

Incorporation and Tax-Exempt Status for Bike Clubs and Advocacy Organizations

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Introduction

The League provides this guide as an introduction to the subject of incorporation and tax-exempt status for bicycle clubs. We advise that organizations consult with legal and financial professionals in pursuing any of the steps outlined.

Why Incorporation?

Incorporation is a state-level recognition of an organization's non-profit purpose and structure. It is typically not difficult to obtain, though the requirements vary from state to state.

There are two important reasons for incorporating as a non-profit:

- Incorporation is required for obtaining tax-exempt status from the Internal Revenue Service (IRS).
- Incorporation limits the liability of club officers and members: If a club is not incorporated, it is likely it "will be considered an association, i.e., a general partnership. Accordingly, volunteer members would likely be jointly and individually liable for unpaid club debts and obligations." (From Volunteer Sports Club Liability, By Robert R. Thompson, <http://www.t-tlaw.com/sc-10.htm>)

Why Tax-Exempt Status?

The most fundamental benefit of obtaining a tax-exempt determination from the IRS is exemption from paying Federal Income Tax.

Additional benefits can include exemption from paying sales tax on club-related purchases, the ability for volunteers to take a tax deduction on some of their expenses, and a discounted postal rate for some high-volume mailings. If your organization obtains 501(c)3 "charity" status, donations to the organization are tax-deductible for the donors. (501(c)3 refers to the section of the tax code dealing with these organizations.)

Note on "non-profit" vs. "tax-exempt"

The two terms are often used interchangeably to indicate tax-exempt status, particularly 501(c)3 status. Non-profit is the type of corporation that will be recognized by the state. Tax-exempt status refers to the section of the IRS code that allows an organization to be exempt from federal income tax.

Incorporation Basics

Incorporation is handled at the state level, and the requirements and regulations vary from state to state. The requirements typically include:

- Choosing unique name, different from all other organizations incorporated in the state
- Creating by-laws for the organization
- Naming a board of directors and having a meeting of that body
- Drafting articles of incorporation

The bylaws and articles of incorporation will require certain provisions and legal language geared towards limiting liability of officers and establishing eligibility for recognition as a tax-exempt organization. Your decision about which tax-exempt status to pursue will affect the contents of these documents, so you should write them after this decision has been made. You should seek qualified legal assistance to help you with these documents – if there is a lawyer on your board or within your membership, they should be able to assist.

Once incorporated, an organization must pay federal, state, and local income taxes until they have received an IRS tax-exempt designation.

Applying for Tax Exempt Status from the IRS

Cycling clubs and advocacy organizations generally fall under one of three tax-exempt designations, as described in [IRS publication 557](#):

- [501\(c\)3 - Public Charities](#)
 - Tax deductions for donors
 - Preferred status by corporate donors/sponsors
 - Organization must have “charitable purpose,” towards which 85% of its activities (which is to say effort and expenditures) must be directed
 - Most stringent requirements for entry and maintenance of status
- [501\(c\)4 - Civic Leagues and Social Welfare Organizations](#)
 - Organization “operated only to promote social welfare to benefit the community”
 - Typically the status of advocacy/lobbying organizations, as it has broader allowances for political activity than (c)3
 - Could apply to clubs with 50% of their activities directed to a charitable purpose; the other 50% could be social and recreational activities
 - No tax deductions for donors
- [501\(c\)7 - Social and Recreation Clubs](#)
 - A good fit for bike clubs, especially those with few educational or outreach activities
 - Management of income from event rides is crucial because of restrictions on income from non-member sources
 - Status can be claimed without applying to the IRS for the designation
 - No tax deductions for donors

Two important notes applying to all of these statuses: All tax-exempt organizations, regardless of size or income, must now file a tax return every year. This filing will use a version of the form 990. Secondly, income from certain activities may result in taxable income if it is unrelated to the organizations’ exempt purpose, as detailed in [IRS publication 598](#).

501(c)3 Tax-Exempt Status

501(c)3, or “public charity” status, is the best known of the tax exempt designations. This is the section of the tax code covering most organizations that solicit donations by direct mail, over the internet, or by other means.

The primary benefit of charity status is in fundraising. Donations to these organizations, and even sometimes a portion of dues, can be tax-deductible for the donor. Corporations and foundations often restrict their sponsorships, donations, or grants to organizations with this status.

Accordingly, the 501(c)3 status is the most expensive and painstaking to apply for, and it requires operational diligence to maintain. To be eligible for this status, an organization must have a charitable purpose. For bike clubs and organizations, this purpose would most likely be one or more of these:

- Education – mostly like about safe cycling,
- Sponsorship or participation in national or international amateur sports competitions, or
- Activities directed towards youth and encouraging the growth of the sport.

Application for 501(c)3 status involves making a compelling case for the charitable purpose of the organization. If the application is ultimately denied, the denial will usually include an assignment of another section that is more applicable for the organization; organization would not need to reapply for another status.

To maintain its 501(c)3 status, an organization must be engaged “exclusively” in these charitable purposes. One IRS source says that a rough guideline is 85% of club activities must fit within the club’s charitable purposes to remain a 501(c)3 organization.

Political activities fall outside of allowable charitable activities, and 501(c)3 must be very careful about their political activities so as not to jeopardize their status. [IRS Publication 4221 PC, Compliance Guide for 501\(c\)3 Public Charities](#) is an excellent resource that covers several topics related to compliance.

For more information on applying, see IRS publication 4220, [Applying For 501\(c\)3 Tax Exempt Status](#).

Even if your organization as a whole does not qualify for 501(c)3 status, there are ways to obtain some of the benefits of this status:

- In some cases, organizations whose activities fall largely outside of the bounds of charitable activity create a second entity for the receipt of tax-deductible donations that support charitable activities. Often, these sub-organizations have Foundation or Education Fund at the end of their name. This approach will significantly increase the level of accounting and reporting required for an organization.
- In order to obtain sponsorships, non-501(c)3 bike clubs can partner with charitable organizations for rides and other events. Receipt of the sponsorships and other donations can be conducted through the partner organization. (Please consult with financial or legal professionals to be sure that these funds are spent and documented in a way consistent with their tax status.)

501(c)4 - Civic Leagues and Social Welfare Organizations

This is the most common tax-exempt status for cycling advocacy organizations, whose activities are primarily political, rather than charitable or recreational.

The 501(c)4 status has broader guidelines for income and expenditures: 501(c)(4) organizations should have at least 50% of their activities be charitable, and/or educational. The remaining 50% of activities can be legislative, political, and/or recreational and social.

The 501(c)4 status can be claimed without formal application to the IRS. Returns would be subject to examination, and the income could be declared taxable if the organization were not operating within the requirements of a 501(c)4 organization.

501(c)7 - Social and Recreation Clubs

Social and recreational clubs are given tax-exemption under the model that these entities are primarily member-funded, to provide benefits back to members. It is in many ways the most applicable designation for recreational and social bicycling clubs.

As with 501(c)4 status, the 501(c)7 designation can be “self-proclaimed” without formal application to the IRS.

The Event Ride Challenge: 501(c)7 Bike Clubs and the 15% rule

501(c)7 organizations need to derive at least 65% of their annual income from members – this includes dues and other fees (to participate in special events that require an extra fee, for instance.) Up to 15% can come from non-member sources; the other 20% can be passive income – from investments, for instance.

This presents a significant hurdle for many bike clubs who are otherwise classic 501(c)7 organizations. There are, however, a number of approaches for structuring special events such that the income does not surpass the 15% limit of income from non-member sources. As always, please check with your own accounting and tax experts to be sure that the approach you use is handled appropriately.

- If a 501(c)3 tax exempt organization is to ultimately benefit from the proceeds of the event, partner with that 501(c)3 organization. Fees and sponsorships can be paid to the 501(c)3. The 501(c)7 organization can still be given a portion of the proceeds, though it would need to be structured in a way that is consistent with the (c)3 organizations’ needs. If the 501(c)3 organization is a member of the 501(c)7, the income could be considered to derive from members.
- If your event ride is benefiting 501(c)3 organizations, or funding charitable work by your club (education or youth work, for instance), you can set up a separate 501(c)3 organization to handle the event ride. Note that there are significant costs in terms of time and accounting fees to keep this compliant.
- You can make every participant in the event or event ride a member of your organization as part of their registration, or at least create a major incentive to join as part of registration via the differential between member and non-member registration fees. The included membership must be equivalent to other memberships -- it can’t be just for the day, or offer lesser benefits than are available to those who join in another manner.

- Business sponsorships could be structured as corporate memberships, making this income member-derived.

Costs and timeline

Based on reports from member clubs, the process of incorporating and attaining an IRS designation can take from 6 months to 2 years. Legal fees have been reported to range from about \$4,000, down to \$500 for an organization that can generate some of the necessary documentation on its own. Some clubs are able to get pro-bono assistance. There is a filing fee of \$750-850 if you're applying for a 501(c)3 designation; applying for charity status is also likely to take longer than applying for another designation.

Additional Resources

Resources from the Internal Revenue Service

- Main IRS site for charities: <http://www.irs.gov/charities/>
- Publication 557, Tax-Exempt Status for Your Organization, which outlines all of the Tax Exempt Statutes, and how to apply: <http://www.irs.gov/publications/p557/index.html>
- Applying For 501 (C) (3) Tax Exempt Status: <http://www.irs.gov/pub/irs-pdf/p4220.pdf>
- Tax basics for 501(c)3 organizations: <http://www.stayexempt.irs.gov/>
- Publication 598, Tax on Unrelated Business Income of Exempt Organizations: <http://www.irs.gov/publications/p598/index.html>
- Publication 4221PC, Compliance Guide for 501(c) 3 Public Charities: <http://www.irs.gov/pub/irs-pdf/p4221pc.pdf>

The NOLO Law for All website has a [section on nonprofit law](#), including how to form a nonprofit corporation. <http://www.nolo.com/legal-encyclopedia/nonprofits/>

Thompson & Thompson – this law firm offers [extensive online resources about nonprofit incorporation](#), with [a special section for sports clubs](#). (<http://www.t-tlaw.com/nonprofit.htm>)

Local universities and law schools may have nonprofit law programs that can provide information or perhaps even low-cost or volunteer assistance in setting up your nonprofit organization.

Major cities often have associations of nonprofit organizations that may offers courses, consulting, or other resources on incorporation and obtaining tax-exempt status

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