



To Be or Not To Be.....a 501(c)(3)



501(c)(3)?

26 U.S. Code § 501. Exemption from tax on corporations, certain trusts, etc.

(c) LIST OF EXEMPT ORGANIZATIONS The following organizations are referred to in subsection (a):

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.



History of Tax-Exempt Organization

- Lack of strong governmental institutions in settlements and subsequent colonies, frontiers, & territories prompted early Americans to take care of each other and form cultural and religious “safety nets”.
- Strong wariness of monarchy and government oversight encouraged communities to take care of themselves and their needy.
- “Industrial Revolution” wealth prompted philanthropy and made government connections and when income and corporate taxes were implemented, exemptions were included for entities engaged in charitable work- as long as no individual made a profit, and by 1917, contributions made to these organizations became deductible as a way to ease the burden of high taxes during WWI.
- As charitable organizations became more complex and more wealthy, accountability became more stringent and requirements more specific.



Michigan Public Libraries ARE Tax-Exempt

Michigan Public Libraries are Government Entities, and therefore are Tax Exempt

26 U.S. Code § 115. Income of States, municipalities, etc.

- Gross income does not include—**(1)** income derived from any public utility or the exercise of any essential governmental function and accruing to a State or any political subdivision thereof, or the District of Columbia; or
- **(2)** income accruing to the government of any possession of the United States, or any political subdivision thereof.

26 USC 170(c)(1)

(c) CHARITABLE CONTRIBUTION DEFINED For purposes of this section, the term “[charitable contribution](#)” means a contribution or gift to or for the use of—**(1)** A State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.



Can a Public Library be a 501(c)(3)?

Public library. A public library organized as a separate entity under a State statute, without power to impose taxes for its operation but whose funds are obtained by certification of a tax rate needed for its operation to the ratemaking authority, qualifies for exemption under section 501(c)(3) of the Code. **See Rev. Rul. 74-15 (IRS RRU), 1974-1 C.B. 126, (see pg. 126).**

It Depends. In order to meet requirements for designation, a government entity must

- (1) **Be a separately-organized entity** (Established independently of the “government”) Libraries are separately organized entities.
- (2) **Pass the organizational test** (religious, charitable, scientific, public safety, literary, or educational. The organization’s enabling documents must also have a dissolution clause leaving assets to a comparable nonprofit. Assets can’t go to the government).
- (3) **Not possess a disqualifying regulatory power** (Ability to levy taxes, pass ordinances, police, etc.)
- (4) **Not be an integral part of the state or municipal government.**((1) whether the organization was created by executive order of the Governor of a state; (2) whether the organization was created by executive order of the Governor of a state as an official state agency; (3) whether a state or state agency has the power to appoint and remove the organization’s board; (4) whether a state or state agency has the power to abolish the organization; (5) whether a state or a state agency monitors the organization’s activities; and (6) whether the organization uses government employees to conduct its activities.)



General Benefits of being a 501(c)(3)

- Exemption from Federal income tax;
- Tax-deductible contributions
 - Higher percentage
- Possible exemption from state income, sales, and employment taxes;
- Reduced postal rates;
- Exemption from Federal unemployment tax; and
- Tax-exempt financing.
- Access to many Grants and Foundation funding opportunities
 - Many grantmaking entities cannot donate to entities that are not non-profit charitable entities.

<https://cullinanelaw.com/benefits-of-having-501c3-tax-exempt-status/>



Why Be a 501(c)(3) Library?

As government entities, Michigan Public Libraries already have limited Federal (and State) Tax obligations:

Payroll Tax

Social Security & Medicare Withholding

Retirement Plan reporting



Benefits for Libraries

- Identification as a “verifiable” and “credible” Charity:
 - Confirmation of certain financial policies and procedures in place
 - Assurance that proper governance policies and procedures in place
 - Assurance of certain reporting
 - Adds Trust
- % of total deduction is higher for a 501(c)(3) (50% of a taxpayers contribution base as opposed to 30%) because gifts not given to “states” etc. has a higher %)
- Private foundations can donate to 501(c)(3), but may have to pay penalty taxes for donations to government entities
- Easier access to many grant-making and donation and partnering entities
 - Many established donors and grant making entities will work only with 501(c)(3)s for their own protection and efficiency.
- Libraries already adhere to political restrictions



Cons of being a 501(c)(3)

- Generally requires an attorney to obtain status
- Status requires libraries to attain and maintain:
 - Governance policies and practices
 - Financial procedures and reporting
 - Recordkeeping
- Requirements to maintain status
 - Annual Reporting
 - Record keeping
 - Financial procedures
 - Governance procedures
 - Knowledge and current awareness of regulations and laws

https://www.stayexempt.irs.gov/se/files/downloads/MaintainingExemptStatus_Print.pdf



Myths of Tax-Exempt Status

- A Library is not eligible to apply for grants if it is not a 501(c)(3)
 - This may be true for some grants, BUT libraries should read grants carefully and look for 170(c)(1) requirements and prepare to show a Government Designation Letter from the IRS. Also, because libraries in different states are organized differently, a library may wish to contact a grant making organization to discover if they can clarify the library's status as a government entity.
- A Library with a 501(c)(3) is a non-profit corp.
 - Nope – a 501(c)(3) library is still a government entity
- 501(c)(3) entities pay no taxes
 - Nope. They pay payroll tax as well as possibly some state taxes (like unemployment). They also must pay taxes on any income derived from unrelated activities.



What if a Library can't be a 501(c)(3)?

- The purpose/advantage of a 501(c)(3) is the Federal Tax exemption and the authority of that label. Public Libraries are tax exempt by nature so it can be useful to communicate and gather documentation that shows tax exempt status to differentiate from other non-501(c)(3) non-profits.
 - Obtain a Government Designation Letter from the IRS
 - In order to obtain a determination letter an organization must file a Form 1023 Application for Exemption, available online at <http://www.irs.gov/pub/irs-pdf/f1023.pdf>. Generally, the I.R.S. will issue a determination letter within three to six weeks.
- Look for Governmental, and community organizational grants that do not require 501(c)(3) status (they are out there)
 - <https://www.grants.gov/learn-grants/grant-eligibility.html>
 - <https://sparkplugfoundation.org/content/guidelines>
 - Join a grant service like Michigan Grant finder



Considering a 501(c)(3)

- Engage an Attorney
- Weigh benefits and detractions – do your homework (see links at end)
 - Why?
- Be patient – Take it slow
- Assemble your documents
- Understand your responsibilities
 - Bylaws
 - Recordkeeping
 - Filing
 - Restrictions



How to become a 501(c)(3)

- It's all about the form
Form 1023, 1023 EZ

Details and accuracy count

Lots of assistance available

<https://www.irs.gov/forms-pubs/about-form-1023>



Resources

- History of Tax-Exempt

<https://www.irs.gov/pub/irs-soi/tehistory.pdf>

- General information on 501(c)(3)

<https://www.statelibraryofiowa.org/ld/f-h/funding-info/gov-affil> (Note - this is from a State of Iowa perspective)

<https://cullinanelaw.com/benefits-of-having-501c3-tax-exempt-status/>

- IRS information on Becoming a 501(c)3

<https://www.irs.gov/charities-non-profits/before-applying-for-tax-exempt-status>

<https://www.irs.gov/charities-non-profits/applying-for-tax-exempt-status>

<https://www.irs.gov/pub/irs-pdf/p4220.pdf>

<https://www.irs.gov/pub/irs-tege/eotopich04.pdf>



Thanks!

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