



## When to Become a 501c3?

By Carol L. Topp, CPA

HomeschoolCPA is frequently asked, “When does my homeschool organization need to file for 501c3 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 IRS Form 1023](#), page 1). \$5,000 is a pretty small organization; 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 tax exempt “qualified charity”
2. File for another type of tax exempt status with the IRS.
3. Reorganize your organization to stay small (i.e. 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 [www.HomeschoolCPA.com/Articles](http://www.HomeschoolCPA.com/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 one in their 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 hospital 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) 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 such as unions, trade organizations, the American Association of Retired Persons (AARP) or the National Association for the Advancement of Colored People (NAACP).

Social welfare organizations are tax-exempt like 501(c)(3) organizations, but donations are not tax deductible. Some fund raising programs may be limited to “qualified charities” and 501(c)(4) social welfare nonprofits would not be allowed to participate. The application for 501(c)(4) status is similar, but slightly less difficult than the 501(c)(3) application. The IRS filing fee is the same.

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 status. Consult an experienced CPA or nonprofit attorney before making your decision. You can read more about 501(c)(4) organizations at the IRS webpage for [Social Welfare Organizations](#).

### **Reorganize Your Group to Stay Small**

Another method that avoids IRS filing would be to organize your group to stay under \$5,000 gross revenues per year. Your organization could split off 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, then 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 a for-profit sole proprietorship, a partnership, a corporation or, possibly, a nonprofit corporation but not tax exempt and therefore 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 in preparing your Form 1120 tax return as these returns are quite complicated.

Corporate status as a for-profit or nonprofit is obtained by filing for incorporation with your secretary of state. See [www.HurwitAssociates.com](http://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 owner's 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 501c3 or c4 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 mention this enough. Homeschool leaders should focus on what they do best—running their homeschool program and let the professional do what they do best—understand the IRS rules! My website [www.HomeschoolCPA.com](http://www.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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