1. **What does it mean for a community group to organize itself as a corporation?**

   Becoming a corporation allows a group to be treated as an entity in and of itself, rather than simply as a collection of individuals. For example, a corporation can own property and enter into contracts in its own name.

   In Kentucky, organizations incorporate by filing “Articles of Incorporation” with the Kentucky Secretary of State. Kentucky law requires certain information to be included in the Articles of Incorporation such as: the corporation’s name and purposes; the names and addresses of its first board of directors; the name and address of a registered agent; and principal office address. Additional provisions are required for groups claiming 501(c)(3) or other tax exempt status.

2. **What does it mean to be a “nonprofit” corporation?**

   A nonprofit corporation is one in which none of the income or profit is distributed to its members, officers or directors. Instead, the income and profits go back into the corporation to further its nonprofit purposes. In contrast, a for-profit corporation exists to make money for its owners and shareholders.

3. **Are all nonprofit corporations exempt from paying income tax?**

   No. Nonprofit organizations are not automatically exempt from paying income tax. A nonprofit must meet specific criteria in order to be exempt and, in the case of most kinds of federal tax exempt status, must apply to the Internal Revenue Service for the particular status desired.

4. **What are some of the pros and cons of becoming a nonprofit corporation?**

   In addition to allowing an organization to be treated as an entity in and of itself, rather than as a collection of individuals, the corporate form also provides some protection to individual members and directors from liability for the organization’s conduct and debts. On the other hand, incorporation decreases the flexibility a group has in running its affairs; once incorporated, it must follow Kentucky law regarding nonprofit corporate governance and decision-making. It will also have to comply with state reporting requirements and state and federal tax laws, and may incur some financial costs – in addition to time and paperwork – to maintain the group’s corporate status.
5. **What are some of the major legal obligations of Kentucky nonprofit corporations?**

Nonprofit corporations must comply with the KY Nonprofit Corporations Acts and other state laws regulating business entities. Among other things, these laws provide that a nonprofit corporation:

- must maintain a board of directors of at least three persons;
- must have a registered agent to receive service of process on behalf of the corporation;
- must file an annual report;
- must have and follow bylaws that contain the corporation’s operating rules and comply with the specifics of the KY Nonprofit Corporations Acts; and
- must keep books and records of account, minutes of its board and membership meetings and make its records available to its members.

6. **What does it mean to be a 501(c)(3) organization?**

A 501(c)(3) organization is a particular kind of nonprofit. “501(c)(3)” refers to a section of the U.S. Internal Revenue Code. Section 501(c)(3) allows a nonprofit corporation to qualify for exemption from federal income tax if it is organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, or to do testing for public safety, foster amateur sports competition or prevent cruelty to children or animals.

7. **What are the major criteria for 501(c)(3) status?**

To qualify for 501(c)(3) status, an organization:

- must be organized and operated exclusively for exempt purposes set forth in section 501(c)(3) and listed in the answer to Question 6, above;
- must not be organized or operated for the benefit of private interests, with none of its earnings inuring to any private shareholder or individual;
- may not attempt to influence legislation as a substantial part of its activities; and
- may not participate in any campaign activity for or against political candidates.

8. **What are the main benefits of 501(c)(3) status?**

A 501(c)(3) organization is exempt from paying Federal income tax on most types of income. Further, donations made to a 501(c)(3) organization are tax deductible, meaning that individuals or businesses that donate money or goods can take a deduction to the extent permitted by law when they file their income tax return. In addition, government entities, foundations and businesses often require the organizations they support to have 501(c)(3) status. Finally, in Kentucky, 501(c)(3) organizations are also exempt from state income tax and most Louisville Metro net profits taxes.

9. **What are the main drawbacks of 501(c)(3) status?**

Because of the tax advantages they enjoy, 501(c)(3) organizations are highly regulated. Members of the board of directors must learn about the many legal requirements that apply to
501(c)(3) organizations. The IRS requires 501(c)(3) organizations to keep detailed records showing proper expenditures and operations and legal compliance with IRS rules. There are also strict prohibitions on individual directors or members profiting from their relationship with the organization, and severe financial penalties for the organization and the individual when these rules are violated. Even though exempt from paying income tax, 501(c)(3) organizations (other than churches and some church-affiliated organizations) must file an annual information return with the IRS. Which form to file and how complex the return will be depends upon the organization’s annual gross receipts and total assets.

In addition, the Internal Revenue Code prohibits 501(c)(3) organizations from taking part in campaigns for political office, either in favor of or in opposition to a candidate. It also restricts the extent to which an organization can try to influence legislation, including the extent to which it can lobby Metro Council on legislative matters.

10. What kind of activities does the restriction on attempting to influence legislation apply to?

The restriction limits how much lobbying a 501(c)(3) organization may do. The term “legislation” includes acts, bills, laws or similar items of a legislative body such as Congress, the General Assembly, Metro Council or Fiscal Court, as well as referendums, ballot initiatives or constitutional amendments to be voted upon by the public. The restriction applies to both “direct” lobbying, meaning communication with a legislator that expresses a view about specific legislation, and “grassroots” lobbying, which means expressing a view about specific legislation to the general public with a call to action.

11. Can a 501(c)(3) organizations lobby at all?

Yes. The restriction states that attempting to influence legislation may not be a “substantial” part of a 501(c)(3) organization’s activities. A 501(c)(3) organization may work to influence legislation, including lobbying Metro Council, as long as these efforts are only an “insubstantial” part of its activities. Organizations must take extreme care in complying with this requirement, as exceeding the limits can result in the IRS imposing an excise tax on the group and/or revoking its tax-exempt status.

12. How does a 501(c)(3) organization make sure it’s lobbying activities are “insubstantial” within IRS limits?

The easiest and safest way to do this is to file a form for that purpose with the IRS. The organization can then use a formula in the law to calculate how much it can spend on lobbying and remain “insubstantial,” based upon its annual budget. The organization will also need to keep a record of its lobbying expenditures, and may be required to report them to the IRS every year.
13. **Is there a tax exempt status that allows nonprofit community organizations to lobby without the restrictions imposed on 501(c)(3)s?**

Yes. Tax exempt status under section 501(c)(4) is available to what the Internal Revenue Code calls “social welfare” organizations or “civic leagues.” Unlike 501(c)(3)s, 501(c)(4) organizations can do as much lobbying as they wish, as long as these activities fall within the organization’s exempt purposes. However, contributions made to 501(c)(4) organizations are not tax deductible.

In addition to the freedom to lobby, 501(c)(4) organizations may also engage in political campaign activities to a limited extent, as long as this is not the organization’s primary activity. However, they must file a special tax return if they do so, and pay a tax based upon the amount spent on campaign activities.

As is the case for 501(c)(3)s, there are strict prohibitions on individual directors or members profiting from their relationship with a 501(c)(4) organization, and severe financial penalties for the organization and the individual when these rules are violated. Section 501(c)(4) organizations, too, must file an annual information return with the IRS. Again, which form must be filed and how complex the return will be depends upon the organization’s annual gross receipts and total assets.

14. **How does a nonprofit corporation become recognized as a 501(c)(3) or 501(c)(4) organization?**

By filing an application for recognition of tax exempt status with the IRS. The type, length and complexity of the application, as well as the filing fee, will depend upon which status is sought and the organization’s annual receipts and assets. Filing fees range from $275.00 to $600.00. Churches and some church-affiliated organizations may enjoy 501(c)(3) status without filing an application to the IRS.

In addition, any nonprofit that intends to operate as a 501(c)(4) organization must so notify the IRS within 60 (sixty) days of its formation. This is done electronically, by filing an on-line form and paying a $50.00 fee. Failure to do so results in a penalty of $20/day for each day the failure continues, up to a maximum of $5,000. This notification requirement applies regardless of whether the organization plans to apply to the IRS for recognition of 501(c)(4) status.

This publication is for general information only and cannot substitute for legal advice. Different organizations will have different needs and problems resulting in different legal consequences. Every issue discussed is complex, so always consult an attorney for advice on specific situations.

Revised March 2020
ELO