

KLAMP & ASSOCIATES P.C.



We are Lawyers Serving the Charitable Community

TEN-STEP GUIDE TO CREATING A NONPROFIT ORGANIZATION

2013

ESTABLISHING A NONPROFIT ORGANIZATION is a unique way to impact your community and world. The corporate structure enables you to raise funds without incurring taxes, collect tax-deductible donations, and conduct charitable activities while minimizing your personal liability risk.

While many people have great ideas for charitable work, the laws and regulations that govern nonprofits can seem convoluted and bewildering – a mix of federal and state law, statutes and agency rules. Klump & Associates has created this simple, ten-step manual to help guide you through the process. This manual is designed to be used *before* the organization begins its charitable activities. Further steps may be advisable depending on the scope and nature of your activities – for example, registering to solicit charitable donations in the states where you fundraise, obtaining insurance, and/or submitting annual tax returns.

Please note that this manual is for general educational purposes only and should *not* be construed as legal advice. The steps described below may not apply to your organization. Consult with an attorney to obtain formal legal advice on how to create and develop a nonprofit.

KLAMP & ASSOCIATES, P.C. is a law firm based in Washington, DC and dedicated to representing charitable organizations. Our mission is to provide quality legal services to organizations of all sizes that are working to serve the public interest. We believe that the needs of our clients are best met by addressing potential legal problems before they arise. We provide effective, reliable, and innovative legal work for our clients with the goal of enhancing and expanding the services they provide. Our clients include international development NGOs, civil rights groups, environmental and religious organizations, scientific research institutions, private foundations, professional associations, and a broad range of other nonprofits and social enterprises.

STEP 1 Formulate a Mission

The first step in creating a nonprofit is to determine its purposes and activities. What do you hope the organization will accomplish? How will it pursue its goal(s)? Will the organization provide services, goods, funding, or a combination of these?

As you formulate your mission, keep in mind that you will eventually need to seek federal tax exemption from the Internal Revenue Service (IRS). It's best to ensure from the outset that the mission and activities you plan to pursue will qualify the organization for tax-exempt status.

The Internal Revenue Code sets forth 27 categories of tax-exempt organizations. In order to obtain tax-exempt status, you will need to convince the IRS that your nonprofit falls into one of them. The broader categories are described below:

- *501(c)(3)*. Organizations that are organized and operated for exclusively charitable, religious, educational, scientific, or literary purposes. This category also includes organizations that do testing for public safety, foster amateur sports, or prevent cruelty to children or animals.

- *501(c)(4)*. Social welfare organizations, which promote the common good and general welfare of a community, civic leagues, and local employee associations.
- *501(c)(6)*. Business leagues, which promote the common business interests of their members, chambers of commerce, boards of trade, professional associations, and similar groups.
- *501(c)(7)*. Social clubs organized for pleasure, recreation, and other non-revenue generating purposes.

Because the IRS has developed detailed criteria and rules for each category, it is important to carefully consider whether your mission and activities will qualify for tax exemption, as well as any restrictions that the IRS may impose on your activities.

STEP 2 Select and Reserve a Name

Select a name that reflects your organization's mission. If possible, avoid using words and phrases that are usually associated with for-profit businesses or other taxable organizations

(for example, “political action group”), as this may prompt extra scrutiny from the IRS.

Make sure that the name you choose (1) is not already trademarked or in wide use by another organization, and (2) complies with all laws of the state where you intend to incorporate (for example, a state may require the name to end with “Inc.”).

After selecting a name, you have the option of registering a trademark at www.uspto.gov.

STEP 3 Select an Initial Board of Directors

The board of directors is legally and financially responsible for the conduct of the organization, so a nonprofit founder should select responsible individuals who share his or her vision and sense of mission. The board members should possess a certain amount of business or organizational competency. They should also understand the importance of good governance and be willing to work in a team environment. It is also advisable to select individuals who will be able to devote time, knowledge, and energy to the new organization.

State laws often set a minimum number of directors.

STEP 4 Incorporate

Incorporation gives the nonprofit a legal existence and protects the individual directors from liability for the organization’s acts. You can choose to incorporate your organization in *any state* – regardless of where its office(s) or operations will be located.

Incorporation is accomplished by filing *articles of incorporation* with the appropriate state agency and (usually) paying a filing fee.

Articles of incorporation set forth the basic purposes, governance, and other key provisions of the organization. A nonprofit’s articles of incorporation should include the following:

- The name of the corporation.
- The corporation’s tax-exempt purpose(s).
- A statement that the corporation will not be operated for profit and that no profits will inure to any private person or entity.
- A statement that, if the nonprofit is dissolved, its assets will be used for exempt purposes.
- The names and addresses of the initial board of directors.
- The name and address of a registered agent with an address in the state. A registered agent is a person or corporation that receives official correspondence and ensures that it gets to the organization.

- Whether the organization will have any members. In this context, “members” usually refers to people or entities empowered to choose the board of directors.

States may require additional information in the articles of incorporation. *Remember that nonprofit status does NOT automatically make the organization tax-exempt.*

Keep In Mind...

You can amend your articles of incorporation and bylaws in the future if your mission evolves or if you decide that a different governance structure would be better for your organization. Amendments usually require at least a majority vote of the board and (if applicable) membership.

STEP 5 Draft Bylaws

Bylaws set forth how the organization will function, including its membership structure, decision-making mechanisms, board composition, officer roles and authorities, and a variety of other issues. The bylaws need to be appropriate for your organization and comply with state law.

Keep In Mind...

A nonprofit is governed by the laws of the state where it is *incorporated*, even if it does not have any offices or operations in that state. An organization that incorporated in New York but operates entirely in Pennsylvania must adopt bylaws that comply with the requirements of New York’s corporate laws, not those of Pennsylvania.

STEP 6 Draft a Conflict of Interest Policy

A conflict of interest policy is not strictly required, but is strongly recommended as a good corporate practice and is helpful for obtaining tax-exempt status. Following a conflict of interest policy ensures that the nonprofit does not enter into transactions that will jeopardize its mission and tax-exempt status. The IRS provides a model conflict of interest policy that is available at www.cof.org/files/.../Conflicts_of_Interest_IRS_Sample_Policy.pdf.

STEP 7 Convene a Board Meeting

The board of directors should hold its first meeting to take the following actions:

- Elect officers. State law usually requires an organization to have certain officers (president, treasurer, etc.), and may restrict the number of offices that a single person can hold at one time.
- Formally adopt the bylaws.
- Formally adopt the conflict of interest policy.
- Authorize an officer to apply for tax-exempt status.
- Authorize any other steps, such as opening a bank account, hiring a chief executive officer, or entering into a contract.

The meeting should be convened and conducted in accordance with the bylaws. Someone should take minutes of the meeting, recording each participant, motion, vote, and decision. The minutes should be reviewed and approved by the board at the next meeting.

If you can't convene a quorum for logistical reasons, most states permit the board to adopt resolutions by unanimous written consent.

STEP 8 Obtain an EIN

An Employer Identification Number (EIN) is used by the IRS to track an organization's tax returns and other paperwork. *Even if you do not expect to have employees*, you must obtain an EIN in order to apply for tax-exempt status.

You can apply for an EIN online at the following website:

[http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Apply-for-an-Employer-Identification-Number-\(EIN\)-Online](http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Apply-for-an-Employer-Identification-Number-(EIN)-Online). This process only takes a few moments once you collect the necessary information.

STEP 9 Apply for Federal Tax Exemption

In order to avoid income taxes and receive tax-deductible contributions, a nonprofit must apply for and receive tax exemption from the IRS.

An organization eligible for exemption as a 501(c)(3) nonprofit should submit the "Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code" (IRS Form 1023, available at www.irs.gov/pub/irs-pdf/f1023.pdf). An

organization eligible for exemption under another 501(c) sub-section (see Step 1) should submit the “Application for Recognition of Exemption Under Section 501(a)” (IRS Form 1024, available at www.irs.gov/pub/irs-pdf/f1024.pdf). If the application is submitted within 27 months of the nonprofit’s incorporation, the tax exemption will be retroactively effective to the date of incorporation.

The application covers topics such as governance, activities, finances or financial projections, and any related organizations. You should include any activities that you expect the organization to engage in. If you add activities or change operations later on, you will report those changes on your annual tax return.

In preparing the application for tax exemption, remember that it is a public document. By law, you must comply with any person’s request to examine the application.

It is advisable to carefully review your application before submitting it, as errors may cause significant delay or denial of the tax exemption.

This is a step that many nonprofits overlook. Although most states and municipalities grant tax-exempt status to any organization that has obtained exemption from the federal government, this status is *not automatic*. You may need to submit an application demonstrating that it has received federal tax exemption.

You should make sure of your tax-exempt status in any state where the nonprofit (1) owns property, (2) earns income, or (3) engages in any other transactions that would normally be taxable.

Keep In Mind...

Tax exemption only applies to certain income and property taxes. Nonprofits with tax-exempt status are still responsible for all other taxes (for example, payroll and sales taxes). Consult with your attorney or tax advisor to determine whether your activities are taxable.

STEP 10 Apply for State and Local Tax Exemption