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Earning Tax-Exempt Status For EAA Chapters

By Patti Arthur

Just because an organization operates without profit doesn't make it officially tax-exempt.

Because tax day just happened, the idea of not having to pay federal income tax is probably pretty appealing about now. Under specific federal tax rules certain organizations can realize this benefit.

The tax rules can be fairly complicated, but if you understand what the IRS is looking for, applying for and receiving federal tax-exempt status is rather straightforward. To explain some of the particulars specific to aviation-type organizations, let's look at an EAA Chapter.

Step 1: Form the Organization

Forming a tax-exempt organization is the first step to earning tax-exempt status. The IRS has no real requirement for a specific type of business entity, and the typical form is a corporation or an "unincorporated association." Because they are easier to work with, we'll only discuss corporations. The regulations surrounding other business entities are beyond this article's scope, and they can be a little tricky.

People must form the organization, like an EAA Chapter, in the typical fashion, starting with a meeting to name the directors, decide on a name, apply for and receive a federal tax ID number (IRS Form SS-4), formally file articles of incorporation with the state, and adopt bylaws. To qualify for federal tax exemption the IRS requires formal "governing documents" like articles and bylaws.

When forming an organization, take care when drafting the governing documents because they must definitively state that the entity has been formed for "charitable purposes" (more on this later). They must also contain provisions about membership, different classes of membership, dissolution procedures, and other specific language that refers to certain federal tax law provisions.

You can find the exact language needed for the governing documents in IRS Publication 557, Tax-Exempt Status for Your Organization. Also, the state in which the entity is formed may have laws that require other information for the articles and bylaws specific to tax-exempt organizations.

Step 2: Applying for Tax-Exempt Status

Once you've formed the organization or Chapter and filed the appropriate documents with the state, applying to the IRS for federal tax-exempt recognition is the next step. This application involves filling out a lengthy application package, enclosing the articles and bylaws, and paying the filing fee. The IRS will review the information and issue a letter that approves or denies (with a reason why it's denied) tax-exempt status.

Most organizations can apply for tax-exempt recognition under different Internal Revenue Code sections. The organization's tax-exempt purpose determines which section to use and which application package to file. Remember, just because an organization

operates without profit doesn't make it officially tax-exempt. It must follow specific rules before the IRS will recognize its tax-exempt status under any code section.

Some aviation organizations can qualify under Section 501(a), which relates to a large number of different types of organizations described in Sections 501(c)(2) through (c)(25). Most EAA Chapters may qualify under Section 501(c)(3) or 501(c)(7).

Organizations seeking 501(c)(3) status are organized and operated solely for charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports, or preventing cruelty to children or animals. Organizations seeking 501(c)(7) status are organized for pleasure, recreation, and other nonprofit purposes. The applications for both are similar, and we'll focus on 501(c)(3) organizations.

An organization applying for tax-exempt status under 501(c)(3) must complete Application Package 1023, which contains Form 1023 and its instructions. Don't be intimidated by this 30-page form because most of its pages don't apply to EAA Chapters or other types of nonprofit aviation organizations.

The most important part of Form 1023 is page 2, where you must describe in detail the organization's tax-exempt purpose. Incorrectly describing the organization's tax-exempt activities in this section is why many organizations do not receive tax-exempt status.

When the IRS examines your organization's tax-exempt description it's looking for certain buzzwords and language. It wants to see that you organized the entity exclusively for religious, charitable, scientific, literary, educational, or like purposes.

Logic suggests that you should be able to say this on the application, right? Wrong. To the IRS's satisfaction, your organization must describe exactly how you'll achieve these purposes. In other words, the organization has the burden of proving to the IRS that it's truly been formed to foster a charitable purpose.

For example, EAA Chapters must establish a purpose, other than meeting occasionally to discuss airplanes, that advances a charitable, educational, or scientific purpose. And on Form 1023 the Chapter must describe in detail the exact activities that further that purpose.

Examples might include associating with Young Eagles to educate children about aviation, giving cost-free educational flights to children and families, traveling to schools and air shows for educational purposes, advancing the science of aviation with experimental aircraft.... You get the picture. This activity description sometimes takes an attorney to get the language just right. Otherwise, the application can be delayed potentially for years.

Once you have a good, solid description of the organization's tax-exempt purpose, the rest of the package is easy to complete. New organizations must include estimated budgets for the next two years, and organizations already in existence must submit their financial statements for the current and three preceding years. As stated earlier, the articles of incorporation and bylaws must also be enclosed, along with the user fee. The completed package is then sent to the IRS Key District Office listed in the application instructions.

Step 3: Maintaining Tax-Exempt Status

If the tax-exempt description and the rest of the application package passes muster, the IRS will send you a determination letter, usually within 30 to 60 days. If the IRS grants federal tax-exempt status, the income and dues the organization generates are free from

federal tax, and donations and dues paid to the organization can be deducted from the giver's federal tax return.

Most federal tax-exempt organizations must file an annual information return, IRS Form 990 or 990EZ). Small organizations with gross receipts of less than \$25,000 per year are not required to file an annual return, but if the IRS mails the organization a Form 990 package, it should complete and return the form.

In addition, the organization will need to conduct activities throughout the year that demonstrate its continuing charitable, educational, or scientific endeavors so that upon further examination by the IRS, tax-exempt status will not be lost. In other words, the entity must do what it originally told the IRS it was going to do.

What we've discussed here are the very basic topics involved in becoming a tax-exempt organization. To properly establish and maintain a tax-exempt organization, you should seek the advice and knowledge of an attorney (like the EAA Legal Advisory Council) or an accountant familiar with tax-exempt organizations. However, overall the process is not difficult, and the benefits can far outweigh the initial work involved at start-up.

Finding IRS Forms

You can download IRS Publication 557, Tax-Exempt Status for Your Organization; Package 1023, Application for Recognition of Exemption; Form SS-4, Application for Federal Tax ID Number, and all other related documents and forms from the IRS website at www.irs.gov (click on "Forms & Pubs"). The website also provides a lot of helpful information about tax-exempt status (click on "Tax Info").

If you don't have Internet access, you can call the IRS's toll-free number and request the documents and forms, and you'll find the IRS number for your area in the phone book's white pages. A CPA or attorney can also get the forms for new organizations.

The state in which you form your organization will have forms for Articles of Incorporation, and bookstores usually have sample boilerplate bylaws for sale. You can get a sample IRS tax-exempt filing package from the EAA Chapter office. But these items are just guides. An accountant or attorney should review the organization's package before it's filed to make sure something in it will not delay—or deny—the application.

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