



When to Become a 501(c)(3)?

By Carol L. Topp, CPA

HomeschoolCPA is frequently asked, “When does my homeschool organization need to file for 501(c)(3) status?” or a similar question, “At what dollar amount do we need to file with the IRS?”

The IRS allows a small nonprofit organization the benefits of tax exemption without filing the Form 1023 if their *annual gross revenue* is normally not more than \$5,000. (See Instructions for Form 1023, page 1 at <http://www.irs.gov/pub/irs-pdf/i1023.pdf>). \$5,000 is a pretty small amount of money; it doesn't take much to bring in \$5,000 a year. Note that the measure is *gross revenue*, meaning *all* your revenue, not just your profit. So what should you do when your organization starts bringing in more than \$5,000 a year?

If your organization has gross revenue of more than \$5,000 annually, there are four options:

1. File form 1023 with the IRS and become a 501(c)(3) tax exempt “qualified charity.”
2. File for another type of tax exempt status with the IRS such as 501(c)(4), a social welfare organization or 501(c)(7) a social club.
3. Reorganize your organization to stay small (i.e. keep your gross income under \$5,000 per year).
4. Pay income taxes.

File for 501(c)(3) Qualified Charity Status

There are certainly advantages to becoming a 501(c)(3) tax exempt organization, but they come at a cost. Read about the pros and cons of 501(c)(3) status in a short article, *Do We Need 501c3 Status?* on my website HomeschoolCPA.com under Leader Tools/Articles. The application process for 501(c)(3) tax exempt status is a big undertaking, but the benefits are substantial. Most organizations seek professional help in applying, since it is an undertaking they will only pursue once in their organization's lifetime.

Your organization does not need an attorney to apply for 501(c)(3) status, but it may be helpful to talk to a lawyer if you are constructing a complicated organizational structure such as one nonprofit corporation controlling another (for

example, a nonprofit and its foundation), or a for-profit and nonprofit being closely controlled by a common group.

The IRS application for 501(c)(3) status is a 28-page application (IRS Form 1023) and involves a good amount of financial reporting. You will need to supply three years of financial history or two years of projected budgets. An knowledgeable CPA can be helpful in preparing these statements.

File for Other Tax Exempt Status with the IRS

Some nonprofit organizations may qualify to be a 501(c)(4) or 501(c)(7) tax exempt organization instead of a 501(c)(3) qualified charity. A 501(c)(4) is a social welfare organization that exists to promote the common good and general welfare of the people in a community. Examples include unions, trade organizations, the American Association of Retired Persons (AARP) and the National Association for the Advancement of Colored People (NAACP). A 501(c)(7) is a social club with limited membership whose main purpose is to gather face-to-face for fellowship and pleasure. Homeschool support groups may fit under the 501(c)(7) definition of a social club.

Social welfare organizations and social clubs are tax-exempt like 501(c)(3) organizations, but donations are not tax deductible. This could be a major drawback if your organization is planning for donations. Also, some fund raising programs may be limited to 501(c)(3) qualified charities and 501(c)(4) social welfare organizations or 501(c)(7) social clubs would not be allowed to participate.

The activities of a 501(c)(4) social welfare organization are less restrictive. 501(c)(4)s are allowed greater freedom in political lobbying and endorsements than 501(c)(3) organizations. For example, the Ohio Society of CPAs, a 501(c)(4) trade organization, endorses candidates for state auditor and treasurer.

Homeschool organizations should carefully research the difference between 501(c)(3) qualified charity and 501(c)(4) social welfare and 501(c)(7) social club status. Consult an experienced CPA or nonprofit attorney before making your decision. You can read more about 501(c) organizations at the IRS webpage for Other Nonprofits at

<http://www.irs.gov/charities/nonprofits/content/0,,id=132157,00.html>.

Reorganize Your Group to Stay Small

Another method that avoids IRS filing for tax exempt status would be to reorganize your group to stay under \$5,000 gross revenues per year. Your organization could split into separate groups based on their programs or geography. Creating separate groups means that you will have more people serving on leadership boards making the organization more difficult to run efficiently. The new organizations will also need separate checking accounts and their own Employer Identification Numbers (EIN). They may also need to file

separate articles of incorporation for nonprofit corporate status in your state. This involves more paperwork and state filing fees.

The extra work of splitting up to stay small may be worth while if you think your group is stable and will not continue to grow. If you are like many homeschool groups that continue to add members each year staying small is not a long term solution.

Pay Taxes

If you are *not* a tax exempt organization or staying under the \$5,000 annual gross revenue limit, then you must pay taxes on any financial surplus. Your organization might be classified in several ways. An organization could be a for-profit sole proprietorship, a partnership or a corporation. Your homeschool group might be a nonprofit corporation that is not tax exempt and therefore should be paying corporate income tax on its surplus.

If your organization is a corporation, you should file a corporate income tax return (IRS Form 1120) and pay taxes at a rate of 15% of your profit (for taxable income under \$50,000). Use professional help such as a CPA in preparing your Form 1120 tax return as these returns are quite complicated.

Corporate status as either a for-profit corporation or nonprofit corporation is obtained by filing for incorporation with your secretary of state. See www.HurwitAssociates.com for a listing of nonprofit filing requirements by state.

Some homeschool groups are organized as for-profit businesses, usually sole proprietorships or partnerships. These groups would pay income tax on their owners' or partners' individual tax returns. Rates vary from 10-35% of net income.

How to decide what to do?

- Discuss the four options with your board. This is an important decision and should not be made by one person alone.
- Determine the costs and benefits of each option based on your specific group. It is beneficial to make a decision chart listing the pros, cons, costs and benefits of each option. This helps promote an objective view of each option.
- Keep the future in mind. The application for 501(c)(3) or 501(c)(4) tax exempt status is a one-time event that will serve your organization well into the future. Once obtained, it is rare for an organization to lose its tax exempt status. There are restrictions and annual reporting requirements, so your leadership should be aware of the responsibilities it is passing to future leaders. Staying small or paying taxes may not be the best option if your group has plans to

grow. Many homeschool organizations find themselves meeting the needs of more families as homeschooling becomes more popular.

- Finally, get advice. I cannot encourage this enough. Homeschool leaders should focus on what they do best—running their homeschool program and let the professionals do what they do best—understand the IRS rules! My website HomeschoolCPA.com is a good place to start reading and educating yourself and your board. I am also available for individual consultation with your group to help you make this important decision.

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