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Organizing a Nonprofit Theater Company

From *The Stage Producer's Business and Legal Guide, Second Edition*

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The choice of whether to organize as a nonprofit depends on what you want to accomplish and what sources you expect to tap for your funding. A for-profit theatrical entity aims to return a commercial gain to its shareholders or investors ("angels"). A nonprofit does not. For a theater company, a nonprofit status is just a different way of doing business.

The commercial for-profit producer must either fund his shows out of his own pockets or else raise money from investors. He is accountable to his backers for the money he raises, takes in, and spends. He must select shows that will attract investor interest and which will appeal to a broad audience. The most obvious example of this is the Broadway theater, where almost all shows are commercial ventures.

The nonprofit producer raises funds from a variety of sources: wealthy patrons of the arts; individual small donors; foundations; government agencies; fund-raising events; and the like. He, too, is accountable for all the money he raises, spends, and takes in—to his board, to his funding sources, and to various government oversight agencies. However, he can select shows with more limited appeal. Since his shows don't have to show a profit, he can focus attention more on "art."

The chief business reason for organizing as a nonprofit is to qualify for financial grants from government agencies and private foundations. A nonprofit may solicit and receive funds from individuals, who in turn receive tax deductions for their donations to nonprofits. It is easier to ask a large corporation to donate money or goods to a nonprofit than it is to ask it to invest in a play for commercial gain. An investment in a commercial show is a business decision that may not fit with the company's aims as well as being a huge risk to its bottom line. However, a donation to a local nonprofit falls under the heading of public relations, of giving back something to the community, of being a good corporate citizen.

Nonprofits enjoy certain privileges, such as exemptions (with exceptions) from federal, state, and local income taxes, sales taxes, and often property taxes. They receive lower rates from the post office on bulk mailings. Sometimes they receive special discounts on purchases from corporate suppliers. They may receive "in kind" donations. For instance, a local printer may print

up their programs or flyers at no charge and then take a tax deduction for the value of his services. Nonprofits also attract volunteer labor to fill positions for which the commercial producer must pay—for instance, actors, directors, stage crew, and so on.

Organizers, directors, and managers of nonprofit corporations enjoy limited liability from corporate obligations (again with certain exceptions). The corporate veil protects their personal assets from judgments. However, delinquent taxes may become a personal liability of the officer responsible. If a manager commits malfeasance in the performance of his duties, he may become liable to the corporation for damages.

Some people believe that nonprofits cannot make a profit. That is incorrect. There is no reason a nonprofit cannot take a profit. The difference occurs in what it may do with the profit. If a commercial theater company earns a profit on its investment, it may choose to distribute that profit to its shareholders or to retain it in the business. However, if a nonprofit makes money, it cannot distribute its net earnings to its organizers or managers. It must use those earnings for charitable purposes, for the benefit of the public. A nonprofit (unless it is a co-op) cannot issue shares or declare dividends. It is not permitted to have shareholders. In a co-op, the very people or entities who use its production and distribution services also own and operate the enterprise.

When a commercial theater company dissolves or winds up its business, its assets must be sold and the proceeds distributed to its shareholders. (Or, conversely, the assets themselves may be distributed to the owners.) However, when a nonprofit dissolves, it must distribute its remaining assets to another tax-exempt nonprofit group.

In this article, I will show you how to organize a nonprofit theater company.

PRELIMINARY CAUTIONARY NOTE

In today's world, there are online platforms, which act as umbrella 501(c)(3) tax-exempt organizations, to help artists raise money for their projects. Donors make their contributions to the online platform, which, because of its tax-exempt status, provides them with charitable deductions. While these platforms may have their place, they are not, as some artists believe, an effective substitute for creating the artist's own 501(c)(3) entity. They have many disadvantages, and I do not recommend them.

LEGAL CONSIDERATIONS

Nonprofit theater companies are governed by a wide variety of federal, state, and local laws. These encompass the laws of contracts; torts; corporations; federal and state income taxes; real estate; charitable solicitations; employment; sales; lease taxes; real estate property taxes. If the company expects to hire persons who are members of collective bargaining organizations, such as Actors' Equity Association, the American Federation of Musicians, the International Association of Theatrical State Employees, United Scenic Designers, and so forth, the company will be bound to sign and honor the terms of the applicable contracts of the respective unions, just the same as any other form of theatrical entity.

CHOICE OF ENTITY

Nonprofits can be organized as an unincorporated association; a charitable trust, which is established as part of a person's estate plan; or a charitable corporation. The average non-profit theater company is set up as a charitable corporation. Therefore our focus shall be on the charitable corporation, and henceforth, in these pages, all references to nonprofits shall mean a charitable corporation.

STATE LAW

Each state has its own laws governing the formation and management of a nonprofit. You must consult your particular state for its specific requirements. [See “Forming and Maintaining a Nonprofit – State by State Guide” on The Foundation Guide website [501c3.org/state-nonprofit-guide]]

FEDERAL TAX LAW

Most nonprofit theater companies operate as 501(c)(3) entities. This is the section of the tax code applicable to tax-exempt businesses. There are other sections of the tax code that govern other types of tax-exempt organizations, but theater companies rarely use them. Therefore, we will not deal with those sections here. Instead we'll focus on the specific requirements of Internal Revenue Code (IRC) section 501(c)(3) and the Treasury regulations thereunder. Incidentally, if you have trouble sleeping, go to the IRS's website (see below) and read IRC section 501(c)(3). I guarantee it will put you to sleep faster and better than any sleeping pill on the market.

Section 501(c)(3) Eligibility

Only certain corporations, unincorporated associations, and trusts may receive 501(c)(3) tax-exempt status. Sole proprietorships, partnerships, and loosely affiliated groups of individuals are not eligible.

IRS Website

It might seem an obvious resource, but many people aren't aware of the amount of helpful information to be found on the Charities and Nonprofits pages of the IRS website. Topics range from incorporating your nonprofit as a 501(c)(3) to handling donations, to annual tax filing guidelines and forms. [irs.gov/charities-and-nonprofits]]

ARTICLES OF INCORPORATION

A nonprofit is organized by filing articles of incorporation with the government agency which oversees corporations. In many states, this is the business division of the department of the secretary of state. Within that division there may be a subunit dedicated to nonprofit corporations. Again, you must consult your state for its requirements.

Purposes

To obtain recognition as a tax-exempt nonprofit company, your organization must be organized and operated for one or more of the following purposes:

- religious
- charitable
- scientific
- testing for public safety
- literary or educational purposes
- to foster national or international amateur sports
- prevention of cruelty to children or animals

Most theater companies, in their most basic forms, will fall under one or more of these. You must set forth your purpose in your articles of incorporation.

Private Inurement

In your articles of incorporation and in your IRS Form 1023 or Form 1023-EZ (more on these below), you must show that your organization will not operate to benefit private interests, such as the organizer, his family, insiders, or persons controlled directly or indirectly by such private interests.

None of the net earnings may inure to the benefit of private shareholders or individuals. This does not mean you cannot pay "reasonable" compensation to your employees or independent contractors. You also may pay "reasonable" compensation to your organizer, provided he is also an employee who is rendering services to your company. For instance, your organizer may be paid as artistic director, provided he actually provides work in that capacity.

The IRS frowns (and that's an understatement) on self-dealing transactions. These are transactions between the charity and its organizers, directors, or officers or other persons in a position to influence the charity's financial affairs.

Conflict of Interest Policy

Conflicts of interest may arise when a director, officer, or other authoritative party may personally benefit from a decision he or she may make. These are known as

"interested persons." The textbook example is the CEO who fixes his own salary, rather than having independent members of the board make that decision. In the operation of any business, it is quite easy for persons in authority to run smack-dab into actual or potential conflicts of interest. In your nonprofit, these could have serious ramifications if, subsequently, they threaten your tax-exempt or public charity status. By putting conflict of interest procedures in place, you are less likely to encounter that problem.

While the IRS doesn't require a conflict of interest policy in order to grant tax exemption, it highly recommends that you create and maintain one. Your state may require such a policy as a condition of recognizing you as a public charity. While the IRS and several states have suggested

language for a conflict of interest policy, I recommend that your attorney draft one that best fits your organization.

At a minimum, your policy should include the following:

- Its purpose;
- Its definition of "interested persons;"
- A requirement that such interested persons disclose to the board all material facts relating to any matter in which they may have a financial interest;
- A requirement that the interested persons should then absent themselves from the meeting while the board determines whether a conflict exists and, if so, votes upon the conflict;
- Procedures for dealing with the conflict of interest;
- Procedures for investigating and, if necessary, punishing violations of the conflict of interest policy;
- A requirement that the board maintain records of the proceedings;
- A requirement that compensation of "interested persons" is determined by independent members of the board;
- A requirement that all persons annually agree in writing to abide by the conflict of interest policy;
- A provision for periodic reviews of the company's operations by outside experts.

Political Activities

Section 501(c)(3) status will not be granted to an organization which participates in political activities, such as campaigning on behalf of or against any candidate for public office. It does not matter whether those activities are a substantial or inconsequential part of its operations. This includes publishing or distributing statements.

It may not engage in lobbying or other efforts to influence legislation (unless it elects to come under provisions which allow certain lobbying expenditures) as a substantial part of its activities.

It is not likely a theater company will engage in political activities,

Dissolution

As part of its articles of incorporation and its applications for tax exemption, the company must include a plan of dissolution. Of course, at the beginning, few companies are thinking of eventually dissolving. Nonetheless, such a plan must be created and included.

The key question arises: If and when the company is eventually dissolved, what will happen to whatever assets it may own at that time after payment of debts and costs of dissolution? This is best understood by realizing that the assets of a tax-exempt organization exist for the benefit of the public, not for the organizers or even for the organization itself. In other words, freedom from paying taxes comes with a cost: the public must receive the benefit of the company's assets.

The direct opposite is the commercial theater company. A commercial theater company will pay taxes, but its assets belong to its shareholders or investors, not to the public. When a commercial company dissolves-even if it is a one-shot production-its assets, after payment of debts and costs of dissolution, will be distributed to its owners. Thus, at the outset, the organizers must satisfy the IRS that the assets of the company, if and when it is dissolved, will inure to the benefit of the public. Typically this means that the company's assets, after payment of creditors and costs, will be disbursed to another 501(c)(3) company. It isn't necessary to provide the name of a specific charity to which you will distribute those assets-only that you intend to disburse them to a 501(c)(3) company.

SUMMARY

In short, your articles of incorporation must include

1. your purpose;
2. your vow not to operate for the private gain of any person or entity; and
3. your plan for if and when the corporation dissolves.

Why Are These Important?

The IRS wants a legal means to pin you down to organize and operate for charitable purposes. If these clauses are included in your articles of incorporation, both the IRS and your state may sue you if you do not abide by them.

Caveat: You must take these rules very seriously. I guarantee that the IRS and your state authorities take them seriously.

Caveat: Remember, the rule is that you must

1. organize for charitable purposes and
2. operate for charitable purposes.

FILE YOUR ARTICLES OF INCORPORATION

The legal requirements to incorporate vary from state to state. You can find those requirements via "Forming and Maintaining a Nonprofit – State by State Guide," on The Foundation Guide website [501c3.org/state-nonprofit-guide].

Employer ID Number

If you pay anyone in your company or use contracted employees, you'll need to obtain an employer ID number from the IRS. Visit irs.gov/businesses/employer-identification-number for details.

IRS Form 1023 or Form 1023-EZ

Once your state agency has filed your articles of incorporation, you are ready for the real fun of obtaining tax-exempt status from the Internal Revenue Service. You must apply for tax-exempt status by completing and filing with it either IRS Form 1023 or Form 1023-EZ.

Tax exemption is not a given just because you apply for it. The IRS must evaluate your organization carefully to determine whether you qualify. That's why it is incumbent on you to make sure you organize and operate according to the rules.

Form 1023 versus 1023-EZ

The Form 1023-EZ is a streamlined application. However, not all organizations qualify to use it. Its instructions contain a worksheet, consisting of eight pages and thirty questions, which you must complete to determine if your organization is eligible to file under it. LLCs must use Form 1023.

Form 1023 is far more complex and detailed than the 1023 EZ. There are additional schedules, which, again depending on your specific situation, you may have to attach to your application.

What Does the IRS Want to Know?

1. These organizational documents must be attached to the Form 1023/1023-EZ:
 - a. your filed articles of incorporation, including all amendments, if any; and
 - b. your adopted bylaws.
2. The identity of your board of directors-names, addresses, titles and positions, and annual compensation from your charity
3. The assets of the organization
4. The source of revenue
5. A detailed narrative of your activities (see below)
6. The source of funding (see below)

Detailed Narrative of Your Activities

The IRS wants to know what you propose to do with your tax exemption. They want facts, not speculations or dreams. What charitable activities do you propose to engage in? How will your activities benefit the public? Why do you deserve to be free from paying taxes?

Usually one or two paragraphs will do.

Think out your proposed narrative carefully. This also will help you to clarify in your own mind the intentions you have for your operations.

Don't be too specific in drafting your narrative. You want to give yourself some degree of flexibility as you actually turn your intentions into reality.

Source of Funding

Under the tax code, qualifying tax-exempt organizations are automatically presumed to be private foundations, unless they fall into a category specifically excluded from that definition. (Still have trouble sleeping? Try reading IRC sections 509(a)(1), 509(a)(2), 509(a)(3),

and 509(a)(4), which set forth these categories. Or you can read them just for fun-if that's your idea of laughs. If neither of those ideas appeals to you, here's the condensed version: tax-exempt organizations under 501(c)(3) are either private foundations or public charities.) Private

foundations obtain the vast majority of their funding from a limited number of sources—a single individual, a family, a business, or the like. Such wealthy persons as Bill Gates, Mark Zuckerberg, and Warren Buffett have created their own foundations.

Public charities receive most of their support from the general public. The IRS has specific tests to determine whether a 501(c)(3) tax-exempt organization is indeed a public charity. To maintain that status, the public charity must satisfy those tests. For now, just understand that most theater companies will seek their tax exemption as public charities, and they must continue to operate as public charities so the IRS doesn't reclassify them as private foundations.

In other words, you must show the IRS that the majority of your support comes from the general public and not from a handful of individuals connected with your company.

Signature

Either a director, trustee, principal officer, or other authorized person must sign the Form 1023/1023-EZ under penalty of perjury. I will repeat that last part: you must file truthful documents because your signatory may face criminal charges of perjury if they contain falsehoods.

User Fee

All applications for exemption must be accompanied by a user fee. Check the IRS website for the current fee. If your application for exemption is rejected, this fee is not refundable.

Expedited Decision

Although the IRS attempts to issue its decisions regarding tax exemption within a "reasonable" time frame, it may take months or even years to process any given application. If the IRS needs additional information from the organization, the process may be delayed.

If you need expedited service for some reason, you can pay a fee, in addition to the user fee. However, the IRS does not guarantee you will receive faster service even if you pay the fee. Like the user fee, the expedited fee is not refundable if you are turned down for tax-exempt status.

Again, check the IRS website for its current expedited service fee.

Retroactive Exemption

In some instances, you may want to have your exemption apply retroactively to the date when you organized your corporation. In that case, you must file your application not later than twenty-seven months after the end of the month in which you were legally formed. There are certain exceptions for organizations that file later than the twenty-seven-month deadline. Your attorney can best advise you if you meet those exceptions.

Retroactive exemption can greatly benefit your company. Here's how it works.

You organize the Soon to Be Famous Theatre Company Inc. by filing articles of incorporation with your state on January 2, 2025. On August 1, 2025, you present your first show, *When Angels Wept*. The production turns a tidy profit of \$30,000. On December 31, 2025, a leading member of your community, impressed by the cultural benefits you are providing, donates \$5,000 to your company. On March 1, 2026, you file Form 1023 or Form 1023-EZ with the director of the IRS district in which your company is located. The IRS grants tax-exempt status to your organization, which relates back to January 2, 2025. In other words, the IRS has recognized you as a tax-exempt entity as of January 2, 2025.

Your timely filing benefits you in two ways. You do not have to pay taxes on the profit you made from *When Angels Wept*. Your kindly donor can deduct his gift of \$5,000 from his taxes. You took your profits and your donor made his gift after the IRS recognized you as tax exempt. Just remember to observe the twenty-seven-months deadline.

How to File

You must file the Form 1023-EZ electronically at www.IRS.gov/Form1023-EZ. You will pay your user fee at www.pay.gov when you file your application.

Since January 31, 2020, the IRS requires that Form 1023 applications for recognition of exemption be submitted electronically online at Pay.gov. The IRS will provide a 90-day grace period during which it will continue to accept paper versions of Form 1023. To submit Form 1023, you must:

1. Register for an account on Pay.gov.
2. Enter "1023" in the search box and
 1. select Form 1023.
 2. Complete the form.

Untimely Filing

What happens if you don't file on time? Your tax-exempt status begins only on the date you actually filed your application.

DETERMINATION LETTER

Once you have submitted all of the necessary documents, one of several events will happen:

- The IRS will issue a ruling or determination letter recognizing you as an exempt organization.
- The IRS may insist that you make changes in your operations, to conform with the appropriate tax-exempt purposes. In that case, it may not grant your exemption until such later date as it is satisfied you have made the requested changes.
- It may deny your application through an adverse determination. You have thirty days after receiving the adverse determination to request consideration by the appeals office. You can request an in-person conference with the appeals office.

- If you have exhausted all of your administrative remedies within the IRS itself, you may seek judicial remedies. This means you can ask either the US Tax Court or the district court for the District of Columbia to issue a declaratory judgment that your organization is exempt from tax. If the court agrees, the IRS will issue a favorable determination, provided you have filed an application for exemption, and you can show both the facts and the law have not changed since the whole rigmarole began.
- The IRS must issue its determination letter or adverse determination within 270 days after you file Form 1023 or 1023-EZ. If it does not do so, you also have the right to ask the court for a declaratory judgment.

Advance Ruling

If your organization has not yet begun operations, you can ask the IRS to give you an advance ruling on its exempt status before you open your doors. You must describe in full the kinds of activities in which you plan to engage. These must meet the requirements in the category in which you are seeking exemption. You must also detail your sources of expected funds, as well as your anticipated expenses. The IRS still may demand that you first provide a record of actual operations before it will give you a determination letter. This is not the same as an expedited decision. (Did you really think this was going to be easy?)

PUBLIC INSPECTION

Keep in mind that if the IRS approves your request for 501(c)(3) exemption, it will make available for public inspection much of your information, such as:

- Your complete Form 1023 and supporting documents;
- All correspondence between you and the IRS concerning Form 1023, including Form 2848;
- The IRS's letter approving your exemption;
- Annual information returns (Forms 990, 990-EZ, or 990-PF);
- Schedules A and B attached to your Forms 990 or 990-EZ, except for identifying information of your donors;
- Schedule B, included with Form 990-PF, including identifying information about your contributors.

When you apply for true-exempt status, you may request that the IRS withhold certain information you do not wish to be made public. You must mark it separately with the words in capital letters "NOT SUBJECT TO PUBLIC INSPECTION" and explain your reasons. The IRS will make the final decision on whether or not to withhold the information from the public.

SUMMARY

To be recognized as tax exempt by the IRS is a wonderful benefit for most theater companies. It opens up a lot of economic benefits that are not available to commercial theater entities.