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# Tax Exempt Organizations



## WHAT ARE THEY AND DO I NEED ONE?

BY CHRISTOPHER D. FOSTER, ESQ.

**A**s a tax and business attorney, I receive many inquiries each week from clients regarding tax exempt organizations and whether establishing one is feasible for the client's needs. This article is intended to provide an overview of tax exempt organizations from an informative side as well as the formation perspective.

### *What is a Tax Exempt Organization?*

In general, tax exempt organizations are formed for either the benefit of the public or for the benefit of the organizers. However, the sole intention for establishing an organization for the benefit of its members must not be for their private gain. Most tax exempt organizations are formed in order to provide specific religious, charitable, scientific, testing for public safety, literary or educational purposes. Additionally, tax exempt organizations may be formed to further amateur sports contests to provide underprivileged individuals with the opportunity

a tax exempt organization, then the organization is automatically tax exempt. Despite the best intentions of an organization, if it is formed for an exempt purpose that does not necessarily qualify it as tax exempt, the organization's goal will be fruitless from a tax standpoint. The difference being is that a qualified tax exempt organization does not have to pay taxes on income acquired for the benefit of the organization. For an organization to qualify as a true tax exempt organization, the organization must meet both federal and state requirements for tax exempt status.

### *How do I set up a Tax Exempt Organization that is truly Tax Exempt?*

I advise all of my clients to form an organization that qualifies under Section 501(c)(3) of the Internal Revenue Code. Providing the organization complies with Section 501(c)(3), the initial step in establishing a tax exempt organization is to define the purpose for the organization and ensure that it meets both state and federal tax exempt status. Assuming that the exempt organization qualifies for tax exempt status in North

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to compete in sports activities. Other examples of tax exempt organizations are those formed to prevent cruelty to children or animals.

The main benefit of setting up a tax exempt organization correctly is so that the organization is exempt from both state and federal taxes on income received by the organization, which the organization uses to further its exempt purpose. Most individuals believe that if one establishes

Carolina and on the federal level, the next decision to make concerns the name of the organization. A name chosen for the organization cannot be the same as any other entity in the State of North Carolina. Thus, a search must be made with the North Carolina Secretary of State to ensure the organization's name availability.

Next, the organization must decide what type of entity best suits the organization. Most tax

exempt organizations are set up as corporations, but the organization may also be a limited liability company (LLC), trust or an unincorporated entity. The main advantage of forming the entity as a corporation is flexibility within the organization and to overcome the perception of self-dealing. Most donors see a corporation as a safer alternative for gifting in order to satisfy their wishes. Additionally, organizations other than a corpora-

corporation. At such organizational meeting, the board of directors elects officers of the corporation, who run the day-to-day operations of the corporation. While there is no mandatory number of board members, a tax exempt organization should have no fewer than five board members, in my opinion, and it is mandated that the majority of board members are not related either by blood or marriage. Furthermore, the board

## The board should consist of members who intend to further the charitable interest of the organization.

tion are subject to stricter regulations, both state and federal. For purposes of this article, we will assume that the corporation is the appropriate entity for any tax exempt organization.

Once the name of the corporation is decided upon by the principals, Articles of Incorporation must be filed with the North Carolina Secretary of State. Articles of Incorporation list the name of the corporation, the incorporator, the name and address of the registered agent and the purpose of the organization. After the Articles of Incorporation are filed, organizational minutes must be prepared pursuant to the initial meeting of the organizers. At the organizational meeting, the attendees appoint a board of directors in order to monitor the actions of the corporation. The board of directors holds a special fiduciary duty to protect and maintain legal compliance within the

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Once a board of directors and officers are elected, the corporation must then prepare bylaws for the organization. Essentially, the bylaws formulate a "blueprint" regarding the operational procedures to serve the public purpose intended by the corporation. More specifically, the bylaws institute the dates of meetings for the board and officers, the number of board members, as well as the general standards of the corporation. In conjunction with the above requirements for a tax exempt organization, a tax identification number must be obtained. A tax identification number, often referred to as an EIN, is essentially a social security number for a corporate entity. The EIN is required to file both state and federal tax returns as well as

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The individuals that benefit from the organizations may be in the local community, the nation or world-wide, but the benefits are decided by the donors as well as the organizers.

providing comfort to donors of the entity.

Finally, all tax exempt organizations should file a Form 1023 (Application for Recognition of Exemption Under 501(c)(3) of the Internal Revenue Code). The approval of a Form 1023 pronounces that any donor will receive a tax deduction when providing a gift to the tax exempt organization. Such gifts can be monetary as well as donations of clothing, furniture, etc.

### Summary

The incentive of establishing a tax exempt organization is to provide assistance to charitable entities. The individuals that benefit from the organizations may be in the local community, the nation or world-wide, but the benefits are decided by the donors as well as the organizers. Tax exempt organizations are quite complex as you can see from this article. Additionally, there are numerous compliance issues that must be addressed to maintain tax exempt status. If you have a desire to form a tax exempt organization, I recommend you seek an attorney well-versed in this field. 