

## **From Congregation to 501(c)(3) Nonprofit Organization**

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The faith community provides many services through church congregations rather than through separate nonprofit organizations. This is perfectly appropriate in many cases. However churches that provide significant charitable services without forming a separate 501(c)(3) nonprofit corporation face greater funding challenges and expose their members to potential liability. It is therefore important to consider incorporating and obtaining an IRS determination of nonprofit status.

### **Whether to Incorporate Under State Law**

A church may choose not to incorporate at all, may incorporate as a church or, alternately, it may form a separate nonprofit corporation to carry out its charitable, educational or scientific functions (i.e., its non-religious 501(c)(3) purposes). Incorporation is not required by the IRS. Incorporating in some form, however, is often advisable so that church members are not individually liable for debts and other liabilities incurred by the church. It also has implications for fundraising. Forming a nonprofit corporation separate from the church has the added benefit of clearly separating the books for the church itself from those of the organization that performs charitable, educational or scientific functions. This makes it easier to ensure that federal grant money is not used for religious — and thus prohibited — purposes. A separate nonprofit corporation may also be eligible for grants not available to churches.

Churches are eligible for federal grants without incorporating or obtaining a tax-exempt determination from the IRS. They must, however, have strict accounting controls to ensure that federal money is not used for “church” purposes. For example, such organizations may not use any part of a direct federal grant to fund religious worship, instruction, or proselytizing or to purchase religious or scriptural materials – such as the Bible, Torah, Koran or Talmud. Creating an organization that is legally separate from the church makes it easier to account for use of public funds and allows the government to monitor the group’s use of grant funds without intruding into the church’s internal affairs.

### **Whether to Seek a Formal IRS Determination of Tax-Exempt Status**

Some grants are only available to entities that have a formal determination letter from the IRS establishing their tax-exempt status. Churches have several options for broadening their eligibility for grants: (1) Obtain a determination letter for the church or be included in a parent church’s group determination; (2) enter a “fiscal agent agreement” with a recognized tax-exempt organization; and (3) form a separate, non-religious 501(c)(3) nonprofit corporation.

#### **1) Determination letter for the church:**

A church can apply for formally-recognized 501(c)(3) status just like any other nonprofit corporation. This will assure donors that the church qualifies for tax benefits and that contributions are generally tax-deductible. Any organization, including a church, that wishes to be recognized as tax exempt under IRC section 501(c)(3) must use Form 1023, including schedule A. Alternatively, if a church has a “parent” organization, it may be included in the parent church’s determination letter. The parent is then required to submit an annual group exemption update to the IRS. Both of these options limit grant opportunities and require the

accounting controls discussed above to ensure that federal funds are not used for inherently religious activities.

**2) Create a separate nonprofit corporation without seeking 501(c)(3) status and obtain grants through a 501(c)(3) fiscal agent:**

If your organization has not yet achieved 501(c)(3) status or if doing so would be unduly burdensome, you can increase grant eligibility by finding a 501(c)(3) nonprofit that has an interest in projects similar to yours and that is willing to serve as a “fiscal agent” by receiving and administering funds while you run the program. Generally, the non-exempt organization solicits grants or donations, donors make the payment to the 501(c)(3) tax exempt sponsor, and the sponsor makes a grant to the non-exempt organization.

**3) Formation of a separate 501(c)(3) organization:**

If your organization can shoulder the administrative burdens associated with 501(c)(3) status, this is the best option for you maximize eligibility for funding. To maximize funding opportunities, faith-based groups seeking to form a separate 501(c)(3) organization for non-religious purposes should keep the following in mind when preparing articles of incorporation and filling out the IRS 1023 form:

- Name: Your name may reflect your faith and may even be your church’s name but, for purposes of seeking grants, the name should not suggest that funds will be used for religious purposes.
- Purpose clause: There is no requirement that you give up your religious identity and mission to obtain tax exempt status. However, it is best to focus on your non-religious purpose so that potential grantors can see that grant money is not used for religious purposes. For example, the purpose of a post-release program for convicts should not be to help them to follow the tenets of a particular religion. Rather, the purpose could be to help released prisoners to reintegrate into society by providing training in employment-related skills.
- Board of Directors: Use standard corporate titles (President, Vice President, Secretary and Treasurer) rather than using church titles such as “pastor” or “youth minister.” Otherwise, grantors may be concerned that funds will be used to fund church functions.