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INCORPORATING YOUR COOPERATIVE AND OBTAINING TAX EXEMPT STATUS

1. Incorporating - formal creation of the cooperative

- 1.1. Why incorporate at all?
  - 1.1.1. To have an entity that can enter into contracts and own things
  - 1.1.2. To have an entity that lasts beyond your personal involvement
  - 1.1.3. To put limitations on your personal liability
- 1.2. Articles of Incorporation
  - 1.2.1. You'll need to comply with State laws, and also IRS requirements (if you plan on applying for a tax exemption)
  - 1.2.2. This involves some special provisions required by IRS, so you need to be very sure that you are comfortable with these requirements
    - 1.2.2.1. The "public support test"
    - 1.2.2.2. The "disqualified persons" issue - you may need to have only a portion of residents be on the board
    - 1.2.2.3. You'll need more than 1/3rd "income" from non-board members
    - 1.2.2.4. What is “income” in this context?
- 1.3. By Laws - this is where you get into number of board members, how they get elected, what the board and/or members are empowered to do, and more
- 1.4. When to do Articles
- 1.5. When to do By Laws
- 1.6. How quickly to apply for exemption - 27 months

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2. Other documents you'll need

- 2.1. Membership Agreement
- 2.2. Lease Documents
- 2.3. Policy Manual (make sure your lease references following the policies)
- 2.4. Make yourself aware of Landlord/Tenant rules - legally the Coop is a landlord AND any given member is a tenant

3. 501c3 vs. 501c7 for tax exemption

- 3.1. Why get a federal tax exemption at all?
  - 3.1.1. By use of depreciation you can go years before needing to actually pay any tax at all, and you may never be “profitable” (Although if, in the future, the Coop sells, there may be capital gains tax to pay.)
  - 3.1.2. however, you don't get the benefits from being a non-profit unless you apply for and obtain the status.
  - 3.1.3. Do you need the benefits of being a non-profit?
- 3.2. “501c3”
  - 3.2.1. This is what most people mean by “Charitable”
  - 3.2.2. The application process is more complicated, and harder to win approval
  - 3.2.3. There are more opportunities for financial assistance from others, grants, etc., because they get to write donations off as tax deductible gift
  - 3.2.4. You do not have to pay any income tax, and often avoid state sales tax
  - 3.2.5. Depending on your location, you may possibly be able to get property tax exemption - now that one is *big*
- 3.3. “501c7”
  - 3.3.1. Another type of non-profit
  - 3.3.2. Much easier to obtain than 501c3
  - 3.3.3. No real opportunities for financial assistance from others - they DO NOT get to write off as deductible gift
  - 3.3.4. Do not have to pay any income tax
  - 3.3.5. Depending on your location, not as likely to be exempt from sales tax - not likely to be eligible for property tax exemption

4. IRS Form 1023 - A step by step guide (follow along with the form)

- 4.1. Part VI - limit services to members, people in right income levels
- 4.2. Part VIII - activities - item 21
- 4.3. Part IX - financial data - call your "rent" membership fees, NOT gross receipts
  - 4.3.1. (note exception from the $5,000 or 1% rule related to the public support requirements)
- 4.4. Part X - The non-private foundation issue
  - 4.4.1. What is a “disqualified person"?
  - 4.4.2. What is the risk of becoming a "private foundation"?
  - 4.4.3. Consider having a smaller board vs. all members being on board. This is a way to avoid becoming a “private foundation.”
  - 4.4.4. In Part X, Pick "h" - the 509(a)(2) - publicly supported
- 4.5. Advance vs. definitive ruling
- 4.6. The fee to apply - no joke, it's a lot - $750.00
- 4.7. Schedule F - section III

5. Safe Harbor Rule for Low income housing

- 5.1. Income requirements for the rule
- 5.2. How to locate the income requirements for your own local area
- 5.3. Verification Document for income

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6. Publicly supported test (509(a)(2))

- 6.1. More than one-third from the public
- 6.2. Not more than one-third from investment income
- 6.3. Issue of "disqualified persons" and what that means
  - 6.3.1. Their payments can not be counted toward the one-third
  - 6.3.2. Includes board members & managers
  - 6.3.3. If all residents are on board - then all "income" is excluded as being from "disqualified persons" - thus fail the 1/3rd test
- 6.4. "Rent" is NOT a "contribution" or a "donation" - because you get the "service" of housing
- 6.5. Payments for "services" by members don't count toward the $5,000 or 1% rule
- 6.6. If fail the test - end up being a "private foundation"
  - 6.6.1. Still 501c3
  - 6.6.2. Operating foundation - don't have to give away a percent of your assets
  - 6.6.3. Many more reporting requirements
  - 6.6.4. "Renting" to "disqualified persons" (board members) not prohibited "self-dealing" if rent amount is same as any other person pays (in other words no special deals)
  - 6.6.5. It can still work - just much more time consuming record keeping

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