

P O Z N A K L A W F I R M L T D

Basics of Not-For Profit and Tax Exempt Organizations

1. **Tax Exempt Organizations in General.** Section 501(c) of the Internal Revenue Code provides for 28 categories of organizations that are exempt from federal tax. These include organizations for charitable purposes, 501(c)(3); for promotion of social welfare (emotional and/or financial), 501(c)(4); and organizations for business leagues, such as chambers of commerce, 501(c)(6).

2. **Organizations the Enable Charitable Tax Deductions.** Only 501(c)(3) organizations enable donors to obtain charity-type income tax deductions for their donations. Contributions to other 501(c) organizations, such as chambers of commerce, might qualify as business deductions but do not qualify as charitable deductions.

3. **Required Purposes for 501(c)(3).** 501(c)(3) organizations must have one of the following purposes: Religious, Educational, Charitable, Scientific, Literary, Testing for Public Safety, Foster National or International Amateur Sports Competition, or Prevention of Cruelty to Children or Animals.

4. **General Requirements to Form Not-For-Profit Organizations.**

- a. Corporations must be *organized* under state law as a not-for-profit corporation, which in Illinois requires one of 33 allowable purposes, including charitable and civic.
- b. The corporation's articles of incorporation must describe the corporation's purpose with sufficient specificity to satisfy the Secretary of State that the corporation's purpose is truly not-for-profit and to satisfy the IRS that the corporation's purpose truly satisfies the requirements of one of the 28 501(c) categories.
- c. The corporation must have at least 3 directors.
- d. Depending on the corporation's purpose, decide whether the corporation will or will not have members (ex: a charitable organization, which does not need to have members, compared with a chamber of commerce).

e. If seeking tax exempt status, upon termination of the corporation, its assets must be given to another tax exempt organization.

5. **Requirements After Forming Not-For-Profit Organizations.**

- a. Record the Articles of Incorporation with the county recorder
- b. File annual reports with the Illinois Secretary of State
- c. File annual federal and state income tax returns if not tax exempt
- d. Obtain yearly sales tax and property exemption letter from the Illinois

Department of Revenue, if charitable.

e. If tax exempt, register and file annual reports with the Illinois Attorney General, Division of Charitable Trust and Solicitations.

6. **Attaining 501(c)(3) Status.** 501(c)(3) status is attained only with IRS approval, which is obtained by filing a Form 1023 with the IRS. The Form 1023 has many requirements, the most important of which is describing how the organization's activities will fulfill the purpose for which the organization is formed.

7. **Losing 501(c)(3) Status.** 501(c)(3) status can be lost due to excess benefit transactions (transactions between the organization and third parties which are intended to unfairly benefit the third party at the expense of the organization) or excess compensation (compensation that is unreasonably high relative to the public and private sector and with regard to the organization's income and assets).

8. **More Information.** IRS Publication 557; Illinois Secretary of State, A Guide for Organizing Not-for-Profit Corporations; Illinois Attorney General website, and Illinois Department of Revenue website.