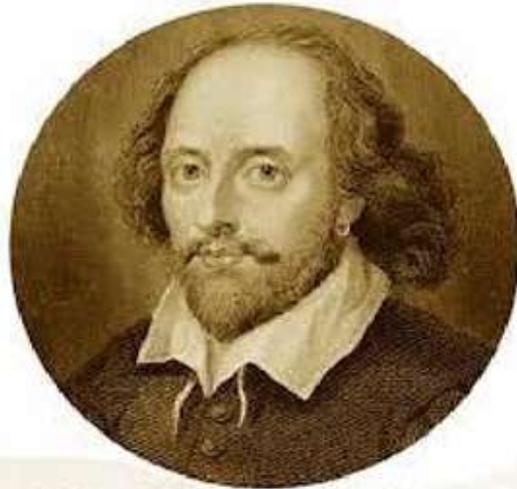


**501(c)(3)...To Be  
or Not To Be????**



*William Shakespeare*

Nonprofit Resource Center  
207 North Second Street  
Muskogee, OK 74401  
918.683.4600

[www.nbn-nrc.org](http://www.nbn-nrc.org)

*Adapted and revised from with permission from the Paul Clarke Nonprofit  
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# 501(c)(3): To Be or Not To Be?

## So, you're thinking of starting a New Nonprofit?

That's great, and we're glad you visited the Nonprofit Resource Center before you got started.

There are lots of things to think about and we hope you'll use this packet to help decide whether or not to start a charitable organization.

To begin, you need to know that there are different types of nonprofit organizations. Some are tax-exempt and some are not. This packet is about tax-exempt nonprofit charitable organizations, often referred to as 501(c)(3)s for the section of the IRS code that describes them.

There are legal definitions, and there are common perceptions of what people mean when they refer to an organization as nonprofit. Here is the IRS definition:

### Exemption Requirements - Section 501(c)(3) Organizations

Organizations described in section 501(c)(3) are commonly referred to as *charitable organizations*.

Organizations described in section 501(c)(3), other than testing for public safety organizations, are eligible to receive tax-deductible [contributions](#) in accordance with Code section 170.

The organization must not be organized or operated for the benefit of [private interests](#), and no part of a section 501(c)(3) organization's net earnings may inure to the benefit of any private shareholder or individual. If the organization engages in an [excess benefit transaction](#) with a person having substantial influence over the organization, an [excise tax](#) may be imposed on the person and any organization managers agreeing to the transaction.

Section 501(c)(3) organizations are restricted in how much political and legislative (*lobbying*) activities they may conduct. For a detailed discussion, see [Political and Lobbying Activities](#). For more information about lobbying activities by charities, see the article [Lobbying Issues](#); for more information about political activities of charities, see the FY-2002 CPE topic [Election Year Issues](#).

**SOURCE:** <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Exemption-Requirements---Section-501%28c%29%283%29-Organizations>

 **A nonprofit is a tax-exempt organization**  
**that serves the public interest** 

This is a common and broad definition that fits the type of information likely to be found online. The public expects to be able to make donations to these organizations and deduct them from their federal taxes. Legally, a nonprofit organization is one that does not declare a profit and instead utilizes all revenue available after normal operating expenses in service to the public interest. These organizations can be unincorporated or incorporated.

The term "nonprofit" does not imply any specific type of legal structure. If the group [incorporates](#), it is a nonprofit [corporation](#). If it does not incorporate, it is an [unincorporated nonprofit association](#).

- An **unincorporated** nonprofit **cannot** be given federal tax-exempt status or the designation of being a 501(c)(3) organization as defined by the Internal Revenue Service.
- An **incorporated** nonprofit organization shares many traits with for-profit corporations except that there are no shareholders.

When a nonprofit corporation is given tax-exempt status, it is exempt from paying federal corporate income tax. While these types of organizations also are often exempt from paying state and local sales tax, property tax and taxes on other assets, this is not always the case as states have different rules.

To make sure that the nonprofit corporation actually works for the public good and earns its tax breaks, the state will required it to set up certain organizational structures such as a [board of directors](#) or board of trustees. The board is responsible for keeping the group on track and fulfilling its [nonprofit mission](#).

EXCERPT FROM SOURCE: <http://nonprofit.about.com/od/qathebasics/f/whatisnonprofit.htm>

## For What Purposes May a Nonprofit Corporation be Formed?



Under IRS Code 501 (c)(3) a nonprofit corporation may be formed to operate for:

- Religious
- Charitable
- Educational
- Literary
- Testing for public safety
- Scientific
- Fostering national or international amateur sports competition
- The prevention of cruelty to children or animals

### Public Charities

The number of public charities eligible to receive tax-deductible contributions

- **1,563,596** in the USA (does not include 278,772 congregations)
  - 966,597 public charities
  - 98,797 private foundations
  - 498,202 other types of nonprofit organizations, including chambers of commerce, fraternal organizations and civic leagues
- **18,572** in Oklahoma (does not include foundations, churches or associations)
  - **359** in Muskogee County
  - **297** in Muskogee



SOURCES: IRS.gov (Sept 2012) & nccs.urban.org

## Answer these questions before you start a new nonprofit

What is the purpose, and is there a need for the new organization? **This is the most important question to answer.**

- What need(s) will the new charity meet? List here:

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- Is there a nonprofit currently providing the same or similar service(s) in your community? List them below:

***Don't skip this step!*** *If you were starting your own business, with your own money, you would want to know who your competition was, and if you could be successful in your endeavor.*

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- What do you know about the program(s) that already exist to meet this need, who they serve and how well they serve them?

*If similar programs are already operating but you believe they could do a better job, be sure you understand where they are falling short and how your new organization could do it better.*

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NOTE: If there are organizations out there that have the same [mission](#) and they do a good job, it is going to be very difficult for you to attract donors, foundation grants, or any other support. You may be passionate about your cause, but the nonprofit "market" will not bear much redundancy.

(Excerpt from: [nonprofit.about.com](http://nonprofit.about.com))

## Do You Have Core Supporters?

- Are there other individuals in the community interested in helping to meet this need?

*While family and friends are usually the first people you will think of to provide the support you will need, they are not always the best choices. To succeed as a strong, viable and sustainable charitable organization there needs to be a wide circle of support.*

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## Where Will You Get the Money to Pay the Bills?

*You can start a nonprofit organization for very little money, but sustainability is long-term.*

Foundation grants for start-up organizations are very hard to find. Locally, funders have said

they are not awarding grants to organizations with less than 3-5 years of operation.

If you hope to find grants in the beginning, two important factors will have to be in place:

1. The organization must be filling a **strong and compelling need**.
2. You must have the proper experience and background to bring credibility to your idea.

## What are the expenses? What will provide income?

- Where will the service be provided? What equipment is needed? Staff? Materials?

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- If you plan to be the primary provider of services, how will you support the agency while you build the organization?

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## What Makes **You** the Best Person to Do This Job?

*Dedication and desire are important elements but they alone are not enough.*

- Have you been working in this field? How long? Where?

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- Do you have an understanding of your potential clients?

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- Have you had special training?

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- Are there licensing requirements that must be met in your city or state?

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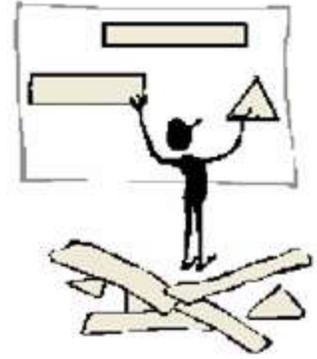


Want more questions? Look here:  
[http://nonprofit.about.com/od/gettingstarted/ss/  
Ask-Yourself-These-Questions-Before-You-Start-A-Nonprofit\\_2.htm](http://nonprofit.about.com/od/gettingstarted/ss/Ask-Yourself-These-Questions-Before-You-Start-A-Nonprofit_2.htm)

## Do you have the skills to start a nonprofit?

Here's a Check list of just a few needed:

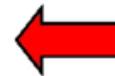
- Good management & administrative skills
- Experience in the field
- Leadership skills
- Ability to inspire others
- Knowledge of finances (budget & accounting)
- Fundraising skills
- High energy
- Marketing
- Open to change



Starting a nonprofit organization is similar to starting a business. It requires a good idea and hard work. But there is one major difference - **no one can "own" a nonprofit organization.**



**Once incorporated, it is no longer "yours"**



**Question:** How Is a Nonprofit Different From a Business?

**Answer:** Here are some of the differences between a business and a **nonprofit**:

When you start a business, it is for the financial benefit of its owners and/or shareholders. Profit is the goal and the business pays taxes on that profit.

- *A nonprofit entity has a **mission** that benefits the "greater good" of the community, society, or the world. It does not pay taxes, but it also cannot use its funds for anything other than the mission for which it was formed.*
- *Nonprofit organizations can and do make a profit, but it must be used solely for the operation of the organization or, in the case of a foundation, granted to other nonprofit organizations.*
- *When a for-profit organization goes out of business, its assets can be liquidated and the proceeds distributed to the owners or the shareholders. When a nonprofit goes out of business, its remaining assets must be given to another nonprofit.*

SOURCE: <http://nonprofit.about.com/od/qathebasics/f/nopvspro.htm>

## Management/Establishment/Pros-and-cons

Q: What are the advantages/ disadvantages of becoming a nonprofit organization?

A: **Advantages:**

**Tax-exemption/deduction:** Organizations that qualify as public charities under Internal Revenue Code 501(c)(3) are eligible for federal exemption from payment of corporate income tax. Once exempt from this tax the nonprofit will usually be exempt from similar state and local taxes. If an organization has obtained 501(c)(3) status, an individual's or company's charitable contributions to this entity are tax-deductible.

**Eligibility for public and private grants:** Nonprofit organizations are allowed to solicit charitable donations from the public. Many foundations & government agencies limit their grants to public charities.

**Formal structure:** A nonprofit organization exists as a legal entity in its own right and separately from its founder(s). Incorporation puts the nonprofit's mission and structure above the personal interests of the individuals associated with it.

**Limited liability:** Under the law, creditors and courts are limited to the assets of the nonprofit organization. The founders, directors, members, and employees are not personally liable for the nonprofit's debts. There are exceptions. A person cannot use the corporation to shield illegal or irresponsible acts on his/her part. In addition, directors have a fiduciary responsibility: if they do not perform their jobs in the nonprofit's best interests, and the nonprofit is harmed, they can be held liable.

A: **Disadvantages**

**Cost:** Creating a nonprofit organization takes time, effort, and money. Because a nonprofit organization is a legal entity under federal, state, and local laws, the use of an attorney, accountant, or other professional may well prove necessary. Aside from legal or other consultant fees, applying for Federal tax exemption can cost \$200-\$850 or more, in addition to state fees for incorporation.

**Paperwork:** As an exempt corporation, a nonprofit must keep detailed records and submit annual filings to the state and IRS by stated deadlines in order to keep its active and exempt status.

**Shared control:** Although the people who create nonprofits like to shape and control their creations, personal control is limited. A nonprofit organization is subject to laws and regulations, including its own articles of incorporation and bylaws. In some states, a nonprofit is required to have several directors, who in turn are the only people, allowed to elect or appoint the officers who determine policy.

**Scrutiny by the public:** A nonprofit is dedicated to the public interest, therefore its finances are open to public inspection. The public may obtain copies of a nonprofit organization's state and Federal filings to learn about salaries and other expenditures.

SOURCE: <http://www.grantSPACE.org/Tools/Knowledge-Base/Nonprofit-Management/Establishment/Pros-and-cons>

# Common Nonprofit Startup Mistakes

By Joanne Fritz, About.com

## 1. Lack of Research & Planning

Lack of a [business plan](#) is one of the most prevalent mistakes that [startup nonprofits](#) make. In their enthusiasm to do good, many founders of nonprofits forget that a nonprofit is a type of business. Businesses have business plans in hand before launching. A business plan encompasses an evaluation of the competitive environment, sources of funding, potential products or services to be offered and to whom, and a [needs assessment](#).

## 2. Lack of Financial Savvy

Close behind lack of planning is unrealistic expectations about funding for a startup nonprofit. Many founders do not anticipate what it will cost to start their nonprofit, much less have any idea of [where to get the funds](#). Any nonprofit startup needs a [funding plan](#), must decide if services provided will be available for a fee or be free, and should institute a good [financial records system](#). A nonprofit that has weak funding at the beginning is unlikely to be able to sustain itself long enough to get a vigorous fundraising program going.

## 3. Thinking It's Easier to Start a Nonprofit Than It Really Is

It is harder to start a nonprofit than most people think. The process alone of [incorporating](#) at the state level and then applying for [exempt status](#) with the IRS entail numerous steps and a lot of elbow grease. Passion is not enough. Hard-nosed realism about what is involved and the time it takes to achieve success is more important for the long haul.

## 4. Not Building an Effective Board

If there is one thing that could make or break your new nonprofit, it might be not paying enough attention to putting together an [effective board](#). Your first [board members](#) represent your "circle of influence," and they should be people who have resources, influence, and lots of other contacts. Your board members should believe in your organization's [mission](#) and be willing to sell that mission to others. They should be able to open doors for you.

SOURCE: <http://nonprofit.about.com/od/gettingstarted/a/What-Are-The-Most-Common-Mistakes-That-Nonprofit-Startups-Make.htm>

## Alternatives to Starting a New Nonprofit

**Many nonprofits are formed with high hopes and a few dedicated people but never get off the ground.**

Because most people thinking about starting a nonprofit have more passion for the purpose than the paperwork, it is wise to understand the ongoing reporting and record keeping requirements for nonprofits. These obligations represent substantial time and financial responsibilities and can be an obstacle to success and an unwanted distraction for people wanting to spend their time directly involved in serving people, creating art, or promoting a cause.



Since many nonprofits are formed with high hopes and a few dedicated people and never get off the ground, **investing time on the front end to determine the level of interest and availability of funds can help you better understand whether a new organization is needed.**



### What is Social Enterprise?

For individuals interested in owning or maintaining executive control over their corporation **becoming a Social Entrepreneur** may be the answer.

"Social enterprise, also known as social entrepreneurship, broadly encompasses ventures of nonprofits, civic-minded individuals, and for-profit businesses that can yield both financial and social returns. Form a for-profit social venture to accomplish your social goals; or set up a small business with the goal of contributing some or all profits to a charitable cause."

SOURCE: <http://www.grantspace.org/Tools/Knowledge-Base/Individual-Grantseekers/For-Profit-Enterprises/Social-enterprise>

"Just as entrepreneurs change the face of business, social entrepreneurs act as the change agents for society, seizing opportunities others miss and improving systems, inventing new approaches, and creating solutions to change society for the better. While a business entrepreneur might create entirely new industries, a social entrepreneur comes up with new solutions to social problems and then implements them on a large scale."

SOURCE: [http://www.ashoka.org/social\\_entrepreneur](http://www.ashoka.org/social_entrepreneur)

## Here are five additional alternatives to starting a new organization.

1. **Join an existing effort.** Study the list of nonprofits already active in the same subject and geographic area and join their efforts as a volunteer, a board member or even as staff.
2. **Create a special program of an existing effort.** Analyze the list of nonprofits already active in the same area, identify the three most compatible with your ideas, and meet with them to explore creating a special project or initiative and negotiate your involvement. You may have ideas that they would welcome, including resources that may be available to finance the new undertaking. Your activity could be a sponsored project with a level of independence, but without the need for separate books, government reporting and boards and committees.
3. **Start a local chapter of a national or regional organization.** Explore the list of national organizations in the subject area of your interest, and see if a local chapter is needed in your geographic area.
4. **Maintain an unincorporated association.** If your effort will be quite local and small, consider remaining an unincorporated association – have meetings and activities but skip the ongoing reporting requirements. Unincorporated associations can operate as a nonprofit; however, *donations are not tax-deductible.*

Those that choose to remain as an unincorporated association may undertake risk to board members and founders by not incorporating the organization. By incorporating, the organization becomes a legal entity and can only be liable for the assets of the organization. *An incident involving an unincorporated organization may put personal assets of board members, volunteers, or others, at risk.*

5. **Find a fiscal sponsor for your organization.** If you are considering creation of a group to finance activities or needs of others, plan to work on a limited-time project, or want to test a program idea first, exploring fiscal sponsorship. Fiscal sponsorship, sometimes referred to as fiscal agency, is a way to receive tax-deductible contributions by using the tax-exempt status of another organization as an umbrella.

Fiscal sponsors often provide more than the use of their tax-exempt status. They often co-locate, provide accounting and administrative services, and strategic planning guidance. The sponsored organization will pay a fee to the sponsor for their services, generally around 10-15 percent of the organization's revenues.

Fiscal sponsorship is a complex, individualized process. Organizations considering working with a sponsor should first identify several possible sponsors with missions in sync with that of the new organization. Work with each of these organizations to find the best fit in terms of missions, working style, and location. Will the sponsorship be structured to re-grant monies to the new organization? Will the sponsored organization purchase services from its sponsor? At what cost? How will both be assured against tax fraud. It is strongly recommended that both parties consult with legal professionals to ensure their interests are being met in the sponsorship agreement.

EXCERPTED FROM: Minnesota Council of Nonprofits

<http://www.minnesotanonprofits.org/nonprofit-resources/start-a-nonprofit/alternatives>

## Still Interested?

Please go online to this **Must Read Information Page**

SOURCE: <http://www.irs.gov/Charities-&-Non-Profits/Frequently-Asked-Questions-about-Tax-Exempt-Organizations>

### [Frequently Asked Questions About Applying for Tax Exemption](#)

Insights into the tax-exempt application process.

### [Questions about the Annual Reporting Requirements for Exempt Organizations](#)

Insights into the Service's annual reporting requirements.

### [FAQs about Issues of Interest to the General Public about Exempt Organizations](#)

Insights into issues of interest to the general public relating to tax-exempt organizations, including public availability of exempt organization returns.

### [Questions About Operating as an Exempt Organization](#)

Insights into the operations of a tax-exempt organization.

### [Exempt Organization Public Disclosure and Availability Requirements](#)

Insights into the rules which require tax-exempt organizations to disclose their exemption applications and annual returns.

### [Automatic Exemption Revocation for Non-Filing: Frequently Asked Questions](#)

Questions and answers about the automatic revocation process for failure to file exempt organization returns

### [Frequently Asked Questions \(FAQs\) - e-File for Charities and Nonprofits](#)

Frequently asked questions about e-file for charities and other nonprofit organizations

### [FAQs about the Annual Form Filing Requirements for Section 527 Organizations](#)

Insights into the annual filing requirements for political organizations.

### [Charitable Organizations Providing Disaster Relief - Questions and Answers](#)

Frequently asked questions about disaster relief provided by charitable organizations.

### [Frequently Asked Questions about Form 1023](#)

Frequently asked questions about the June 2006 revision of Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code

IRS Page Last Reviewed or Updated: 2012-08-14



## Do You Have a Plan?

After thinking through the realities of starting a nonprofit; answering the questions in this packet; researching similar agencies; determining how those organizations are doing; and identifying supporters the next step is writing a business plan.

Business planning with its own particular set of questions and priorities, we've found that the process typically includes four distinct components:

1. **Strategic clarity:** Developing a concrete description of the impact for which the organization will hold itself accountable over some specified period of time (its intended impact) and the cause- and-effect logic explaining how its work will lead to that impact (its theory of change);
2. **Strategic priorities:** Determining what specific actions and activities must take place to achieve the intended impact;
3. **Resource implications:** Understanding the resources—financial, human, and organizational—needed to pursue these priorities and mapping out a plan to secure them;
4. **Performance measures:** Establishing the quantitative and qualitative milestones that make it possible to measure progress toward the intended impact.

SOURCE:

<http://www.bridgespan.org/WorkArea/linkit.aspx?itemid=2382&linkidentifier=id>

## Web Resources

### **IRS: Life Cycle of a Charity**

[www.irs.gov/Charities-&-Non-Profits/Life-Cycle-of-an-Exempt-Organization](http://www.irs.gov/Charities-&-Non-Profits/Life-Cycle-of-an-Exempt-Organization)

### **The Foundation Center: How to Start a Nonprofit**

[www.grantspace.org/Tools/Knowledge-Base/Nonprofit-Management/Establishment/Starting-a-nonprofit](http://www.grantspace.org/Tools/Knowledge-Base/Nonprofit-Management/Establishment/Starting-a-nonprofit)

### **Resources for Nonprofit Organizations**

[www.idealists.org/npofaq/03/21.html](http://www.idealists.org/npofaq/03/21.html)

### **How-to information and FAQs** (focuses on Wildlife Rehabilitators, but good general information).

[www.ewildagain.org/nonprofit/501c3.htm#501](http://www.ewildagain.org/nonprofit/501c3.htm#501)

### **Before You Start A Nonprofit**

[nonprofitmanagement.suite101.com/article.cfm/before\\_you\\_start\\_a\\_nonprofit](http://nonprofitmanagement.suite101.com/article.cfm/before_you_start_a_nonprofit)

### **Steps for Developing a Nonprofit Strategic Business Plan**

[www.grantspace.org/Tools/Knowledge-Base/Nonprofit-Management/Sustainability/Business-plans](http://www.grantspace.org/Tools/Knowledge-Base/Nonprofit-Management/Sustainability/Business-plans)

[www.score.org/resources/business-plans-financial-statements-template-gallery](http://www.score.org/resources/business-plans-financial-statements-template-gallery)

### **The Technology Place for Nonprofits**

[www.techsoup.org](http://www.techsoup.org)

### **Mission & Vision Statements**

[www.help4nonprofits.com/NP\\_Bd\\_MissionVisionValues\\_Art.htm](http://www.help4nonprofits.com/NP_Bd_MissionVisionValues_Art.htm)

[www.foundationcenter.org/getstarted/tutorials/establish/statements.html](http://www.foundationcenter.org/getstarted/tutorials/establish/statements.html)

[www.raise-funds.com/1101forum.html](http://www.raise-funds.com/1101forum.html)