

NONPROFIT CORPORATION

Definition of Non-profit corporation

A non-profit corporation is a special type of corporation that has been organized for specific tax-exempt purposes. To qualify for non-profit status, your corporation must be formed to benefit (1) the public, (2) a specific group of individuals, or (3) the membership of the nonprofit. Examples of non-profits include religious organizations, charitable organizations, political organizations, credit unions and membership clubs (such as the Cosmo Club or a country club).

Non-profit corporations enjoy the same limited liability protection that regular corporations and limited liability companies enjoy. In other words, your directors, trustees, members, and employees are not responsible for the debts and liabilities of the corporation. There are also significant federal and state tax benefits available for incorporating as a non-profit. But one of the most attractive benefits of having a non-profit is that you are allowed to receive grants from the federal government and private foundations.

It's important to note that simply forming a non-profit corporation does not automatically qualify you for federal and state tax exemption. Instead, it's only the first step. Only a validly organized non-profit corporation can take that second step and apply for federal and state tax exemption. This application is often referred to as the 501(c) (3) application, since that is the most common IRS code section applicable to non-profit organizations. In fact, there are more than 20 code sections where a non-profit can qualify, with the most important being 501(c)(7) for social and recreational clubs.

A non-profit corporation does NOT mean that the corporation cannot sell goods or services for money. In fact, many non-profits make money from selling everything from clothing to medical services. A non-profit can pay salaries to its officers and employees, but it cannot distribute any profits for the benefit of its directors, officers or members – such as dividends.

Members and Membership

Different from a regular corporation, a non-profit corporation does not have stockholders (since non-profit corporations do not issue stock). Instead, as an option, non-profit corporations may choose to have members.

A formal membership structure will often grant members certain basic rights, such as the power to vote for directors and the right to approve a sale or merger. Most non-profits (especially smaller ones) do not have members, due to the additional paperwork and formalities that are required.

Even without members, other people may still participate as an advisor, patron or contributor, but without a formal vote. However, if your non-profit is a club or social organization, it might make sense that all of the members have a formal vote on certain important matters.

The 501(c) 3 Tax Exemptions

Section 501(c) 3 of the IRS Code exempts payment of federal income taxes for groups who are organized for charitable, religious, scientific, literary and educational purposes. It is one of many sections in the IRS code which grants tax exemption to certain entities, but the most common one. Section 501(C) (3) covers organizations formed for the following:

1. Charitable purposes are defined as "providing services beneficial to the public interest." Examples include a battered women's shelter or a low-cost medical clinic.
2. Religious purposes are valid as long as the organization's directors, officers and members appears to truly and sincerely hold the values and beliefs espoused by the religion.

3. Scientific purposes are defined as individuals and groups who conduct scientific research for the benefit of the public.
4. Literary and educational purposes include instruction of the public on topics for which there are sufficient facts to permit an individual or the public to form an independent opinion or conclusion. An unsupported opinion is not considered educational.

As previously noted, unless a non-profit corporation files a 501(c) (3) application with the IRS, it will not be exempt from paying federal income taxes. If your non-profit's purpose qualifies under 501(c)(3), then Law offices of Runan Zhang can help prepare the application for you. The state also requires a tax exempt application. However, most states will accept the federal application for tax exempt status in place of their own application

If you do not qualify under 501(c) (3), you may still be eligible for tax-exempt status under a different IRS code section. Some of the other common ones include:

- Labor and Agricultural organizations: 501(c) (5)
- Business leagues: 501(c) (6)
- Social and recreational clubs: 501(c) (7)
- Fraternal benefit societies: 501(c) (8)
- Credit Unions: 501(c) (14)
- Farmer's Cooperatives: 501(c) (16) and 521(a)

It will take the IRS 3-5 months to examine and approve your 501(c) (3) application, but the processing time will be longer. Accordingly, we suggest that you start on the process by forming your corporation BEFORE completing the 501(c) 3 applications. While Law offices of Runan Zhang is filing your incorporation documents, you can use the time to select your board members, prepare your financial budget and refine your activities and programs.

Operating a Non-Profit Corporation

Below are some of the most common issues relating to the operating a non-profit corporation.

1. Keep things separate

It's important to keep the affairs of your non-profit corporation separate from the personal affairs of the directors and officers. This means setting up a separate bank account, maintaining separate records, and keeping separate books for accounting purposes.

2. Director Meetings

Like a regular business corporation, directors need to hold periodic meetings. Meetings can take place in person or by telephone. Either way, be sure to make a written record of the items discussed and actions approved at the meetings. Alternatively, you can just get all the directors (or a majority of the stockholders) to sign a statement approving corporate actions.

3. Tax Returns

Even non-profit corporations that are exempt from federal and state income taxes sometimes must file an information tax return. Federal income is reported on IRS Form 990 and must be filed by April 15 if your corporation's fiscal year ends on December 31. If you operate certain public charities where your gross receipts are less than \$25,000 per year, you may be exempt from filing a return. The IRS will inform you if you qualify for the exemption.

4. EIN and Licenses

Every corporation must obtain a federal tax identification number, which is similar to an individual's social security number. Some states also require a separate state tax number.

5. Maintain tax exempted activities

Nonprofit corporation must maintain its business operation in the intended activities for the public interests and avoid activities which will cause the confusion for tax issues.