

- religious
- charitable (includes relief for the poor and reducing the burdens of government)
- scientific
- testing for public safety
- literacy
- educational

There are several types of tax exempt organizations. The preferred form of organization is a publicly-supported 501(c)(3) organization. Public support generally requires that one-third or more of the organization's support comes from the government and small contributors.

How does one go about setting up a nonprofit tax exempt organization?

There are many different forms of tax exempt organizations. The most popular is a nonprofit corporation. In South Carolina such an organization is created by filing Articles of incorporation with the South Carolina Secretary of State. These Articles must specify that the organization is nonprofit (that is, not setup for the benefit or profit of its incorporators). In order to be a tax

exempt 501(c)(3) organization the Articles must specify that the organization is created for public benefit through pursuit of a specified exempt purpose, that the organization will not engage in activities in which a tax exempt organization is not supposed to engage, such as political campaigns or substantial lobbying activities, and that upon dissolution of the organization its assets will pass on to another 501(c)(3) organization.

How does a nonprofit corporation become a tax exempt 501(c)(3) organization?

The organization must apply to the Internal Revenue Service for confirmation of its exempt status. This is done on Form 1023, which seeks very detailed information as to the organization's intended activities, its anticipated sources of funds and planned expenditures of those funds. Financial statements for the organization and budgets of anticipated revenues and expenditures for the next 2 years must be submitted. The organization must specify whether or not it anticipates that it will meet the public support test. The IRS Exempt Organization division typically reads these applications carefully and very often requests additional information. It usually takes four months or more for an application for confirmation of exempt status to be processed. Also, in South Carolina it is very important that the organization register to solicit charitable contributions with the Secretary of State.

How does a nonprofit corporation maintain its tax exempt status?

A 501(c)(3) tax exempt organization is required to file annual information returns on Form 990. However, if the organization's gross receipts are \$25,000 or less, it only needs to file a very simple notice on Form 990-N. Of course, the organization must continue to meet the public support test and the Form 990 requests detailed information as to the organization's sources of support. The organization's information returns must be available for inspection by any member of the public.

What are the principal benefits of an organization's status as a publicly supported 501(c)(3) organization?

The principal benefit is the tax deductibility of contributions. Individuals can contribute appreciated property (for instance, appreciated land or securities), get a full fair market value deduction, with no tax on the appreciation. Individuals can shelter up to 50% of their adjusted gross income with deductions from such contributions.

In addition to exemption from income tax, such organizations in South Carolina are entitled to an exemption from property tax on property used in performance of their exempt purposes. This can involve significant savings particularly with respect to real estate. Such organizations may sell personal property free of sales tax, so long as sales proceeds are used for their exempt purposes.

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