

# incorporation & tax exemption

achieving non-profit & charitable status  
for your climbing organization

*A publication of*



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*Please note that the information contained in this publication is for informational purposes and should not be construed as legal advice. For answers to specific questions concerning your situation, you should consult a knowledgeable attorney who can advise you regarding your particular circumstances.*

## **preface**

This document was prepared by the staff of the Access Fund\* as a guide for climbing organizations that wish to organize themselves as tax-exempt or charitable organizations under the rules of the IRS. This guide is only a general overview and should be used as a resource in pointing the organization in the right direction. It should not be considered a definitive text on how to achieve tax-exempt and charitable status.

The laws relating to tax-exempt and charitable organizations are complex. Any climbing organization considering applying for this status must conform to the state laws for nonprofit, charitable, and tax-exempt organizations; the general state laws of corporations; and the Internal Revenue Service rules. This can be a tangled and confusing web.

If the organization has the resources, it may want to consider hiring an attorney or accountant. As an alternative, you may request a professional review before you file a packet created by the organizations' members with the appropriate state and federal departments.

Other sources of legal advice, referrals, and/or guidance include:

- a business or tax lawyer, accountant, paralegal or legal secretary who is also a member/volunteer of your organization
- a legal clinic at a local law school
- a local legal aid clinic
- a Chamber of Commerce
- a local Retired Executives organization
- another tax-exempt organization in your state with which you share similar objectives.

\*with assistance from International Mountain Bicycling Association



## **pros and cons of incorporating and tax exemption**

Many climbing organizations begin as casual affiliations of climbing activists who do valuable volunteer work with no formalities. Such organizations may have members and officers, yet have no formal legal status. In such circumstances, the organization opens itself to potential problems with taxation and liability. If the organization earns more money than it spends in a year, should it pay taxes on that profit? In whose name would the organization pay? What if someone gets hurt while maintaining trails with potentially dangerous tools? Are the officers or members of the organization liable to the injured party for medical expenses and other damages?

These issues can be addressed by creating a legal non-profit corporation and seeking federal non-profit recognition. Corporate status significantly limits the personal liability of the corporation's organizers, directors and employees, but it also requires a lot of time and money to start and maintain. The most-common non-profit status, a 501(c)(3) designation (named for the applicable section in the Internal Revenue Code), allows donors to such organization to take a tax deduction for contributions.

## **to incorporate and seek exemption or not**

### **Non-profit 501(c)(3) Privileges**

- Limited Liability/Legal Buffer
- Credibility
- Tax Deductibility for Donors
- Exemption from State and Federal Income Tax
- Exemption from F.U.T.A.
- Eligible for Government & Foundation Grants
- Eligible for Bulk Mailing Permit
- Some Property Tax Exemptions

### **Non-profit 501(c)(3) Responsibilities**

- Keep Adequate Records
- Have to Raise Funds
- File Required Returns
- Obey Disclosure Laws
- Generate and Maintain Public Support
- Limit Political Activity
- Limit Legislative Activity
- Limit Unrelated Business Activity
- Assets must be dedicated to charitable purposes

# first steps to incorporation & exemption

Forming a nonprofit corporation under state law is just the first step. That legal status will help shield the directors and officers from liability and may allow the corporation to not pay sales tax on purchases of equipment and supplies, but it does not avoid taxes on potential income, even if that income never goes to personal enrichment of individuals. To avoid taxation and allow contributors to deduct donations to the corporation from their federal income tax, a nonprofit corporation must also be allowed under federal law and recognized by the U.S. Internal Revenue Service to be a tax-exempt organization.

Three steps to start the process:

1. Either contact the Secretary of State (SOS) in your state or visit your states SOS website to learn how the process of filing for corporate status works. To locate your Secretary of State on the web, visit: <http://www.infoctr.edu/swl/> or <http://www.ilrg.com/corp/> and click on the appropriate state. The Secretary of State is usually a division of the Executive Branch. Most state sites provide information on the required steps and information needed in order to incorporate. The SOS or their website will direct you to where you can acquire the appropriate forms. What these forms request is useful in guiding you through the process.
2. Contact the IRS and request the following forms:
  - a. Package 1023 (which contains Form 1023 for 501(c)(3) recognition and Form 872-C),
  - b. Form SS-4 (Application for Employer Identification Number),
  - c. Form 8718 (Determination Letter Request), and
  - d. Publication 557 (a guide to tax-exempt status).
3. Read the relevant laws of your state and the IRS provisions that govern nonprofit and charitable organizations.

# state filing to incorporate and achieve nonprofit status

## procedural nuts & bolts

1. Find out specific requirements for non-profit incorporation in your state
2. Become familiar with federal tax exempt requirements
3. Draft and file Articles of Incorporation (usually 2 copies) and fee with your Secretary of State and prepare Bylaws
  - a. *Make sure Articles of Incorporation and Bylaws meet IRS requirements*
  - b. Board size and diversity – consider directors who represent or are members of other organizations and/or directors who bring specific skills to the organization, such as attorneys and accountants

## explanation

This is perhaps the easiest step in the process for your organization. The best place to start is by contacting the Secretary of State and requesting their standardized forms. You can expect that they will either send you the forms or direct you to a location where you can procure them. You should make this contact while you are in the initial stages. This is important because the forms provided by the state are generally straightforward and touch on the information that must be included when you file to become a non-profit corporation.

In general, a nonprofit organization that is a corporation is formed by preparing and filing **Articles of Incorporation**, with its operating rules embodied in **bylaws** (which are not filed with the state).

The contents of the Articles of Incorporation are established by state law and usually include:

- The name of the organization
- A general statement of its purposes  
How you prepare the Articles of Incorporation is linked with your IRS filing. To qualify for federal tax-exempt status, a nonprofit corporation must be organized and operate for some religious, charitable, educational, literary or scientific purpose permitted under 501(c)(3) of the tax code. This purpose must be included in the organization's Articles of Incorporation that are filed with the state.
- Location of the corporation
- The name(s) and address(es) of its initial director(s)
- The name and address of its registered agent  
The registered agent is the person who can accept notices, including a subpoena or summons, for the corporation. This can be anyone who resides within the state, whether or not they are an organization member. By agreeing to be the agent, one does not assume any liability other than assuring delivery of the document. If the agent should move, it is very important that the organization amend their filing with the state.
- The name(s) and address(es) of its incorporator(s)
- Language referencing the applicable federal tax law requirements

Other information you may have to include in your Articles of Incorporation include:

- The number of directors. Length and number of their terms as directors. Their voting rights. Number or percentage of directors necessary for quorum.
- The officers of the organization. Length and number of their terms as officers. Their duties. Limitations on number of offices that can be held by the same individual.

- Who has authority to sign documents or otherwise act on behalf of the organization.
- Will your organization have members? What are the members' rights? When must they meet? How can they vote?
- How to amend the organization's governing instruments.
- The process of dissolving the organization and distributing its assets upon dissolution.

The **bylaws** of a nonprofit corporation will usually include provisions with respect to:

- Its purpose (it is good to restate them in the bylaws)
- The election and duties of its directors
- The election and duties of its officers
- The role of its members (if any)
- Meetings of members and directors, including dates notice, quorum, and voting
- Role of executive and other committees

If you are an organization member or organizer working through this process yourself, the governing laws of your state will provide you with many answers to these questions. However, you may still be uncertain as to how to formulate your answers and what these documents should look like. Many resources are available to you. For example, "form" books at your local library may be available that provide standardized answers and format for your state. A law library will also have books on how to form corporations. You may also turn to a legal stationary store. Books and forms there are less comprehensive, but often adequate to this purpose. The World Wide Web is also an excellent resource.

If these resources are not available, you can always go to the offices of another nonprofit corporation in your state and ask them if you can review their organizational documents. Reading these can give you a good idea of what format is used, and how the questions are answered.

# federal filing for tax-exempt and charitable status

## procedural nuts & bolts

1. **FORM SS-4:** Once you have received notification from the Secretary of State that your organization's Articles of Incorporation have been accepted, your organization can fill out and file Form SS-4 with the IRS to receive an EIN. An employer identification number (EIN) is your account number with the IRS and is required regardless of whether the organization has employees. Include the organization's EIN on all correspondence to the IRS. Apply for an EIN by completing and mailing Form SS-4, Application for Employer Identification Number or by submitting an online version of the form via [www.irs.gov](http://www.irs.gov). For more information about EINs, see Publication 1635, Understanding Your EIN.

2. **FORM 1023:** Complete Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, and mail to the address indicated in the instructions. The required user fee must accompany Form 1023. The IRS will not process an application until the user fee is paid. NOTE: most organizations must file Form 1023 by the end of the 15th month after they were created, with a 12-month extension available.

3. **FORMS 2848 and 8821 (optional)**

Attach Form 2848, Power of Attorney and Declaration of Representative, if someone other than your principal officer or director will represent you on matters about the application. Attach Form 8821, Tax Information Authorization, if you want the IRS to be able to provide information about your application to an employee other than a principal officer or director.

## explanation

### *introduction*

For most people, the concept of what is a nonprofit organization and what is a tax-exempt organization may seem the same. In addition, for most people, a nonprofit/tax-exempt organization is synonymous with a charitable organization... but neither is true. In reality, the idea of a nonprofit organization is much broader than that of a tax-exempt organization and a charitable entity is merely one of many types of exempt organizations.

The federal tax law uses the term "charitable" in two ways. First, a charitable organization means all organizations that are eligible to receive deductible contributions (what your organization wants). Used this way, the term includes entities that are religious, educational, scientific, and the like, as well as certain other organizations not pertinent to this discussion. These organizations are IRS Code 501(c)(3) organizations --probably the most widely recognized provision of the code.

Second, the term charitable organization is used to describe organizations that are defined as that type of entity under law, as opposed to religious, educational, scientific, and like entities. The federal tax law definition of a charitable organization contains at least 15 different ways for a nonprofit entity to be charitable. These definitions include: advancing education; lessening the burdens of government; beautifying and maintaining a community; preserving natural beauty; and promoting environmental conservation. *These are the types of phrases that you want to use when describing the purpose of your organization in its organizing documents and its IRS application.*

As an example, advancement of education, as a charitable activity, includes advancing knowledge through research or disseminating knowledge by means of publications, seminars, lectures, and the like.

Another way for an organization to be charitable under the federal tax law is to lessen the burdens of government. This can include the building and maintenance of public trails and park facilities. For this status, the organization's activities must be those that a governmental unit (such as the Forest Service) considers to be its burdens and that actually lessen that burden.

Somewhat overlapping the concept of lessening burdens of government is the charitable activity of community beautification and maintenance, and the preservation of natural beauty. An organization that is charitable under this definition is one that may maintain community recreational facilities, assist in community beautification projects (cleaning up litter at trailheads), or work to preserve and beautify public parks.

And finally, an organization can be charitable because it endeavors to promote environmental conservation: a range of activities to preserve and protect the natural environment for the benefit of the public. The IRS has recognized as legitimate a national policy of conserving the nation's unique natural resources; this type of organization serves to implement that policy.

Any combination of the above classifications may be present in relation to the purposes and activities of a nonprofit organization. However, when organizing your organization, it is best to choose one main purpose, such as "**keeping climbing areas open and conserving the climbing environment**", and then list the other purposes as means to achieving that goal. For example: "The Organization will promote and participate in regular stewardship activities for the purpose of bringing together all climbers in order to educate them in responsible trail and crag use and environmental conservation."

#### *the application*

Under the federal income tax system, every element of income received by a person whether a corporate entity or an individual is subject to taxation, unless there is an express statutory provision that exempts either that form of income or that type of person. Many types of nonprofit organizations are eligible for exemption from federal income tax. However, the exemption is not granted merely because an organization is not organized and operated for profit. Organizations are tax-exempt where they meet the requirements of the particular statutory provision that supplies the tax-exempt status.

Whether a nonprofit organization is entitled to tax exemption, on an initial or continuing basis, is a matter of law. It is the U.S. Congress that defines the categories of organizations that are eligible for tax exemption and it is up to the Congress to determine whether an exemption from tax should be continued. Except for state and local governmental entities, there is no constitutional right to a tax exemption.

Despite what many may think, the IRS does not "grant" tax-exempt status. Congress does that. The function of the IRS is to recognize the tax exemption. Therefore, when an organization makes an application to the IRS for a ruling or determination as to tax-exempt status, it is requesting the IRS to recognize a tax exemption that already exists (assuming that the organization qualifies). Charitable organizations, to be tax-exempt, file with the IRS an application for recognition of the exemption.

A request for recognition of tax-exemption for a charitable organization is commenced by filing a form, entitled "Application for Recognition of Exemption" also known as Form 1023. New organizations normally have only 27 months (15 months with a 12 month extension) to submit a Form 1023, 501(c)(3) Application, to the IRS. When a Form 1023 application is filed late, the IRS grants 501(c)(3) status "prospectively" - that is, effective beginning with the date postmarked on the application envelope, forward. However, the "15/27 Month Rule" is waived for small organizations. Small organizations are not officially required to file the application as long as gross receipts continue to average less than \$5,000 per year. Although tax law provides deductibility of contributions for small organizations, the burden of proof for tax deductibility is on the donor. A small organization might choose to apply for 501(c)(3) recognition to save donors possible embarrassment and inconvenience during an audit. In addition, almost every grant making agency, public or private, requires a 501(c)(3) determination letter from grant applicants.

#### *the procedure*

The IRS has specific rules by which an organization may receive a ruling in response to a request for a tax-exempt determination. An organization seeking recognition must file an application, and all information required, with the key district office for the organization's principal place of business (see page 2 of Package 1023). The determination of exemption will generally be issued by the district office unless the application presents some novel issue or unresolved point of law. **Organizations should allow at least three months for the processing of an application for recognition of tax-exemption.**

A ruling or determination will be issued to an organization, as long as the application and supporting documents establish that it meets the particular statutory requirements. The application must include a statement describing the organization's purposes, copies of its governing instruments (such as, the Articles of Incorporation and bylaws), and either a financial statement or a proposed

multi-year budget. For a charitable organization (such as your organization), the application must also include a summary of the sources of financial support, its fund-raising program, the composition of its governing body (e.g., board of directors), the nature of its services or products and the basis for any charge for them, and its membership.

The IRS is generally free to seek and obtain further information deemed to be necessary for a ruling. However, once the organization has made the requisite "threshold showing," the IRS must grant recognition of exemption. If the application is not complete, the IRS will not retain it and ask for the remaining information, and will instead return the application and all of the supporting documents to the organization and request that it file again by submitting a complete application.

The information filed with the IRS pursuant to this procedure is used to make three sets of determinations: whether the organization will be recognized as tax-exempt, whether it will be eligible to receive deductible charitable contributions, and whether the organization will be a public charity or a private foundation. The manner in which the answers to the application are phrased can be extremely important, with the prime objective being accuracy. *That is why emphasis was given earlier in this paper to obtaining all the necessary state and federal materials first before diving into the formal process.*

An application for recognition of exemption should be considered an important legal document and be prepared accordingly. Throughout the organization's existence, this document will likely be reviewed. Further, as an organization you will be required to keep a copy of this application, and supporting documents and related correspondence, available for scrutiny by anyone during regular business hours. As mentioned in the beginning, it is not necessary for an organization to retain the services of a lawyer to help in the preparation of an application for recognition of exemption. However, because of the complexities involved, it is a good idea to obtain the assistance of a professional who understands the process if only to review the documents before they are filed.

With care and perseverance, a climbing organization can obtain both state nonprofit status and federal tax exemption.

# **glossary of terms**

## **Articles of Incorporation**

The centerpiece of the incorporation process is the “Articles of Incorporation.” Filing this document with your state brings a corporation to life and begins the process of organizing your business. The Articles of Incorporation is usually a basic form that contains information about your corporation, its appointed representative, and its organizer. It is filed with a state agency responsible for corporations. The Articles of Incorporation go by different names in some states. It may be called a certificate of incorporation, charter, articles of organization, or similar title.

## **Assumed name**

Sometimes a corporation may want to transact business under a different name than its corporate name. This is referred to as using an assumed name, or assumed corporate name. Some states refer to it as a fictitious name, or trade name (not trademark). Some simply call it a d.b.a., or “doing business as,” as in ABC Corp., doing business as, “Dean's bookstore.” Using an assumed name, allows you to present yourself to the public as different entities, while using only one corporation and keeping only one set of books.

## **Board of Directors**

The directors that oversee the affairs of the corporation are referred to collectively as the Board of Directors. The board may consist of one or more persons.

## **Bylaws**

Bylaws are the internal rules by which the corporation operates.

## **Corporation**

A corporation is a body of persons granted a charter legally recognizing them as a separate entity having its own rights, privileges, and liabilities separate from those of its members. It is a separate and distinct entity

that acts for, or on behalf of a person or group of people. A corporation can consist of one person.

**Delayed effective date**

A delayed effective date is put in the Articles of Incorporation so that the filing won't be effective until that date. If you are incorporating toward the end of the year, you may want to include a delayed effective date of incorporation so that your corporation won't begin until the first of the upcoming year.

**Directors**

Directors are the individuals who constitute the Board of Directors and who oversee the affairs of the corporation on behalf of its members to protect the members' interests. They meet from time to time to review the actions of the corporate officers who run the corporation on a day-to-day basis.

**Employer Identification Number (EIN) or Federal tax ID number.**

This number is assigned by the IRS. It is an identifying number, essentially a social security number for your business. An Employer Identification Number is obtained by filing a form SS-4 with the IRS.

**Incorporator**

The incorporator is simply the person who files the Articles of Incorporation with the state. The incorporator really has no rights except appointing the initial corporate directors. After the directors are appointed, the incorporator has no further responsibility [they actually rarely officially resign] and new directors are appointed by the Board of Directors.

**Minutes**

Whenever a meeting of directors or members is held, a record of what was discussed is kept. This record is known as the minutes of the meeting.

**Officers**

Officers are responsible for running the corporation on a day-to-day basis if the organization does not have staff members, or overseeing the staff functions if there are staff members. They answer to the directors of the corporation.

**Organizational meeting**

The organizational meeting is held after the Articles of Incorporation are filed with the state. At the organizational meeting the directors listed in

the Articles of Incorporation are affirmed and the officers of the corporation are appointed.

**Purpose clause**

A purpose clause is sometimes required in the Articles of Incorporation. The purpose clause tells the state what kind of business your corporation will operate. Some states require this purpose clause to be very specific, while others allow the use of a “general” purpose clause, which basically says the corporation will engage in any legal business activity.

**Registered agent**

A corporation’s registered agent is the person appointed to accept legal documents on behalf of the corporation. If someone sues you, the papers will be served on the registered agent at the “registered office.” Some states use the term “resident” agent.

**Secretary of State**

In most states, this is the state agency that is responsible for the formation and regulation of corporations. In some states, it is known as the Department of State, or Bureau of Corporations.