



**GUIDE TO FORMING A
CHARITABLE, TAX-EXEMPT,
NONPROFIT CORPORATION
IN CALIFORNIA**

PREFACE

This guidebook provides a basic overview and discussion of some of the issues to consider in determining whether to form a nonprofit tax-exempt organization. It is intended for potential organizers of nonprofit organizations as a general guide and not as specific legal advice.

The material contained in this booklet is a summary of a complex subject. Therefore, you should consult with your attorney or legal advisor to determine your organization's course of action and to make sure that you are in compliance with all of the rules and regulations that apply to your organization.

Public Counsel's Community Development Project (CDP) prepared this guidebook. CDP builds strong foundations for healthy, vibrant and economically stable communities through its comprehensive legal and capacity building services for nonprofits that assist low income neighborhoods in Los Angeles County. If your organization needs legal assistance, or to access the latest version of this document, call (213) 385-2977, extension 200 or visit www.publiccounsel.org/practice_areas/community_development.

Public Counsel
610 South Ardmore Avenue
Los Angeles, CA 90005
Tel: (213) 385-2977 ext. 200
Fax: (213) 385-9089
www.publiccounsel.org

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INTRODUCTION

The purpose of this guide is to help you decide whether to form a nonprofit organization and, if so, whether it should be organized as a nonprofit corporation. It will also explain the basic steps required to form a California nonprofit corporation and to secure tax-exempt status from the state of California and the federal government.

1. *Is the organization necessary?*

The first question is whether there is a need in the community for this new organization. It is very important to know the answer to this question before forming a new nonprofit corporation, because donors and foundations that give grants for nonprofit programs are unlikely to provide any funding unless they can see a need for the programs. Some of the factors to consider in answering this question are:

- What is the primary purpose to be served by your organization?
- What is the community that will be served by this organization?
- Does the community have a need?
- Are there competing organizations that are already providing the same or similar services to this community?
- Is there a strong commitment from the organizers and participants to build your organization?
- Is there an adequate source of funds to support the organization?

2. *What is a nonprofit corporation?*

A corporation is a legal entity created under state laws. A corporation is managed and operated by a Board of Directors and officers. The Board of Directors is responsible for the oversight and supervision of the officers and employees. The officers are responsible for the day-to-day operations of the corporation and supervision of employees. A corporation is treated as legally separate from the people who own, manage, and operate it. The corporation is able to enter into contracts, incur debts, and pay taxes just like any person. The corporation's rights and obligations are separate from those of the people who own or run the corporation. In other words, if the corporation were to lose a lawsuit, the people who work there, manage, or own it would not be personally financially accountable, with some exceptions.

An important distinction between nonprofit and for-profit corporations is a for-profit corporation has shareholders who are the owners of the corporate property. A nonprofit corporation is one that is organized and operated for one of the nonprofit purposes recognized under state corporation law and federal and state tax statutes. What makes a corporation "nonprofit" is that (a) the mission of the corporation is to undertake activities whose goal is not primarily to earn a profit; (b) no person owns shares of the corporation

or interests in its property; and (c) the property and any income of the corporation are not distributed to any “owners,” but instead are recycled into the corporation’s activities. This does not mean that the corporation cannot make a profit. A nonprofit corporation may earn money as long as it is organized and operated for a recognized nonprofit purpose (for example, an educational or charitable purpose) and earnings are put back into the nonprofit corporation’s charitable activities, rather than distributed to people for individual gain.

3. *Should you form a nonprofit corporation?*

Once you have determined that there is a need for your proposed programs, the next question you must consider is whether to form a nonprofit corporation to operate these programs. If your project is for a short duration or you are uncertain as to the ability to fund your project, you may consider alternative ways to form and/or operate your organization.

A. *Alternatives to incorporation*

Can your goals be achieved by joining with an existing organization? If you meet certain requirements, you may be able to align with an existing organization and operate under its tax-exempt status. Under this alternative your organization is operating under the “umbrella” of the existing organization, also known as a “fiscal sponsor.” The advantage of following this procedure is that it provides you with the time to grow and develop your organization.

When your organization has built a solid foundation it can then determine whether to incorporate and operate as a separate and independent entity. For more information about fiscal sponsorship, please see Public Counsel’s Fiscal Sponsorship: An Alternative to Forming a Nonprofit 501(c)(3) Corporation at: www.publiccounsel.org/tools/publications/files/fiscal_sponsor.pdf.

B. *Unincorporated nonprofit association*

It is possible to form and operate the organization as an unincorporated nonprofit association. The association can be organized easily and informally and without necessity of filing with the state of California. It can operate without the mandated formalities of a corporation. A potential disadvantage to the unincorporated association is that its members may not be protected from legal liability for their acts or the acts of the association. This type of structure would only be recommended for a small or short-term project that does not involve risky activities.

NONPROFIT INCORPORATION UNDER CALIFORNIA LAW

State law governs the powers and characteristics of corporations. California recognizes three types of nonprofit corporations: public benefit, mutual benefit (benefiting members only), and religious. Since this guide is designed to assist in the creation of organizations intended to promote public benefit purposes, we will only discuss public benefit nonprofit corporations.

Examples of groups with public benefit purposes are childcare centers, shelters for homeless people, community health care clinics, museums, hospitals, schools, performing arts groups, conservation groups, and affordable housing groups, to name a few. We will discuss various definitions of public benefit purposes below.

1. Nonprofit Public Benefit Corporations

A nonprofit public benefit corporation offers some important benefits as a result of its corporate and tax-exempt status. Some of the advantages of becoming a nonprofit public benefit corporation include:

A. Limited Liability

Limited liability means that the directors and officers have limited personal liability for debts of the corporation. In general, creditors can only go after corporate assets to satisfy liabilities incurred by the corporation.

B. Exemption from Income Tax

If the corporation satisfies federal and state requirements, the corporation will generally not be required to pay taxes on its earned income. This will be discussed more extensively below.

C. Contributions Are Tax Deductible if the Corporation Successfully Applies for 501(c)(3) Tax-Exemption

If there are private persons or entities that want to contribute to your organization, they may deduct such contributions from their taxable income. This is a great tool for encouraging contributions.

2. Special Characteristics of Nonprofit Public Benefit Corporations

- The nonprofit corporation, in a sense, is “owned” by the public. No private person can claim ownership of the corporation. The nonprofit corporation is managed and controlled by its board of directors (or statutory members, if they exist), but they do not own the corporation’s assets.
- The assets of a nonprofit corporation are *irrevocably dedicated* to charitable, scientific, and/or educational purposes. That means the nonprofit’s cash, equipment, and other property cannot be given to anyone or used for anyone’s

private benefit and, moreover, this property is permanently to be used for exempt purposes. When and if the corporation decides to dissolve, any assets remaining after the debts and liabilities are paid must go to another public benefit organization and not to any persons associated with the former corporation or any other private individual or for-profit company.

- The California Attorney General has power to oversee the operations of public benefit corporations and can commence legal actions against the corporation to make sure it complies with the law.
- Any transaction in which the corporation is a party and in which any director has a material financial interest must be approved by a majority of directors in office, not counting the vote of the interested director. This includes compensation agreements, sales, leases, loans, etc.
- The board of a public benefit corporation must be “disinterested.” A “disinterested” board is one in which no more than 49 percent (in other words, less than half) of the Board of Directors are paid or related to other persons who are paid employees or officers of the corporation. For example, if there are five directors on a board, no more than two can receive a salary as an officer or employee or be related to someone who does.

TAX EXEMPTION UNDER FEDERAL LAW

For most groups, the preferred form of tax exemption is under section 501(c)(3) of the Internal Revenue Code (IRC). Corporations exempt under section 501(c)(3) generally do not pay income taxes and donors to such corporations can deduct their contributions from their taxable income. A 501(c)(3) organization must be organized and operated for an “exempt purpose” – what constitutes an exempt purpose will be discussed below. Organizations exempt under section 501(c)(3) may not participate in any political campaign activity, although they can engage in a limited amount of lobbying. Each 501(c)(3) organization is further classified as either a “public charity” or a “private foundation.” Nonprofit corporations engaging in substantial political activities can be exempt from paying tax on income, under IRC section 501(c)(4), but their donors cannot deduct contributions from their taxable income.

We will first briefly discuss the range of purposes and activities that qualify for exemption under section 501(c)(3), and then we will go into greater detail regarding possible exemption for nonprofit community development corporations. We will then discuss the differences between “public charities” and “private foundations” for the purposes of section 501(c)(3).

1. Exempt Purposes

Tax-exempt status under section 501(c)(3) is available to groups organized and operated for one of several exempt purposes, including religious, charitable, scientific, educational, or literary purposes. We will briefly discuss charitable purposes and educational purposes.

A. Charitable Purposes

Charitable purposes are broadly defined as services that are beneficial to the public interest. To meet the requirements, the group’s purpose must be beneficial to society and the group must serve an open class of people, not a limited number of group members. For instance, an organization established to provide food to homeless people in the community would be a charitable organization, but an organization established to provide food to Paul, Henry and Mary would not be. The beneficiary class needs to be open and unspecified, but does not have to be large. An organization established to feed hungry people in a certain two-block area would also qualify as a charitable organization.

Examples of charitable purposes include relief of the poor, distressed, or underprivileged; advancement of education or science; lessening the burdens of government; elimination of prejudice and discrimination; lessening neighborhood tensions; combat community deterioration and juvenile delinquency; and defense of human and civil rights secured by law. Keep in mind, however, that an organization does not need to fall neatly within one of these purposes to be considered charitable.

B. Educational Purposes

Educational purposes include instruction of the public on subjects useful to individuals for the benefit of the community and for self-development. The IRS allows a curriculum to present particular viewpoints if there “. . . is sufficiently full and fair exposition of pertinent facts to permit an individual or the public to form an independent opinion or conclusion.” However, mere presentation of unsupported opinion is not (considered) educational.¹

Some examples of educational purposes include:

- publishing public interest educational materials that do not conflict with the requirement above;
- conducting public discussion groups, forums, panels, lectures, or workshops;
- offering a correspondence course or one that uses other media such as television or radio;
- operating a museum, zoo, planetarium, symphony orchestra, or other performance groups;
- serving an educational institution, such as a college bookstore, alumni association, or athletic organization; and
- publishing educational newsletters, pamphlets, books, or other material.

2. Charging for Services and Commerciality

While there is no prohibition on a 501(c)(3) organization charging for its charitable (or educational, literary, etc.) services, the IRS will not recognize exemption if it engages in its exempt activities in a manner that is “commercial” in nature. There are several factors the IRS and courts look at when assessing whether an organization’s activities are overly commercial: competition with commercial firms, failure to offer any free or below-cost services, the presence of net profits, the use of commercial promotional methods, failure to use volunteers, and a lack of financing in the form of contributions from the public.² Nonprofits with a fee-for-service model should structure their activities in such a way to avoid operating in a manner similar to for-profit businesses by, for example, offering services at or below cost and supplementing revenue with charitable donations and reliance on volunteers.

¹ IRS Publication 557 (Rev. January 2019) *Tax-Exempt Status for Your Organization*, at p. 25.

² *Living Faith, Inc. v. Comm’r*, 950 F.2d 365 (7th Cir. 1991); *B.S.W. Group, Inc. v. Commissioner of Internal Revenue*, 70 T.C. 352, 358-61 (1978); *Airlie Found. v. I.R.S.*, 283 F. Supp. 2d 58, 63 (D.D.C. 2003).

3. *Community Development Organizations*

One important category of charitable activities that can potentially raise difficulties in applying for tax-exempt status is community economic development, such as job training, small business assistance, or microlending. While lending and investing in commercial businesses are not normally thought of as charitable, the IRS has recognized that these activities could be considered charitable when they are aimed at relieving the poor and distressed, eliminating discrimination, combatting deterioration, or lessening neighborhood tensions.³ For example, the IRS has granted exemption to a nonprofit that provided funds to small businesses that were unable to obtain financing from conventional sources due to “the poor financial risks involved in establishing and operating enterprises in [the communities where they were located] or because of their membership in minority or other disadvantaged groups.” In its ruling, the IRS made several observations about the business opportunities in the community the nonprofit served, including the lack of capital for development, the limited entrepreneurial skills of business owners, the social unrest and instability of the area, and the depressed market in which the businesses operate.⁴ The IRS has also ruled that purchasing land in an economically needy area to develop an industrial park with favorable terms for new businesses was a charitable activity when it was aimed at providing new employment opportunities in an economically depressed area.⁵

Conversely, organizations which seek to promote business in general, as opposed to businesses owned by disadvantaged groups or businesses experiencing difficulties because of their location in impoverished areas, will likely not qualify for tax-exempt status under section 501(c)(3). For example, the IRS denied exemption to an organization that tried to increase business patronage in a deteriorated area inhabited mainly by minorities by providing information on the area’s shopping opportunities, transportation, and accommodations, reasoning that the “overall thrust [of the activities] is to promote business rather than to accomplish exclusive [exempt] objectives.”⁶ In the same ruling, the IRS denied exemption to an organization that planned to construct a shopping center in an area experiencing economic decline in order to stem the flow of business to competing shopping centers in outlying areas. In denying exemption, the IRS explained that the organization did not limit its aid to businesses owned by minorities or to business that would only locate to the area because of the center.⁷

³ Rev. Rul. 74-587.

⁴ Id.

⁵ Rev. Rul. 76-419.

⁶ Rev. Rul. 77-111.

⁷ Id.

4. *Public Charities vs. Private Foundations*

Every section 501(c)(3) organization is classified as either a “private foundation” or a “public charity.” Private foundations and public charities are primarily distinguished by the level of public involvement in their activities. Public charities generally receive a greater portion of their financial support from the general public or the government and have greater interaction with the public. A private foundation, on the other hand, is typically controlled by a small group of individuals (who may or may not be related) and derives its support from a small number of sources and from investment income. Because they are less open to public scrutiny, private foundations are subject to strict operating rules and regulations that don’t apply to public charities.

Importantly, a section 501(c)(3) organization that does not automatically qualify as a public charity is presumed to be a private foundation unless it requests, and qualifies for, a ruling or determination as a public charity. This is done on either Form 1023 or Form 1023-EZ, which are further discussed in the section of this guide entitled “Getting Started Step by Step.” Certain organizations, such as churches, schools, and hospitals, qualify as public charities by virtue of their activities. Others must show, via Form 1023 or Form 1023-EZ, that they are publicly supported, which generally means either:

- (1) They must be able to show that they receive at least one-third of their support from contributions, membership fees, or gross receipts from activities related to their exempt functions **and** that not more than one-third of their support is derived from gross investment income and net unrelated business income; or
- (2) They must be able to pass the “public support test” **or** the “facts and circumstances” test.

Public support test: an organization must receive either (1) at least one-third of its total support from governmental agencies, contributions from the general public, and contributions or grants from other public charities; or (2) at least 10% of its total support from governmental agencies, contributions from the general public, and contributions or grants from other public charities **and** also satisfy a facts and circumstances test.

Facts and circumstances test: facts and circumstances include (1) the amount of support the organization received from the general public, governmental units, or public charities; (2) whether such organization has a continuous and bona fide program for solicitation of funds from the general public, governmental units, or public charities; and (3) all other facts and circumstances, including the public nature of such organization’s governing board, the extent to which such organization’s facilities or programs are publicly available, the extent to which such organization’s dues encourage membership, and whether such organization’s activities are likely to appeal to persons having a broad common interest or purpose.

For more information on the public support test, please see Public Counsel’s Public Support Test available at <http://www.publiccounsel.org/publications?id=0244>.

5. *Social Welfare Organizations Under IRC § 501(c)(4)*

Another category of nonprofit organizations whose purposes include pursuing public benefit is a social welfare organization or civic league. These organizations receive slightly different tax treatment than section 501(c)(3) nonprofits because their activities are directed more toward their members or toward influencing public opinion and the legislative process. Tax exemption is offered to such groups under section 501(c)(4) if they, “. . . operate primarily to further (in some way) the common good and general welfare of the people of the community (such as by bringing about civic betterment and social improvements).”⁸ Section 501(c)(4) organizations may engage in political activities, although that may not be their primary activity. However, they may further their exempt purposes through lobbying as their primary activity without risking their tax-exempt status.⁹ For this reason, founders of section 501(c)(3) organizations sometimes choose to form an affiliated section 501(c)(4) organization to carry out lobbying efforts. This is acceptable so long as the section 501(c)(3) organization and section 501(c)(4) organization are kept organizationally distinct (e.g., no commingling of funds).

Some examples of section 501(c)(4) social benefit organizations include volunteer fire companies, community associations, crime prevention associations, or organizations interested in promoting industrial development in a community.

A major difference between section 501(c)(4) and section 501(c)(3) organizations is that donations to section 501(c)(4) organizations are not tax deductible. This is an important factor to consider when setting up a nonprofit organization.

⁸ IRS Publication 557 (Rev. January 2019) *Tax-Exempt Status for Your Organization*, p. 48.

⁹ *Social Welfare Organizations*, IRS Website, <https://www.irs.gov/charities-non-profits/other-non-profits/social-welfare-organizations>.

TAX EXEMPTION UNDER CALIFORNIA LAW

California corporations are subject to an annual corporate franchise tax on the net income of the corporation. Importantly, California corporations must pay a minimum franchise tax of \$800 per year, regardless of income. California nonprofit corporations can apply to be exempt from paying this annual franchise tax.

California tax law exempts the same type of groups as are covered by IRC section 501(c)(3) – religious, charitable, scientific, literary and educational organizations.

GETTING STARTED STEP BY STEP

Now that you have reviewed some of the basic issues to consider when forming a nonprofit organization, the steps you will need to take in order to proceed with incorporation are discussed below. Remember, there are state and federal requirements that must be met. For a summary of the below steps, including samples of documents discussed below and links to the relevant information and forms, please see Public Counsel's [Steps to Form a Nonprofit Tax-Exempt Corporation in California](http://www.publiccounsel.org/tools/assets/files/0570.pdf), at www.publiccounsel.org/tools/assets/files/0570.pdf.

1. *Choose a Corporate Name*

Ensure that the name you have chosen is available by checking with the Secretary of State's office. You may reserve your corporate name by sending a Name Reservation Request Form and \$10 to the Secretary of State, Name Availability Unit, 1500 11th Street, 3rd Floor, Sacramento, CA 95814, with a list of up to three names that will be reserved for you. A corporation may also reserve a name over the counter at the Los Angeles regional office located at 300 South Spring Street, Room 12513, Los Angeles, CA 90013 for a fee of \$20. For questions, call the Secretary of State Corporate Division, Name Availability at (916) 322-2387, or visit its website at www.sos.ca.gov/business-programs/business-entities/name-availability/.

2. *Articles of Incorporation*

Prepare the Articles of Incorporation that are to be filed with the Secretary of State's office. The Articles of Incorporation establish the formation of the corporation and state its broad purposes. Articles of Incorporation must contain and meet certain statutory requirements.

3. *Filing Articles*

Once the Articles are prepared, they can be mailed to the Secretary of State, Business Entities Filings Unit, P.O. Box 944260, Sacramento, CA 94244-2260. A \$35 fee (\$30 filing fee plus a \$5 certification fee) must accompany the Articles. Articles may also be hand delivered to the Secretary of State's Sacramento office location for an additional \$15 over-the-counter processing fee. The Sacramento office is located at 1500 11th Street, 3rd Floor, Sacramento, CA 95814.

The Secretary of State will certify as true and correct one copy of the filed document for a \$5 certification fee. Though the Secretary of State will provide an uncertified copy free of charge, a certified copy of the articles is required as part of the Form 1023 (Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code) and as part of the eligibility requirements for the Form 1023-EZ (Streamlined Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code). Additional copies will be certified upon request and payment of a copy fee (\$1 for the first page and \$0.50 for each additional page) plus a certification fee of \$5 per copy.

4. *Minute Book*

Obtain a minute book in which the corporation will keep the minutes of its Board of Directors' meetings and other documents such as Articles of Incorporation and Bylaws. This can be a minute book obtained at an office supply store, or even a three-ringed binder in which you insert signed copies of the meeting minutes.

For sample Board of Director's minutes, consents and resolutions, please see Public Counsel's "[Annotated Sample of Minutes, Consents, and Board Resolutions](http://www.publiccounsel.org/tools/publications/files/0255.pdf)", at <http://www.publiccounsel.org/tools/publications/files/0255.pdf>.

5. *Draft and Adopt Bylaws for the Corporation*

In general, the Bylaws set out the rules and operating procedures for the activities and conduct of the corporation. They serve three purposes: (1) to provide rules for matters not covered by state law; (2) to alter specific rules that control in the absence of a contrary bylaw; and (3) to provide a ready reference to the governing laws and rules for the corporation's attorney, directors, and officers.

6. *Board of Director's Meeting*

At the first meeting of the board, the directors must approve certain activities necessary to set up and run the nonprofit's operations, and must give specified people ("officers") the authority to do those things. Minutes of this and all meetings of the Board of Directors should be recorded and filed in the corporation's minute book. For example, the directors should:

- Accept their election as directors (if they did not already do so when the Articles were filed);
- Approve the Bylaws;
- Elect officers to manage the corporation's day-to-day operations;
- Authorize officers to set up bank accounts for the corporation's cash and expenses;
- Set compensation amounts (wages or salary), if any, for the officers;
- Determine the exact location of the principal office;
- Authorize the officers to prepare and file the applications for tax exemption; and
- Any other items requiring approval by the Board of Directors.

7. *Apply for a Federal Employer Identification Number (EIN)*

All tax-exempt organizations (with or without employees) must obtain a Federal EIN. The organization will use this identification number on all of its federal tax returns and reports.

To obtain an EIN you will need to complete and submit IRS Form SS-4. Visit the IRS website at the following link to obtain the form: www.irs.gov/pub/irs-pdf/fss4.pdf. To receive an EIN immediately, you may use the online procedures described in the instructions for Form SS-4.

8. *Apply for Federal Tax Exemption*

In order to obtain federal tax-exempt status under section 501(c)(3), the organization must complete and file Form 1023 or Form 1023-EZ with the IRS. Form 1023-EZ is the “streamlined” version of Form 1023, but note that organizations must meet certain eligibility requirements to file Form 1023-EZ, notably that the organization anticipates that it will receive \$50,000 or less in gross receipts in the current year and the next two years. To determine an organization’s eligibility to file Form 1023-EZ, complete the Eligibility Worksheet found at the end of the Form 1023-EZ instructions. Visit the IRS website at www.irs.gov to obtain the appropriate form and instructions for Form 1023 or Form 1023-EZ.

If a nonprofit applies for tax exemption within 27 months of incorporating, the IRS will automatically grant tax-exempt status retroactive to the date of incorporation. If a nonprofit applies after 27 months have passed, exemption will be effective to the date of application, unless the organization requests an earlier effective date from the IRS. The 1023 application states that retroactive exemption to the date of incorporation may be granted after 27 months if the applicant provides evidence to establish that it acted reasonably and in good faith, and that the grant of relief would not prejudice the interests of the government. If an organization does not receive tax-exempt status retroactive to incorporation, then income accrued between incorporation and applying for tax-exempt status may be subject to income tax and donations given during that time will not qualify for a tax deduction. Importantly, if an applicant applies for California tax exemption using form 3500A (see below for more information), state tax-exempt status is retroactive to the date of federal tax-exempt status. If state tax-exempt status is not retroactive to the date of incorporation, *the corporation would owe the minimum franchise tax of \$800 even if the corporation had no income during that time.* The Franchise Tax Board will only grant retroactive tax exemption to corporations that do not have retroactive IRS tax exemption if the corporation can prove that it has been engaging in charitable activities – many organizations that delay applying for tax exemption are unable to prove that they have been active. **Therefore, it is important to apply for tax-exempt status within 27 months of incorporation.**

Form 1023: The IRS requires that Form 1023 applications be submitted electronically on Pay.gov. The organization must register for an account at Pay.gov and enter “1023” in the search box to select Form 1023. The organization can then complete and submit Form 1023 as well as pay the user fee. The 1023 asks for a detailed narrative description of the organization’s current or planned activities as well as financial information, including a statement of expenses and revenues and balance sheet. The 1023 also asks several questions about potential conflicts of interest, including about transactions between the organization and directors and officers.

You must also include with Form 1023 the following:

- A certified copy (certified by the Secretary of State) of the articles of incorporation; and
- A copy of the bylaws, signed by a principal officer or accompanied by a written declaration signed by an authorized officer of the corporation certifying that the document is a complete and accurate copy of the original Bylaws. If the Board of Directors has not yet approved the Bylaws, a copy of the proposed bylaws will suffice.
- The application fee for the Form 1023 is \$600.

Form 1023-EZ: If you have completed the Eligibility Worksheet found at the end of the Form 1023-EZ instructions and determined that you are eligible to file Form 1023-EZ, register for an account on [Pay.gov](https://www.pay.gov) and enter the term “Form 1023-EZ” in the search box to select Form 1023-EZ. The organization can complete and submit Form 1023-EZ as well as pay the user fee. Please note that Form 1023-EZ must also be filed electronically only on [Pay.gov](https://www.pay.gov).

- Signature requirements

Form 1023 and Form 1023-EZ must be electronically signed by an officer, director, or trustee or other authorized official of the organization. To electronically sign, the signer must check the “penalties of perjury” box, type such signer’s name on the line provided, and provide the title or authority of the signer and the date.

Form 1023-EZ does not require any attachments or copies of organizational documents. The application fee is \$275.

9. *Apply for California Franchise Tax Exemption.*

If the corporation already has a letter from the IRS recognizing exemption under section 501(c)(3), then the corporation may file form FTB 3500A to obtain state tax-exemption. This one page form requires attaching a copy of the IRS determination letter. There is no fee to file this form. For FTB 3500A filers, exempt status with the FTB is effective the same day as IRS exempt status. If IRS exempt status is not retroactive to the date of incorporation and your organization desires (and qualifies for) FTB exempt status to be retroactive to the date of incorporation, your organization should file the Form 3500.

The form should be mailed to the FTB at the following address:

Exempt Organizations Unit MS F120
Franchise Tax Board
P.O. Box 1286
Rancho Cordova, CA 95741-1286

If the corporation does not have a section 501(c)(3) determination letter from the IRS, or if IRS exemption date is not retroactive to the date of incorporation and you wish to apply for retroactive FTB exemption, the corporation must complete form FTB 3500 and file it with the California Franchise Tax Board (FTB) along with a \$25 application fee. The FTB will only grant retroactive tax-exempt status if a corporation could prove that it has been active during the period of retroactivity.

The form should be mailed to the FTB at the following address:

Exempt Organizations Unit MS F120
Franchise Tax Board
P.O. Box 1286
Rancho Cordova, CA 95741-1286

If you have any questions, call the California Franchise Tax Board toll-free number: (800) 852-5711 or visit its website at www.ftb.ca.gov.

10. Maintaining Your Tax-Exempt Nonprofit Status

Nonprofit, tax-exempt corporations must file certain forms every year in order to remain in good standing. These forms are discussed below:

A. Federal Forms

➤ Annual Exempt Organization Returns (IRS Form 990/990-EZ/990-N)

Public benefit corporations exempt from federal income tax under section 501(c)(3) must annually file IRS Form 990/990-EZ (Return of Organization Exempt from Income Tax) and the accompanying Schedule A by the 15th day of the 5th month after the close of the organization's tax year. This form is an informational return providing the IRS with information about your finances and activities. Organizations with annual gross receipts of \$50,000 or less are required to file Form 990-N, an annual electronic notice form known as the "e-Postcard," instead. These forms can be obtained at www.irs.gov. Churches and other specified organizations are exempt from filing any annual return.

Failure to file an annual return three years in a row results in automatic revocation of tax-exempt status with the IRS. A corporation should file the appropriate 990 return even if it has not yet filed for or received tax-exempt status from the IRS, since the first filing is due after the first fiscal year ends, even if the corporation is not yet exempt. It is possible for an organization that has delayed in applying for tax-exempt status to receive tax-exempt status and then immediately be informed that the status is revoked for failure to file the 990 return.¹⁰

¹⁰ For example, if a corporation is formed on November 1, 2019 with a fiscal year end of December 31, it will need to file its first return on May 15, 2020 and subsequent returns will be due on May 15, 2021 and 2022. If that corporation does not applying for tax-exempt status until January 2022, it may not hear back from the IRS until

➤ **Unrelated Business Income Tax Return (Form 990-T)**

Section 501(c)(3) organizations having annual gross incomes of \$1,000 or more from unrelated trade or business activities must file an Exempt Organization Business Income Tax Return (Form 990-T). The obligation to file Form 990-T is in addition to the obligation to file the annual information return. Tax-exempt organizations must make quarterly payments of estimated tax on unrelated business income if the tax for the year is expected to be \$500 or more. The Form 990-T must be filed by the 15th day of the 5th month after the close of the organization's tax year. The organization must pay federal income tax on unrelated business income at the same rate as the normal corporate federal income tax. Note that unrelated business activity is not prohibited and could be a useful source of funding for your charitable organization, even if taxed. However, the IRS will revoke the tax-exempt status of organizations that are spending a "substantial" amount of time and resources on unrelated business activities.

B. California Corporate Tax Returns and Reports

➤ **Annual Exempt Organization Returns (FTB Form 199/199-N)**

Any organization that must file the IRS Form 990/990-EZ must file the FTB Form 199, which is California's version of the Form 990. Organization with annual gross receipts that are normally \$50,000 or less must file Form 199-N, which is an electronic notice similar to IRS Form 990-N. Note that churches and religious orders are not required to file Form 199 or Form 199-N. Both Form 199 and Form 199-N must be filed by the 15th day of the 5th month after the close of the organization's tax year.

Note that, as with the 990 series, **failure to file the 199 or 199-N three years in a row results in automatic revocation of exempt status with the FTB.** Public benefit corporations are required to begin filing the 199 or 199-N for their fiscal year and may lose tax-exempt status with the FTB soon after receiving it if there has been a delay in applying for tax-exempt status and the 199 series was not filed during the interim.

➤ **Unrelated Business Income Tax Return (Form 109)**

If your corporation's gross income from an unrelated trade or business is \$1,000 or more during one year, you must file an annual Exempt Organization Business Income Tax Return, Form 109. This return must be filed by the 15th day of the 5th month after the close of the organization's tax year. Payment of the tax on the income must be estimated and paid during the year for which the tax is due.

after May 15, 2022. If that organization has not been filing the annual return during that time period, it will have its status automatically revoked by the IRS.

➤ **Statement of Information (Form SI-100)**

The Statement of Information (Form SI-100) must be completed and returned to the Secretary of State's office along with a \$20 filing fee within 90 days of registering with the California Secretary of State. Thereafter, the California Secretary of State requires this filing to be made every two years during a specific six-month filing period based on the original registration date. Failure to comply with the filing deadlines will subject the corporation to a penalty charge, and possibly to suspension of the corporation's right to do business in California and revocation with the FTB. The Form SI-100 can be completed online at <https://www.sos.ca.gov/business-programs/bizfile/file-online/>.

➤ **Registration with and Annual Periodic Report to Attorney General (Form CT-1 and RRF-1)**

Generally, each nonprofit public benefit corporation must register with the Attorney General's Registry of Charitable Trusts within 30 days after first receiving any assets. The initial registration form, Form CT-1, and the list of other required documents and information can be found at www.oag.ca.gov/charities/forms.

Thereafter, the corporation must file a form RRF-1 with the registry of Charitable Trusts each year. The registrar of Charitable Trusts should mail this form to the organization's principal place of business each year. Nonprofit corporations that have revenues of at least \$25,000 during the preceding fiscal year are required to pay an annual registration fee, which must be enclosed with the Form RRF-1. Failure to file the Form RRF-1 or pay the registration fee (if required) may result in a loss of tax exemption and an assessment of a minimum tax of \$800 plus interest. Nonprofit organizations also submit to the Attorney General all IRS Form 990, 990-EZ or 990-PF, and schedules filed with the IRS. The RRF-1 including these attachments, must be filed within four months and fifteen days after the close of the corporation's accounting period unless the corporation gets an extension to file its tax returns with the IRS. Effective February 1, 2020, organizations that file the Form 990-N must file Form CT-TR-1 "Annual Treasurer's Report" along with their RRF-1. The CT-TR-1 is meant to provide the Attorney General with financial information about the charity that would otherwise be provided on IRS Form 990 or 990-EZ. Organizations that are current in their registration and annual reporting requirements may submit renewal data and IRS forms and pay fees online through the Online Renewal System. Instructions for the Online Renewal System can be found at oag.ca.gov/charities/renewals.

HOW TO FIND HELP

Public Counsel's Community Development Project (CDP) can assist organizations serving low-income communities or addressing issues of poverty within Los Angeles County with the completion of these filings and *pro bono* legal assistance. CDP can also assist with other corporate legal issues, from amending bylaws to large transactions like an affordable housing project. For more information, please call the CDP Intake Line at (213) 385-2977, ext. 200.

You may also download Public Counsel's Steps to Form a Nonprofit Tax-Exempt Corporation in California, which contains links to the various required forms and sample corporate documents (e.g., articles, bylaws and minutes) for your use. It is available on our website, at www.publiccounsel.org/tools/assets/files/0570.pdf.

NOTES

RESOURCES FOR NONPROFIT ORGANIZATIONS

- Public Counsel

Community Development Project
610 South Ardmore Avenue
Los Angeles, CA 90005
Tel: (213) 385-2977, ext. 200
Fax: (213) 385-9089
www.publiccounsel.org/practice_areas/community_development

- Center for Nonprofit Management in Southern California
1000 N. Alameda Street, Suite 250
Los Angeles, CA 90012
Tel: (213) 266-8488
www.cnmsocal.org

- The Nonprofit Partnership
4900 East Conant Street
Building 0-2, Suite 225
Long Beach, CA 90808
Tel: (562) 888-6530
www.tnpsocal.org

- Valley Nonprofit Resources
Sierra Hall (SH) 281
18111 Nordhoff Street
Northridge, CA 91330
Tel: (818) 677-2774
www.csun.edu/valley-nonprofit-resources

- List of Resources for Nonprofit Organizations
www.publiccounsel.org/tools/assets/files/0031.pdf