



STARTING A NONPROFIT – FAQs

How do we form a nonprofit organization: A checklist

Every nonprofit organization must have a carefully developed structure and operating procedures in order to be effective at fulfilling its purpose. Good governance starts with helping the organization begin on a sound legal and financial footing in compliance with the numerous federal, state, and local requirements affecting nonprofits.

Determine the purpose of the organization. Every organization should have a written statement that expresses its reason for being. Resources: Board members, potential clients and constituents.

Form a board of directors. The initial board will help translate the ideas behind the organization into reality through planning and fundraising. As the organization matures, the nature and composition of its board will also change.

File articles of incorporation. Not all nonprofits are incorporated. For those that do wish to incorporate, the requirements for forming and operating a nonprofit corporation are governed by state law. Resources: Your secretary of state or state attorney general's office.

Draft bylaws. Bylaws — the operating rules for the board — should be drafted and approved by the board early in the organization's development. Resources: An attorney experienced in nonprofit law.

Develop a strategic plan. The strategic planning process helps you express a vision of the organization's potential. Outline the steps necessary to work toward that potential, and determine the staffing needed to implement the plan. Establish program and operational priorities for at least one year. Resources: Board members; planning and management consultant.

Develop a budget and resource development plan. Financial oversight and resource development (e.g., fundraising, earned income, and membership) are critical board responsibilities. The resources needed to carry out the strategic plan must be described in a budget and financial plan. Resources: financial consultant.

Establish a record keeping system for the organization's official records. Corporate documents, board meeting minutes, financial reports, and other official records must be preserved for the life of the organization. Resources: Your secretary of state or state attorney general's office.

Establish an accounting system. Responsible stewardship of the organization's finances requires the establishment of an accounting system that meets both current and anticipated needs. Resources: Certified public accountant experienced in nonprofit accounting.

File for an Internal Revenue Service determination of federal tax exempt status. Nonprofit corporations with charitable, educational, scientific, religious, or cultural purposes have tax-exempt status under section 501(c)(3) – or sometimes section 501(c)(4) – of the Internal Revenue Code. To apply for recognition of tax-exempt status, obtain form 1023 (application) and publication 557 (detailed instructions) from the local Internal Revenue Service office or from the IRS Web site www.irs.gov. The application is an important legal document, so it is advisable to seek the assistance of an experienced attorney when preparing it. Resources: Your local IRS office, an attorney.

File for state and local tax exemptions. In accordance with state, county, and municipal law, apply for exemption from income, sales, and property taxes. Resources: State, county, or municipal department of revenue.

Meet the requirements of state, county, and municipal charitable solicitation laws. Many states and local jurisdictions regulate organizations that solicit funds within that state, county, or city. Usually compliance involves obtaining a permit or license and then filing an annual report and financial statement. Resources: state attorney general's office, state department of commerce, state or local department of revenue, or county or municipal clerk's office.

Other steps:

- Obtain an employer identification number (EIN) from the IRS
- Register with the state unemployment insurance bureau
- Apply for a nonprofit mailing permit from the US Postal Service
- Obtain directors' and officers' liability insurance

What is an Employer Identification Number?

All nonprofit corporations and exempt organizations, with or without employees, must have a nine-digit Employer Identification Number (EIN). This number could be considered the Social Security number for your organization. It is the reference number that you must use whenever communicating with the federal government. Form SS-4 is the form used to apply for an EIN.

What is an IRS determination letter?

A determination letter is the most important legal document your organization possesses. The IRS sends you this letter after you have successfully applied for the recognition of your organization's tax-exempt status. In this document the IRS indicates under which section of the Internal Revenue Code your organization is qualified.

For instance, if you file Form 1023, you expect to be recognized as a 501(c)(3) tax-exempt organization. In order to avoid revocation of your status, your organization must continue operating according to the manner you described in your application.

The determination letter is the only official document and proof that your organization is recognized as a tax-exempt organization. Keep it in a safe place.

Do all nonprofits have to apply for recognition of tax exemption?

No. Three groups are automatically exempt from filing an application: churches, organizations with gross receipts of less than \$5,000, and affiliates of existing nonprofits covered by group exemption. All other nonprofits must file if they want to be formally recognized by the IRS as tax-exempt organizations.

The IRS automatically recognizes several types of groups as public charities. These include (besides the special category of churches) certain educational institutions, hospitals and medical research organizations, public safety organizations, certain government organizations, and "supporting" organizations. Any other organization, if able to show that it is publicly supported, is granted a 501(c)(3) status. Public support means that the organization is successful in raising funds from numerous sources, has a diverse board, or provides services that appeal and are accessible to the general public. As the definitions of some of these terms are not necessarily self-explanatory, it is always wise to

officially obtain a determination letter from the IRS as soon as possible. It is the only way you can prove your status.

Can a nonprofit's tax-exempt status be recognized retroactively?

A nonprofit must file its Form 1023 within 27 months after its incorporation. The original regulations specify an initial 15-month waiting period, but the IRS automatically extends this by another 12 months. If the nonprofit makes the deadline and receives a determination letter, the IRS recognizes the organization as a tax-exempt entity from its inception — the date when it registered its organizing documents with the state. If it misses the deadline, the organization will be recognized as a tax-exempt entity from the day the application was mailed.

Can we raise money before receiving our determination letter?

If you are expecting your organization to be recognized as a 501(c)(3) public charity, it will ultimately be able to receive tax-deductible donations. Before your determination letter arrives from the IRS, it makes sense to get ready for fundraising. Draft your documents and brochures. Research potential donors and foundations. Create your fundraising plan.

If you do any active fundraising before your status is cleared, it is necessary to let the potential donors know that your application for the tax-exempt status is pending and contributions are not tax-deductible before your determination letter has arrived. Most foundations won't be interested in considering your application until you can attach that very important document to the rest of your profile.

However, if you filed with the IRS on a timely basis, the favorable determination on the part of the IRS is retroactive to the date of formation of the entity. Therefore, upon receipt of a favorable determination from the IRS all of those donations received in advance of the favorable determination will be tax deductible.

What should be included in your articles of incorporation?

Your articles of incorporation are a binding legal document. The content requirements vary from state to state and, as a general rule, you should include only what the law requires. Your bylaws, which are more easily amended, will handle

more detailed policies to govern your organization. Normally, you would include the following items in your document:

- Name of the corporation
- The organization's specific purpose (be brief and broad to allow for future evolution, but clearly indicate its tax-exempt focus)
- Duration of the corporation's existence (often perpetuity)
- Location of the organization's office
- Number, names, and addresses of the initial board of directors
- Whether or not this is a membership organization
- Provisions for distribution of assets when the corporation is dissolved

What is a Unified Registration Statement (URS)?

Any nonprofit involved in far-reaching fundraising campaigns knows the pain and agony of having to register in every state where it engages in raising funds. Each state seems to have different regulations, different forms, and different fees. This process can turn into a bureaucratic nightmare.

The National Association of State Charity Officials and the National Association of Attorneys General have created a standard form of registration, which presently is accepted by the District of Columbia and 36 states requiring charities to register. This form can simplify the process considerably. You can download the form and instructions, as well as the list of participating states.

What control does a nonprofit founder have over the organization?

Getting a nonprofit organization up and running is no small feat. Nonprofit founders invest a great deal of time, effort, and often personal funds, to get their organizations established. Rightfully so, they possess a certain pride of ownership and sense of personal accomplishment. Their creativity and commitment deserves real respect.

Naturally, nonprofit founders feel closely attached to organizations they start. But they do not “own” the organization the same way founders of a small business have personal equity in their companies. In fact, no one “owns” a nonprofit organization. Rather, boards of directors – not the founder alone – are responsible and accountable for the health and future of the organization. Nonprofit

founders need to recognize that, ultimately, the buck stops with the board. It is in everyone's best interest if the founder and the board find a productive way to work together for the good of the organization.

Founders serve their causes best when they build a solid organizational structure. They may serve as a member of the board and/or as chief executive. As a part of the board, a founder can voice opinions during meetings and when voting, like all board members. As the chief executive, he or she manages the operations, reports to the board and, like all nonprofit chief executives, should be evaluated by the board on his or her performance.

Because of their passionate commitment and personal sacrifices, founders exert considerable influence that extends well beyond managing the organization. Many founders have difficulty imagining someone else leading the organization, and it is natural for them to fear losing control as time passes and others get involved. Some founders seek to establish a permanent position for themselves by amending the bylaws. However, “founder” does not fit into an organizational chart and does not have easily defined roles and responsibilities within an organization.

The greatest legacy nonprofit founders can leave — to themselves and the causes they champion — is to create an organization that is able to continue past the tenure of any individual and well into the future.

Why do we need a mission statement?

Every organization needs to define its fundamental purpose, philosophy, and values. The mission statement answers the basic question of why the organization exists, and describes the needs the organization was created to fill. Without the guidance of a mission statement, programmatic priorities are difficult to establish.

The mission statement provides the basis for judging the success of an organization and its programs. It helps to verify if the organization is on the right track and making the right decisions. It provides direction when the organization must adapt to new demands. Attention to mission helps the board adhere to its primary purpose and serves as a touchstone for decision making during times of conflict. The mission statement can also be used as a tool for resource allocation. A powerful mission statement

attracts donors, volunteers, and community involvement.

When to revise a mission statement

- Is it short (17 or fewer words) and sharply focused? Would it fit on a T-shirt?
- Do board members and staff know the mission statement? Is it clear and easily understood?
- Does it define why you do what you do?
- Does it provide direction for doing the right things?
- Does it inspire your passion and commitment?
- Does it say, in the end, what you want to be remembered for?
- Have you revisited your mission statement in the last three years?

Do you need to revise your mission statement?

Pose the following questions to determine if it is time to revise your statement:

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- Do board members and staff know the mission statement? Is it clear and easily understood?
- Does it define why you do what you do?
- Does it provide direction for doing the right things?
- Does it inspire your passion and commitment?
- Does it say, in the end, what you want to be remembered for?
- Have you revisited your mission statement in the last three years?

What is a vision statement?

Through a vision statement, a nonprofit defines its ultimate motivation, its dreams, and its image of a desired future.

A vision statement describes the ideal situation if the organization could fulfill its utmost wish.

What are some examples of vision statements?

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A vision statement describes the ideal situation if the organization could fulfill its utmost wish.

Examples of vision statements:

“No child in our city will go hungry to bed in the evening.”
(Soup kitchen)

“In two decades our services will no longer be needed.”
(Illiteracy program)

“We will be recognized as the best symphony orchestra in America.”

(Symphony orchestra)

How can our for-profit company become a nonprofit?

If you already have a for-profit company and you want to become a nonprofit organization, you need to go through the same process as in forming a new nonprofit. This means the following must be done:

- Study the state laws and the IRS regulations that cover nonprofit and tax-exempt organizations. Learn what the main differences are between a for-profit company and a nonprofit organization. Make sure you can accept these expectations and structure and operate your organization accordingly.
- Apply for the recognition of your tax-exempt status with the IRS by filing Form 1023 or 1024.
- Rewrite your Articles of Incorporation and file them with the office of your secretary of state. The office of the Secretary of State is a good source for technical assistance.
- Rely on legal counsel when transferring the assets of your present company to the new nonprofit organization — unless as the owner you keep the profits and start the nonprofit as a totally separate and new entity.
- Form a board that will be the responsible and liable entity for the organization.

Does my state have an organization that provides services for nonprofits?

The National Council of Nonprofits, the nation’s largest nonprofit network, works through its member State Associations to amplify the voices of America’s local community-based nonprofit organizations, help them engage in critical policy issues affecting the sector, manage and lead more effectively, collaborate and exchange solutions, and achieve greater impact in their communities.

Resources

IRS

www.irs.gov/businesses/small/article/0,,id=98350,00.html
www.irs.gov/charities/content/0,,id=96986,00.html

IRS Publication 557 <http://www.irs.gov/pub/irs-pdf/p557.pdf>

The Nonprofit Board’s Role in Mission, Planning, and Evaluation
Available at www.boardsource.org or by calling 202-349-2516

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