

Top Reasons to Form a Nonprofit Entity



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So you've decided to volunteer with a philanthropic group and find out it's "flying under the radar." Now what?



Nonprofit Entity Formation, Step #1

What are the options for formation?

- Unincorporated Association
- Nonprofit Corporation
- Religious Society
- LLC
- Trust



Nonprofit Entity Formation, Step #1

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- **Unincorporated Association**
- Nonprofit Corporation
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Nonprofit Entity Formation, Step #1

Unincorporated Association:

- What is it?
 - “Unincorporated association” means an unincorporated group of two (2) or more persons joined by mutual consent for a common lawful purpose, whether organized for profit or not. <http://www.nolo.com/legal-encyclopedia/what-an-unincorporated-nonprofit-association.html>
 - Many so-called nonprofits are simply groups of people who come together to perform some social good. These informal groups are called unincorporated nonprofit associations. When a group of people get together and decide to perform some community benefit without filing any legal paperwork or establishing any formal legal structure, whether they know it or not, they have formed an unincorporated nonprofit association.
- The biggest drawback to the unincorporated nonprofit association, and the reason nonprofits often abandon this form in favor of a nonprofit corporation, is that the unincorporated nonprofit association has no separate legal existence apart from its individual members.



Nonprofit Entity Formation, Step #1

Unincorporated Association:

- Pros:
 - EASY! Just assemble
- Cons:
 - Personal liability for participants (not a separate legal entity)
 - Unless your state law contains an “enabling statute” granting rights, an unincorporated association cannot hold or receive property, or sign contracts, in its own name.
 - Solicitation and gift acceptance is problematic – there’s no “thing” you’re soliciting on behalf of!
 - Bank account? EIN “for banking purposes only”



Nonprofit Entity Formation, Step #1

What are the options for formation?

- Unincorporated Association
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Nonprofit Entity Formation, Step #1

Nonprofit Corporation:

- What is it? An entity incorporated under state laws and approved by both the state's Secretary of State and its taxing authority as operating for educational, charitable, social, religious, civic or humanitarian purposes. <http://legal-dictionary.thefreedictionary.com/nonprofit+corporation>
- The nonprofit corporation is the most typical legal entity used to form a foundation/charitable organization.



Nonprofit Entity Formation, Step #1

Nonprofit Corporation:

- Pros:
 - Personal liability for participants only in limited circumstances (separate legal entity)
 - Entity has its own EIN, or Tax ID # (i.e., XX-XXXXXXX)
 - Entity can own property (and might be eligible for exemption from property tax)
 - Entity can sign contracts through its agents
 - Entity can solicit and accept gifts
- Cons:
 - Articles of Incorporation and Bylaws must be drafted properly with state and federal requirements included.
 - Structure – Regular meetings of the governing body are necessary and required; need “Directors” and “Officers”



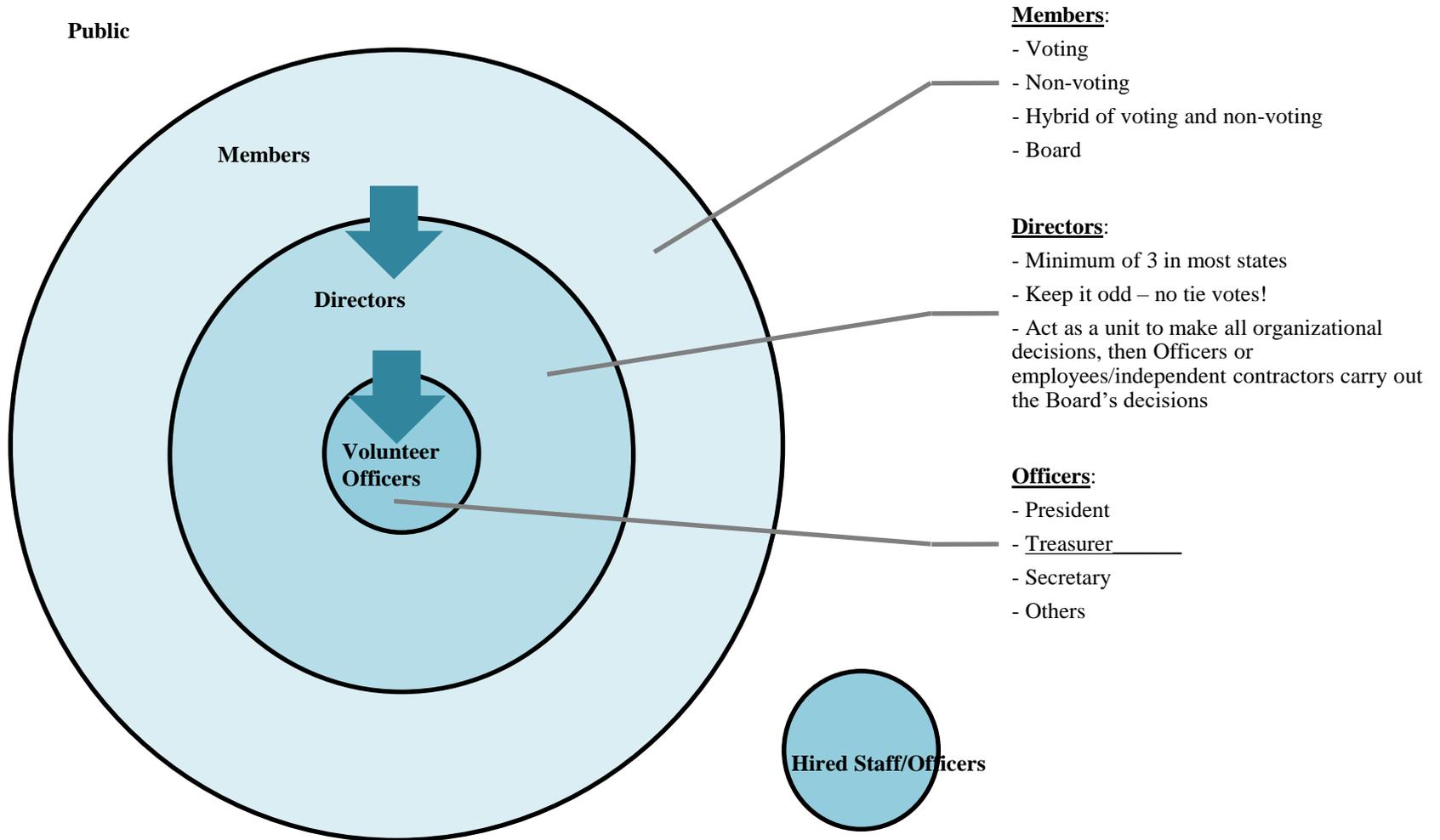
A Tactical Look at the Nonprofit

Every nonprofit corporation is composed of the following parts:

- 1.) Public
- 2.) Members
- 3.) Directors
- 4.) Officers

Let's learn about each component, and the powers, responsibilities, duties, and roles incumbent upon those components!

Diagram of a Nonprofit Corporation





The Public

Outside the circles, waiting to engage with the organization, is the public. The goal of the nonprofit is to make the public aware that it exists, educate the public about its mission and goals, and attract the public to participate as a donor, member, director, officer, and/or volunteer.



The “Members” Ring

Remember that in nonprofit corporations there is no ownership by individual people or shareholders. Instead, the community (a group of "charitable beneficiaries") owns the nonprofit. Nonprofits do not have any ownership rights, or shares / capital stock. Members are one form of “charitable beneficiary,” or stakeholder, in nonprofitland. A stakeholder is someone who is affected by the organization’s actions, objectives, and policies. So, for example: parishioners in a church, parents in a youth athletic organization, supporters of a museum, or a partner of the public radio.

Nonprofit corporations will have one of three basic types of membership as a part of its structure:

- 1.) Voting members
- 2.) Non-voting members, or
- 3.) Directors as the members



Voting Membership

- The first type of membership is voting membership. Voting membership is when, in exchange for the person's time, efforts, and/or dues/fees, the individual gets a right to vote.
- This voting right is limited to matters brought forward at the organization's annual meeting and any regular/special voting members' meetings.
- Typically, the matters voted upon by voting members include electing the Board of Directors (and sometimes the officers), approving changes to the organization's governing documents, and approving whether the organization merges/dissolves/consolidates/dissipates a majority of its assets. The voting members do not participate on governance matters or vote at Board of Director's meetings.
- To check the legal requirements for membership in your state, see: <https://www.harborcompliance.com/information/nonprofit-governance-by-state>
- All 501(c)(6)s, all 501(c)(7)s, some 501(c)(4)s, and some 501(c)(3)s (including many churches and some youth athletic organizations) will use the voting membership model.



Voting Membership

- “Pros” of voting membership: 1.) under this model, like the U.S. Congress, there becomes two (2) “chambers” where organizational business occurs – limited organizational business occurs under the care and control of the voting membership, and a majority of organizational business occurs under the care and control of the Board of Directors – the voting membership, in essence, affords a limited but powerful check and balance to the Board of Directors; and 2.) in organizations with clearly defined stakeholders, voting membership provides these stakeholders with a constructive way to express their opinions.
- “Cons” of voting membership: 1.) under this two (2) “chamber” model, like the U.S. Congress, organizational business can grow even slower (if not become deadlocked), and that can present difficulties on short timelines; 2.) sometimes confusion arises amongst the voting members with regard to their role, and they believe they have more rights than they really do (i.e., they believe they get to vote at Board of Director meetings when they do not; they believe they get to dictate day-to-day organizational business or discipline staff, when they do not; etc.); and 3.) sometimes there is apathy amongst the voting membership and it is difficult to get enough voting members to attend member meetings to meet the quorum requirement.



Non-Voting Membership

- The second type of membership is non-voting membership. Non-voting membership is when, in exchange for the person's time, efforts, and/or dues/fees, the individual does not get voting rights, but instead gets "other benefits." Think of your annual membership to the zoo or a museum, or to National Public Radio (NPR) – when you join, you join knowing you will not get to vote to elect the organization's Board of Directors or approve any organizational documents. Instead, you join because you know you will get free/discounted entry into the zoo or the museum during the membership year, and you may also get a discount in the gift shop. When you join NPR, you ordinarily get a key fob that is good for discounts at local retailers.
- Some 501(c)(4)s and some 501(c)(3)s will use the non-voting membership model.



Non-Voting Membership

- “Pros” of non-voting membership: 1.) under this model, there is only one (1) chamber where voting occurs instead of two (2), which allows more organizational control to stay with the Board of Directors in order to minimize “external forces” on the operation of the business (i.e., election disputes and “takeovers,” electioneering and campaigning, gridlock when amending organizational documents); however, the organization is still providing its clearly defined stakeholders with a constructive way to engage with the organization; and 2.) no separate voting membership meetings are necessary, which reduces expense, quorum headaches, and delay.
- “Cons” of non-voting membership: 1.) if your organization does not have any “other benefits” to offer, this model will not work; and 2.) sometimes confusion arises amongst the non-voting members with regard to their role, and they believe they have more rights than they really do (i.e., they believe they should get a right to vote when they are not entitled to do so; they believe they should get a voice in who is elected to the Board of Directors (or as volunteer officers) when that is not their right; etc.).



Hybrid Membership

- While it's really not its own type of membership, organizations can also choose to have multiple classes of members, with some voting members and some non-voting members, and have a structure that's called a hybrid membership. In this scenario, the qualifications for membership will be drafted to make some members voting and others non-voting.
- Some 501(c)(4)s and some 501(c)(3)s will use the hybrid membership model.



Board of Directors are the Members

- The third type of membership is when the organization's directors also serve as the organization's members. Under this model, there is only one (1) chamber where voting occurs instead of two (2), and the board of the organization will vote on all business decisions and elect itself (ordinarily through a nomination committee, and either individual director by director, or all at once as a full slate).
- This membership model is common when an organization does not have any clearly defined stakeholders, has no "other benefits" to offer, or for various other reasons wants to keep more organizational control with the Board of Directors. One reason could be to minimize "external forces" on the operation of the business (i.e., election disputes and "takeovers," electioneering and campaigning, gridlock when amending organizational documents). Another reason could be a situation where the founders want to keep the Board of Directors more closely controlled.



Board of Directors are the Members

- “Pros” of board as members: 1.) under this model, there is only one (1) chamber where voting occurs instead of two (2), which allows the organizational control to stay with the Board of Directors; and 2.) no separate voting membership meetings are necessary, which reduces expense, quorum headaches, and delay.
- “Cons” of board as members: 1.) if the organization’s Board of Directors is not very inclusive, or operates in a “closed” manner, it can cause participants to grow suspicious, become disenfranchised, and discontinue volunteering or otherwise contributing; 2.) if the organization does not have a good method of encouraging new people to participate and be nominated to the Board of Directors (i.e., term limits, officer rotations, etc.), the entity may run the risk of having the same directors elected time after time and not infuse new ideas or fresh perspectives; and 3.) sometimes confusion arises amongst the participants with regard to their role, and they believe they have more rights than they really do (i.e., they believe they should get a right to vote when they are not entitled to do so; they believe they should get a voice in who is elected to the Board of Directors (or as volunteer officers) when that is not their right; etc.).



The “Directors” Ring

- Remember a nonprofit corporation looks like a bullseye, or concentric circles, when drawn on paper. The first ring of the circle depicts the nonprofit’s members. The second ring of the circle represents the nonprofit’s directors, or the Board of Directors. And, one should be a member in order to be a director.
- Every nonprofit corporation has a Board of Directors, regardless of membership type. Remember that nonprofit corporations generally are not allowed to have a single leader. In many states, the minimum number of Directors is three (3).
- In fact, best practice is that the Board of Directors be larger than three (3) – perhaps five (5) to eleven (11) – always keeping the board at an odd number to avoid tie votes.



Function of the Board

The critical function of a nonprofit Board of Directors is to **govern the organization's efforts in carrying out its mission, and supervising the corporation's overall business and affairs.**

It is ordinarily **not the function of the Board Members to manage the day-to-day activities of the organization** or to act in the role of an Executive Director. Rather, Board of Directors should appoint Officers, hire staff, and/or secure volunteers, as well as assign responsibilities to these individuals, so that the Officers, staff, and volunteers can effectively carry out the daily tasks of running the nonprofit.



Function of the Board

The Board of Directors should be fulfilling the following functions:

- Hold Annual and Regular Board Meetings
- Elect/appoint Officers (assuming this function lies with the Board and not a voting membership)
- Elect Board Members (assuming this function lies with the Board and not a voting membership)
- Approve Prior Actions of Officers (if necessary and proper)
- Approve Prior Actions of Board Members (if necessary and proper)
- Revise/maintain/implement the Articles of Incorporation and Bylaws, as well as all other policies and procedures
- Approve Proactive Compliance Measures and Necessary Reviews
- Approve Actions by Authorized Agents (Accountant, Attorney, Other Advisors, etc.)
- Approve Financial Statements, including: Budget, P&L, Balance Sheet, & Others
- Approve Major Agreements (Contracts, Purchase/Lease Agreements, Loans, etc.)
- Approve Major Purchases (Equipment, Building(s), Vehicles, Technology, Furniture, etc.)
- Approve General Business Actions (Audits, Tax Forms and other Governmental Filings, Insurance, Investments, etc.)
- Approve Employee Matters (Additions, Terminations, Benefits Changes, Handbooks, Classifications, etc.)
- Approve Compensation Paid (Employee Wages/Salaries, etc.)
- Hire/fire employees and Contractors (unless this function lies with the Executive Director)
- Assure the organization is financially viable and sustainable



Beware: Personal Liability from Express Contractual Liability

The Board of Directors acting as a whole, not any of the individual directors or officers, is the decision-maker and authorizer when it comes to business transactions, contracts, and agreements.

If the Board does not vote to authorize a particular business transaction, contract, or agreement, the organization has not approved the action.

If a director or officer acts without Board approval, he/she may become **personally liable** for that action.



Preserving Limited Liability

Nonprofit corporations generally provide limited liability for their Directors, Officers, Trustees, Members, employees, volunteers, etc.:

- Beware: In many states, as well as under the federal Volunteer Protection Act of 1997, limited liability protection is conditioned upon NOT receiving compensation in exchange for executing one's official organizational responsibilities. So, in many states and under the federal statute, in order to retain one's limited liability protection as a director or officer, you must serve as a volunteer. Be aware that compensation is not limited to the exchange of paper money for services, but also includes gift cards, free tuition, and/or other tangible benefits that would otherwise be purchased by the director/officer.
- NOTE: Some states have *de minimis* \$ value exceptions, and others mandate \$0 in value.
- Traps where limited liability may be lost:
 - willful/wanton conduct (actions/omissions must be in good faith)
 - compensation (and/or improper financial benefit)
 - breaching his/her fiduciary duties
 - being sued under federal law and federal Volunteer Protection Act does not apply
 - being sued based on the person's express contractual obligation (i.e., he/she signs a contract without Board of Directors' approval)
 - being sued for activities outside his/her official activities as a director or officer (acting outside the scope)
 - being sued under criminal statutes (not a civil case)



Fiduciary Duties

Being a Director and/or Officer is more than an honor – Directors, Trustees, and Officers have fiduciary obligations to ensure that the mission of the organization is honored and that resources of the nonprofit are used wisely in support of that purpose. There are at least 3 Fiduciary Duties:

- Duty of Care
- Duty of Loyalty
- Duty of Obedience

Failure to follow through on one's legal duties can have devastating consequences for a charitable organization. There may also be civil or criminal penalties levied against Directors/Officers who shirk their responsibilities, particularly in situations in which they have benefitted from their action or inaction.



Fiduciary Duties

Duty of Care:

- Nonprofit directors must discharge their duties in good faith, in a manner the Board Member reasonably believes to be in the best interests of the organization, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances.
- This means nonprofit directors have a responsibility to be active in the nonprofit corporation's affairs:
 1. by preparing for and attending board meetings;
 2. by asking questions, making informed decisions, and exercising independent judgment;
 3. ensuring the organization's purposes are fulfilled efficiently and the entity is following sound business practices; and
 4. ensuring internal controls are implemented and followed.



Fiduciary Duties

Duty of Loyalty:

- Board Members have an absolute duty of complete, undivided loyalty to the organization.
- Nonprofit directors must put the interest of the nonprofit corporation and its objectives over his/her personal interests and those of his/her family or friends.
- This means:
 1. establishing and following a written conflicts of interest policy;
 2. abstaining from all board votes where he/she has a conflict of interest;
 3. not personally attempting to usurp opportunities that would be advantageous for the organization to engage in; and
 4. not voting to engage in any transaction that would damage the organization.



Beware: Personal Liability from Self-Dealing

Federal Excise Tax Issues (“Intermediate Sanctions”):

- Self-dealing between **private foundations** and insiders prohibited, with limited exceptions.
 - Definition of “insiders” is extremely broad.
 - 10% tax imposed on self-dealer; increases to 200%
 - 5% tax imposed on managers who act knowingly; increases to 50% with \$20,000 limitation
- Self-dealing between **public charities** and insiders permitted, if transactions are conducted for FMV or better.
 - Definition of “insiders” is narrow (i.e., directors, officers).
 - Safe-harbor under section 4958 requires disinterested directors to make decision using solid evidence of comparability and contemporaneously documenting the decision.



Fiduciary Duties

Duty of Obedience:

- Board Members must understand and follow the charity's governing documents (Articles of Incorporation, Bylaws, Constitution, Codes of Conduct, Codes of Ethics, Policies & Procedures, etc.)
- Board Members must be familiar with state and federal laws related to nonprofit entities, fundraising, and tax-related issues as well as legal issues connected with the organization's charitable purpose and operations.
- The nonprofit corporation must comply with state and federal registration and reporting requirements, including annual filings with the Attorney General's Office, the Secretary of State, the IRS, and other governmental entities.
- Board Members must ensure that charity funds are used for lawful purposes. This includes the organization's mission, a reasonable amount of administrative expenses, and not the private inurement of directors/officers.



The “Volunteer Officers” Ring – Volunteer Board Officers

- Remember a nonprofit corporation looks like a bullseye, or concentric circles, when drawn on paper. The first ring of the circle depicts the nonprofit’s members. The second ring of the circle represents the nonprofit’s directors, or the Board of Directors. The third, most inner, ring of the circle, illustrates the nonprofit’s volunteer officers. One should be a member in order to be a director, and one should be a director in order to be a volunteer officer.
- Every nonprofit corporation has a Board of Directors, regardless of membership type. And, every board must have officers. The officers implement the tasks delegated to them by the Board of Directors, or as required of them in the Bylaws.
- At a minimum, it is prudent for every nonprofit corporation to have a President (or Board Chair), a Treasurer, and a Secretary; however, additional officers may be required by your state. Other officers to consider including in your organization are: Vice President (or Vice Board Chair), Volunteer Coordinator, Development/Fundraising Coordinator, Communications Coordinator, and/or IT/Technology Coordinator. Remember, these officers must act only under the authority of the Board of Directors.
- To check the legal requirements for officers in your state, see:
<https://www.harborcompliance.com/information/nonprofit-governance-by-state>



The “Hired Officers” Ring – Employees

- Some larger nonprofit corporations have paid officers (i.e., Executive Director, President/CEO, CFO, COO, CIO, etc.). It is important to understand that these paid officer positions function slightly differently than volunteer officers.
- Paid officers are highly compensated employees, hired and fired by the Board of Directors, and are directly accountable to the Board of Directors for their performance.
- On the circle diagram, you will see hired officers as a separate bubble outside the bullseye. This is because most hired officers do not serve within the internal governance structure (member, director, volunteer officer) but rather perform the day-to-day operations on an employee-employer relationship basis.
- Paid officers do not have limited liability protection under statutes requiring that no compensation be paid. Instead, paid officers generally carry additional liability insurance to account for the lack of statutory limited liability protections.



Nonprofit Entity Formation, Step #1

Nonprofit Corporation: HOW?? INCORPORATION

- A nonprofit corporation is formed by its incorporator(s). An incorporator is a person who is in charge of setting up a corporation.
- An incorporator can be an attorney; however, it is not mandatory. The person designated as the incorporator is listed on the Articles of Incorporation and s/he will be contacted by the state, if needed.
- The incorporator files the Articles of Incorporation with the state in which the corporation is registering, and files any other corporate documents needed until the corporation is formally registered and recognized by the state.
- Other duties of the incorporator include selecting members for the board of directors or organizing an initial meeting of the board.
- Once the corporation is registered with the state, then there are generally no formal duties for the incorporator.



Nonprofit Entity Formation, Step #1

Nonprofit Corporation: HOW?? INCORPORATION

- *Articles of Incorporation:*
 - The Articles of Incorporation is a document that must be filed with the state in order to incorporate. Each state has its own system of approval of articles, prohibits names which are confusingly similar to those of existing corporations, and sets specific requirements for non-profits (charitable, religious, educational, public benefit, and so forth). Articles must be signed by the incorporating person or persons or by the first board of directors. The Articles of Incorporation will be filed, along with a fee, at the state's Secretary of State for approval. <http://definitions.uslegal.com/a/articles-of-incorporation/>
 - Like “Declaration of Independence”
 - Contract between entity and state
- *Bylaws:*
 - The rules and regulations enacted by a nonprofit corporation to provide a framework for its operation and management. The written rules for conduct of the organization. Bylaws should not be confused with the Articles of Corporation which only state the basic outline of the company. Bylaws generally provide for meetings, elections of a board of directors and officers, filling vacancies, notices, types and duties of officers, committees, assessments and other routine conduct. Bylaws may also specify the qualifications, rights, and liabilities of membership. Bylaws are, in effect a contract among members, and must be formally adopted and/or amended. <http://legal-dictionary.thefreedictionary.com/bylaws>
 - Like “Constitution”
 - Contract between entity and members



Drafting for Success

Articles of Incorporation



Drafting for Success

Articles of Incorporation must have the following provisions:

- Proper purpose clause with 501(c) language and indication that the organization will serve the public at large rather than a small group of individuals or a narrow class of intended beneficiaries
- Proper dissolution clause
- Prohibition against private inurement
- Prohibition against political activity as a substantial part of the organization's activities
- NOTE: There are also other highly recommended provisions that are not required by the IRS (may be required by your state!)



Drafting for Success

- Vision Statement
 - Aspirational
 - Compare where the organization is to a future version
 - Imagine transformational change
- Values Statement
 - Explains organization's principles and ethos
 - Provides a model of how the organization will behave
- Mission Statement
 - Call to action
 - Short, sharp, forceful
 - Slight generality
 - Marketing statement that explains what the organization does and why it exists
 - *Example: The mission of the Jones Family Foundation is to identify, initiate and support endeavors that positively impact the quality of life in the Red Wing area of Minnesota.*
 - Having a mission statement is associated with good governance
- Purpose



What is a Purpose?

- The dictionary defines a purpose as “[t]he reason for which something exists or is done, made, used, etc. An intended or desired result; end; aim; goal.” See: <http://dictionary.reference.com/browse/purpose>.
- In Nonprofitland, a purpose is a technical statement that “marries” together your inspiration, mission, goals, and activities with the definition(s) found within an IRS tax-exempt classification.



Drafting for Success

Proper Purpose Clause:

- Unlike a for-profit, a nonprofit's purpose should NOT be “any lawful purpose.”
- Must include the following language if the entity will ultimately be a 501(c)(3): “The corporation is organized exclusively for charitable, religious, educational, and scientific purposes under section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future federal tax code.”

<http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Life-Cycle-of-a-Public-Charity-Sample-Organizing-Documents-Draft-A-Charter>



Drafting the Purpose: Permitted Purposes

- A great purpose is a technical writing. It's not a mission statement.
- The purpose marries together the mission (which describes the programming and inspiration in flowery, marketing language) with the government's definition(s) based on the appropriate 501(c) classification and/or the appropriate "exempt purpose" category or categories (i.e., charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competition, and preventing cruelty to children or animals).
- Use the government's "definitional words" to fit the nonprofit's purpose into established "exempt purpose" categories.



Why the Purpose Statement Matters

- The purpose statement is important because it defines the scope of activities for a nonprofit – it describes what the organization will (and won't) do during its lifetime. A nonprofit should be accomplishing what its purpose says, and avoiding activities outside of its stated purpose. The purpose statement will be part of the Articles of Incorporation and Bylaws.
- The purpose statement is how funders, beneficiaries, other nonprofits, and government entities will understand what your organization does and how it fits into the rest of the nonprofit ecosystem (or if it doesn't).



Why the Purpose Statement Matters

- The purpose statement, in large part, is how government agencies determine whether an organization qualifies for various types of nonprofit “benefits.”
- The IRS will examine the purpose to decide whether the entity will be granted federal income tax exemption.
- Beyond the IRS definitions, the state may have specific requirements in order to qualify for exemptions/benefits:
 - State income tax exemption
 - State sales and use tax exemption
 - Property tax exemption
 - Charitable gaming license(s)

So, refer to your state’s laws, rules, and regulations to determine whether additional specific language is needed.



Why the Purpose Statement Matters

- The purpose statement is also the tool that helps the government determine whether a nonprofit is subject to Unrelated Business Income Tax (UBIT).
- Tax-exempt organizations are exempt from paying income tax only to the extent that the income earned is *substantially related* to the exempt purposes. Unrelated business income, also called UBI or UBIT, is taxed at the normal corporate tax rate.
- Unrelated business income is defined as the income from a trade or business regularly carried on by an exempt organization and not substantially related to the performance by the organization of its exempt purpose or function, except that the organization uses the profits derived from this activity. To be “substantially related,” the relationship must be causal. The activities that generate the income must contribute importantly to the accomplishment of the organization’s exempt purposes to be substantially related. And, too much UBIT could jeopardize an organization’s 501(c) status.



Drafting the Purpose: Permitted Purposes

- NOTE: The IRS has “definitional” guidance on just about every classification and category.
<http://www.irs.gov/publications/p557/>
- Don't forget to look at your state statutes!!



Drafting for Success

Proper Dissolution Clause:

- Must include the following language if the entity will ultimately be a 501(c)(3): “Upon the dissolution of this corporation, assets shall be distributed for one or more exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code, or corresponding section of any future federal tax code, or shall be distributed to the federal government, or to a state government, for a public purpose.”
- Possible additional language: “Any such assets not so disposed of shall be disposed of by a court of competent jurisdiction of the county in which the principal office of the corporation is then located, exclusively for such purposes or to such organization or organizations, as said court shall determine, which are organized and operated exclusively for such purposes.”

<http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Life-Cycle-of-a-Public-Charity-Sample-Organizing-Documents-Draft-A-Charter>



Drafting for Success

Operations Clauses:

- Prohibition against Private Inurement: “No part of the net earnings of the corporation shall inure to the benefit of, or be distributable to its members, trustees, officers, or other private persons, except that the corporation shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth above.”
- Prohibition against political activity as a substantial part of the organization’s activities: “No substantial part of the activities of the corporation shall be the carrying on of propaganda, or otherwise attempting to influence legislation, and the corporation shall not participate in, or intervene in (including the publishing or distribution of statements) any political campaign on behalf of or in opposition to any candidate for public office.”
- Other: “Notwithstanding any other provision of these articles, the corporation shall not carry on any other activities not permitted to be carried on (a) by a corporation exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future federal tax code, or (b) by a corporation, contributions to which are deductible under section 170(c)(2) of the Internal Revenue Code, or the corresponding section of any future federal tax code.”

<http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Life-Cycle-of-a-Public-Charity-Sample-Organizing-Documents-Draft-A-Charter>



Drafting for Success

Other highly recommended provisions for the Articles of Incorporation that are not required by the IRS:

- Name
- Registered Office
- Type of Governing Body (Voting Members, Self-Perpetuating Board)
- Initial Directors
- Indemnification of Directors/Officers and/or elimination of personal liability (if possible)
- Conflict of Interest Policy/Self-Dealing Prohibitions



Drafting for Success

Bylaws



Drafting for Success

Bylaws: Key Provisions to Include

- If voting or non-voting members:
 - What the members' rights entail
 - Meeting procedures, if applicable (including quorum and proxies)
 - Termination/Sanction procedures
- Directors and Officers
 - Set out the size of the Board in a range
 - Duties and responsibilities of all
 - Election procedures
 - Meeting procedures (including quorum and proxies)
 - Removal procedures
- Committees (standing and temporary)
- Advisory Board
- Internal Controls
- Fiscal Year End
- Amendment procedures



Nonprofit Entity Formation, Step #1

Nonprofit Corporation:

- **WHAT DOCS ARE REQUIRED??**
 - Articles of Incorporation
 - Bylaws
- **WHAT DOCS ARE ALSO SUGGESTED??**
 - General Operating Policies/Procedures
 - Conflict of Interest Policy
 - Financial Control Policy
 - Investment Policy
 - Gift Acceptance Policy
 - Joint Venture Policy
 - Document Retention Policy
 - Whistleblower Policy
 - Volunteer and/or Employee Handbook



Directors’/Officers’ Governance by State

<https://www.harborcompliance.com/information/nonprofit-governance-by-state>

| State | Directors: | Officers: | Members: |
|--|--|--|----------|
| Massachusetts Startup Guide <ul style="list-style-type: none"> • Number: minimum 1 • Qualifications: Natural persons must be 18 years of age or older. No residency requirement. No membership requirement. • Term: minimum 1 year, maximum 5 years • Quorum: majority • Committee: minimum 1 director | <ul style="list-style-type: none"> • A president, a treasurer, and a clerk are required. • The president must be a director. • The clerk must be a Massachusetts resident unless a resident agent was appointed. | <ul style="list-style-type: none"> • Members: If there are no members then the directors are members. • Quorum: majority of entitled votes | |
| Michigan Startup Guide <ul style="list-style-type: none"> • Number: minimum 3 • Qualifications: A corporation organized for purposes described in section 501(c)(3) of the internal revenue code of 1986 may include 1 or more directors on its board who are 16 or 17 years of age as long as that number does not exceed 1/2 the total number of directors required for a quorum for the transaction of business. No residency requirement. No membership requirement. • Term: next annual meeting and until successor elected and qualified • Quorum: majority • Committee: minimum 1 director | <ul style="list-style-type: none"> • A president, a secretary, and a treasurer are required. • Two or more offices may be held by the same individual. This person may sign instruments in only one capacity when the signatures of two officers are required. | <ul style="list-style-type: none"> • Members: optional. A corporation organized upon a nonstock basis shall be organized upon a membership basis (has members) or a directorship basis (may or may not have members). • Annual meeting: required with the exception of written consent • Quorum: majority of entitled votes | |
| Minnesota Startup Guide <ul style="list-style-type: none"> • Number: minimum 3 • Qualifications: Natural persons. Majority must be adults. No residency requirement. No membership requirement. • Term: 1 year • Quorum: majority • Committee: One or more natural persons, need not be directors. | <ul style="list-style-type: none"> • One or more natural persons exercising the functions of the offices of president and treasurer, however designated. • Two or more offices may be held by the same individual. This person may sign instruments in only one capacity when the signatures of two officers are required. | <ul style="list-style-type: none"> • Members: optional. No members by default. • Annual meeting: required • Quorum: 1/10th votes | |
| Mississippi Startup Guide <ul style="list-style-type: none"> • Number: No minimum. Set by articles or bylaws. • Qualifications: Individuals. No residency requirement. No membership requirement. • Term: 1 year • Quorum: majority • Committee: minimum 2 directors | <ul style="list-style-type: none"> • Defined in bylaws or board resolution. One officer prepares minutes of the directors' and members' meetings and authenticates records of the corporation. • Two or more offices may be held by the same individual. | <ul style="list-style-type: none"> • Members: optional • Annual meeting: required • Quorum: 1/10th votes | |
| Missouri <ul style="list-style-type: none"> • Number: minimum 3 | <ul style="list-style-type: none"> • A chairman or president, or both a | <ul style="list-style-type: none"> • Members: optional | |



Nonprofit Entity Formation, Step #1

What are the options for formation?

- Unincorporated Association
- Nonprofit Corporation
- Religious Society
- LLC
- Trust

Nonprofit Entity Formation, Step #1

Religious “Societies”:

[Home](#) > [British & World English](#) > [religious society](#)

Definition of *religious society* in English:

religious society



NOUN

An association or organization formed for the purpose of worship or religious activity (now especially in the local community).

Origin

Early 17th century; earliest use found in John Robinson (d. 1625), Church of England clergyman and separatist theologian.



Nonprofit Entity Formation, Step #1

Religious “Societies”:

- Specialized type of corporate entity for churches and religious organizations
- List of Religious Societies:

https://en.wikipedia.org/wiki/List_of_religious_organizations



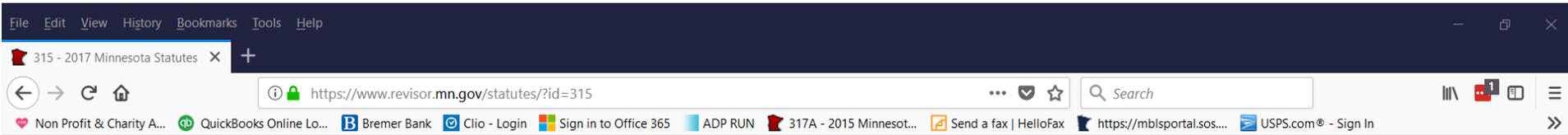
Nonprofit Entity Formation, Step #1

Religious Societies – Example: Minn. Stat. Chapter 315

- Pros:
 - Not restricted to 1 total Board of Directors (with required number of Directors and required Officers – see: <https://www.harborcompliance.com/information/nonprofit-governance-by-state>). Minn. Stat. 315 is a bit more flexible such that the organization can have more than 1 Board, but at least 1 Board is required.
 - Don't need to renew the corporation each year with the State Secretary of State's Office (annual renewals are usually required with the State Secretary of State's Office to remain in good standing).
- Cons:
 - Need 3 incorporators to file organizing document per Minn. Stat. 315.21.
 - Organizing document is filed with the county recorder (not the State Secretary of State's Office), so people looking for the organization will not find it in the State Secretary of State's records. This includes banks, members of the organization, etc.
 - In order to amend the organizing document, a unanimous vote is necessary pursuant to Minn. Stat. 315.31 and .32. The vote to amend must be authorized by a resolution passed at a special meeting of the religious corporation. The special meeting must be called for expressly that purpose, and must be attended by at least a majority of the members. NOTE: This is voting members, not Board Members. So, once the organizing document is adopted, it is virtually IMPOSSIBLE to amend it because of the realities involved with getting a majority of the voting members to attend any single meeting and the realities of getting all of those people to vote unanimously.
 - The Board Members are called Trustees. Trustees can serve terms of 3 years or less per Minn. Stat. 315.06.
 - No member of the religious corporation may vote at an election until the member has attended public worship in the congregation for at least 6 months before the election and has contributed to its support according to its customs. So, Minn. Stat. 315.07 requires a membership restriction regardless of whether you want one.
 - In order to sell real estate, the Board must be authorized by a resolution of at least 2/3 of the voting members present at a special meeting called specifically for that purpose. See Minn. Stat. 315.12. So, selling real estate once purchased is very difficult.
 - If the corporation wants to dissolve, there is no way to do so other than to apply to the court and ask for a hearing.



Nonprofit Entity Formation, Step #1



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CHAPTER 315. RELIGIOUS SOCIETIES

| Section | Headnote |
|-------------------------|--|
| 315.01 | FORMATION; TRUSTEES. |
| 315.02 | CERTIFICATE OF ELECTION OF TRUSTEES. |
| 315.03 | CERTIFICATE RECORDED. |
| 315.04 | TRUSTEES, POWERS. |
| 315.05 | TRUSTEES, MANAGEMENT POWERS. |
| 315.06 | TRUSTEES, TERMS, ELECTION; QUORUM. |
| 315.07 | VOTERS, QUALIFICATIONS. |
| 315.08 | DEFINITIONS. |
| 315.09 | GENERAL POWERS OF RELIGIOUS CORPORATIONS. |
| 315.10 | POWERS OF CERTAIN CORPORATIONS. |
| 315.11 | LIMITATION OF RIGHT TO HOLD PROPERTY. |
| 315.12 | SALE OR ENCUMBRANCE OF REAL ESTATE. |
| 315.121 | RELIGIOUS CORPORATIONS, CERTAIN CONVEYANCES VALIDATED. |
| 315.13 | EXISTING SOCIETIES CONFIRMED; REORGANIZATION. |
| 315.14 | LANDS HELD IN TRUST. |
| 315.15 | PARISH CORPORATIONS, ORGANIZATION. |
| 315.16 | DIOCESAN CORPORATIONS; FORMATION; POWERS. |
| 315.17 | PARISH OF PROTESTANT EPISCOPAL CHURCH. |
| 315.18 | ANNUAL MEETING; VESTRY, ELECTION, MEETINGS. |
| 315.19 | ARTICLES AMENDED. |
| 315.20 | CATHEDRALS. |
| 315.21 | INCORPORATION. |
| 315.22 | EXISTING CHURCHES MAY INCORPORATE; REINCORPORATION; PROPERTY TO VEST. |
| 315.23 | INCORPORATION OF DIOCESAN COUNCIL, SYNOD, PRESBYTERY, CONFERENCE, ASSOCIATION, CONSOCIATION, OR SIMILAR ORGANIZATIONS. |
| 315.24 | SPECIAL POWERS. |
| 315.25 | ANNUAL MEETING; NOTICE OF MEETING. |

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Nonprofit Entity Formation, Step #1

Garden Variety Nonprofit Corporation – Example: Minn. Stat. Chapter 317A:

- Pros:
 - Organizing document (Articles of Incorporation) is filed with the State Secretary of State's Office, so people looking for the organization will have no trouble finding it so long as it is annually renewed.
 - The Board Members are called Directors. Directors can serve terms of 10 years or less. Generally, no one wants to serve a term that long, but you are not limited to 3 years like in Minn. Stat. 315.06.
 - No restriction on voting rights of the membership unless you add them to the Bylaws.
 - If the corporation wants to sell real estate, the Board of Directors and Voting Members can authorize by a majority vote of each body. A notice to the State Attorney General's Office is likely required if the real estate is not sold to another church or 501(c)(3).
 - If the corporation wants to dissolve, the Board of Directors and Voting Members can authorize dissolution without court intervention.
- Cons:
 - Structure is firm and operating rules are set. Restricted to 1 single governing Board of Directors with the required number of Directors and Officers) – see: <https://www.harborcompliance.com/information/nonprofit-governance-by-state>. But you can have committees and non-governing Advisory Board(s).



Nonprofit Entity Formation, Step #1

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CHAPTER 317A. NONPROFIT CORPORATIONS

| Section | Headnote |
|--------------------------------|--|
| GENERAL PROVISIONS | |
| 317A.001 | CITATION. |
| 317A.011 | DEFINITIONS. |
| 317A.015 | LEGAL RECOGNITION OF ELECTRONIC RECORDS AND SIGNATURES. |
| APPLICATION | |
| 317A.021 | APPLICATION AND ELECTION. |
| 317A.022 | ELECTION BY CERTAIN CHAPTER 318 ASSOCIATIONS. |
| 317A.031 | TRANSITION; CONTINUATION OF LEGAL ACTS. |
| 317A.041 | RESERVATION OF RIGHT. |
| 317A.051 | SCOPE OF CHAPTER. |
| 317A.061 | FOREIGN NONPROFIT CORPORATIONS; SECTIONS APPLICABLE. |
| INCORPORATION; ARTICLES | |
| 317A.101 | PURPOSES. |
| 317A.105 | INCORPORATORS. |
| 317A.111 | ARTICLES. |
| 317A.113 | PRIVATE FOUNDATIONS; PROVISIONS CONSIDERED CONTAINED IN ARTICLES. |
| 317A.115 | CORPORATE NAME. |
| 317A.117 | RESERVED NAME. |
| 317A.121 | REGISTERED OFFICE; REGISTERED AGENT. |
| 317A.123 | CHANGE OF REGISTERED OFFICE OR REGISTERED AGENT; CHANGE OF NAME OF REGISTERED AGENT. |
| 317A.131 | AMENDMENT OF ARTICLES. |
| 317A.133 | PROCEDURE FOR AMENDMENT OF ARTICLES. |
| 317A.139 | ARTICLES OF AMENDMENT. |

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Nonprofit Entity Formation, Step #1

What are the options for formation?

- Unincorporated Association
- Nonprofit Corporation
- Religious Society
- LLC
- Trust



Nonprofit Entity Formation, Step #1

LLC:

- What is it? A limited liability company (LLC) is a legal entity, owned by one or more members, that may be organized and operated for a wide variety of purposes, including charitable purposes. One of the major advantages of an LLC is the limited liability protection it offers to its members. Members are generally not liable for the debts and obligations of the LLC except to the extent of their investments in the LLC. While technically, there is no such thing as a nonprofit LLC, there are tax-exempt LLCs, and these entities are commonly referred to as “nonprofit limited liability companies” or “nonprofit LLCs.”
<http://www.nonprofitlawblog.com/nonprofit-limited-liability-company-2/>
- Members = owners
- 2 Basic types:
 - LLC as “main nonprofit entity” – not incredibly common
 - LLC as “subsidiary entity” – VERY common
 - Option 1: Disregarded entity
 - Separate risk/liability from parent from business perspective
 - Parent entity’s 501(c)(3) status flows through to activities (disregarded for tax purposes)
 - Financial activity flows up onto parent’s Form 990 – Schedule R
 - Not for use with unrelated business activities
 - Option 2: Separate filer (not disregarded)
 - Does NOT flow up onto parent’s Form 990 – must file it’s own tax return
 - Used primarily if there are UBIT concerns – pay tax at LLC level and profit is owned by parent



Nonprofit Entity Formation, Step #1

What are the options for formation?

- Unincorporated Association
- Nonprofit Corporation
- Religious Society
- LLC
- Trust



Nonprofit Entity Formation, Step #1

Trust:

- By creation of an estate planning attorney
- What is it?
 - In order to be valid, a charitable trust must fulfill certain requirements. A charitable trust is a set of assets or *res* – usually liquid assets – that a settlor (donor) signs over or uses to create a charitable foundation.
 - The settlor must intend to create this type of trust and the charitable purpose must be expressly designated.
 - The assets are held and managed by the trustee (charity) for a specified period of time, with some or all interest that the assets produce going to the charity for use by the public.
 - A definite class of persons comprised of indefinite beneficiaries within it must actually receive the benefits from the charity.
- 2 Basic types:
 - Remainder Trust
 - Lead Trust



Nonprofit Entity Formation, Step #1

Remainder Trust:

- A charitable remainder trust is a trust that provides for a specified distribution, at least annually, to one or more beneficiaries, at least one of which is not a charity. The distribution must be paid at least annually for life or for a term of years, with an irrevocable remainder interest to be held for the benefit of, or paid over to, one or more qualified charities. The specified distribution must be either a sum certain, which is not less than five percent and not more than fifty percent of the initial net fair market value of all property placed in trust (a charitable remainder annuity trust), or a fixed percentage, which is not less than five percent and not more than fifty percent, of the net fair market value of the trust assets, valued annually (a charitable remainder unitrust).
<http://www.pgdc.com/pgdc/charitable-remainder-trusts>
- In order to qualify as a charitable remainder trust, the trust must meet all of the requirements set forth in IRC § 664, the regulations promulgated thereunder, Revenue Rulings, and Procedures.



Nonprofit Entity Formation, Step #1

Lead Trust:

- Charitable lead trusts are designed to provide income payments to at least one qualified charitable organization for a period measured by a fixed term of years, the lives of one or more individuals, or a combination of the two; after which, trust assets are paid to either the grantor or to one or more noncharitable beneficiaries named in the trust instrument. Also referred to as a “charitable income trust,” the term “charitable lead trust” is used more commonly because the payment of the income interest to charity leads or precedes the payment of the remainder interest. <http://www.pgdc.com/pgdc/charitable-lead-trust>
- In theory, charitable lead trusts can be thought of as the inverse of charitable remainder trusts. In practice, however, many of the rules that govern the operation and taxation of charitable lead trusts differ significantly from those for charitable remainder trusts.
 - Charitable lead trusts are not tax-exempt entities as are charitable remainder trusts.
 - The rules governing charitable remainder trusts are designed to protect the charitable remainder interest, whereas the rules governing charitable lead trusts protect the charitable income interest.



Nonprofit Entity Formation, Step #2

Once the nonprofit corporation has been formed according to the laws of your state, the next step is to ask the IRS for and Employer Identification Number (EIN):

- Every exempt organization must have an EIN, whether or not it has any employees. An EIN is required before an exemption application is submitted. Information on how to apply for an EIN can be found online at <https://www.irs.gov/businesses/small-businesses-self-employed/employer-id-numbers>. The EIN is issued immediately once the application information is validated on-line.
- If you previously applied for an EIN and haven't yet received it, or you are unsure whether you have an EIN, please call the IRS's toll-free customer account services number, 1-877-829-5500, for assistance.



Nonprofit Entity Formation, Step #3

Once the nonprofit corporation has been formed according to the laws of your state and you've received your EIN from the IRS, the next step is to ask the IRS for income tax exemption. Income tax exemption is also called 501(c) status.

You may think that all nonprofits are charitable organizations that “do good” in the community and offer a tax deduction to their donors. They are not. In general, only a small subset fit this description – 501(c)(3)s.

There are actually 29 different types of tax-exempt organizations under section 501(c) of the Internal Revenue Code: 501(c)(1) all the way to 501(c)(29), and additional miscellaneous types of tax-exempt organizations under other subsections of Internal Revenue Code section 501.

We can look at all of the different types of tax-exempt classifications a bit closer: <http://www.irs.gov/publications/p557/ar02.html>



Nonprofit Entity Formation, Step #3

Asking the IRS for tax-exemption is like driving down a highway. There are many different types of cars you could theoretically drive down that highway in order to get to the desired final destination: income tax exemption.

However, we need to pick the “right” car that best describes how the organization will operate and what it will do. That is called classification.

Classification refers to which subsection of the Internal Revenue Code will govern the organization — which federal “rules of the road” the nonprofit must follow, and what type of tax-exempt organization the nonprofit will be.

You may find that the organization has aspects of more than one classification. Ultimately, the business model and how it operates will dictate which classification is appropriate. We need to choose our car, and then stay in our lane and follow the appropriate rules of the road.

If you don't apply for and receive 501(c) status, you are a taxable nonprofit.



Nonprofit Entity Formation, Step #3

| | | | | | |
|------------|--|--|------------------------|---|--|
| 501(c)(1) | Corporations Organized under Act of Congress (including Federal Credit Unions) | Instrumentalities of the United States | No Form | None | Yes, if made for exclusively public purposes |
| 501(c)(2) | Title Holding Corporation For Exempt Organization | Holding title to property of an exempt organization | 1024 | 990 ¹ or 990-EZ ⁸ | No ² |
| 501(c)(3) | Religious, Educational, Charitable, Scientific, Literary, Testing for Public Safety, to Foster National or International Amateur Sports Competition, or Prevention of Cruelty to Children or Animals Organizations | Activities of nature implied by description of class of organization | 1023, 1023-EZ | 990 ¹ or 990-EZ ⁸ , or 990-PF | Yes, generally |
| 501(c)(4) | Civic Leagues, Social Welfare Organizations, and Local Associations of Employees | Promotion of community welfare; charitable, educational, or recreational | May self-declare, 1024 | 990 ¹ or 990-EZ ⁸ | No, generally ^{2, 3} |
| 501(c)(5) | Labor, Agricultural, and Horticultural Organizations | Educational or instructive, the purpose being to improve conditions of work, and to improve products of efficiency | May self-declare, 1024 | 990 ¹ or 990-EZ ⁸ | No ² |
| 501(c)(6) | Business Leagues, Chambers of Commerce, Real Estate Boards, etc. | Improvement of business conditions of one or more lines of business | May self-declare, 1024 | 990 ¹ or 990-EZ ⁸ | No ² |
| 501(c)(7) | Social and Recreational Clubs | Pleasure, recreation, social activities | May self-declare, 1024 | 990 ¹ or 990-EZ ⁸ | No ² |
| 501(c)(8) | Fraternal Beneficiary Societies and Associations | Lodge providing for payment of life, sickness, accident or other benefits to members | 1024 | 990 ¹ or 990-EZ ⁸ | Yes, if for certain Sec. 501(c)(3) purposes |
| 501(c)(9) | Voluntary Employees Beneficiary Associations | Providing for payment of life, sickness, accident, or other benefits to members | 1024 | 990 ¹ or 990-EZ ⁸ | No ² |
| 501(c)(10) | Domestic Fraternal Societies and Associations | Lodge devoting its net earnings to charitable, fraternal, and other specified purposes. No life, sickness, or accident benefits to members | 1024 | 990 ¹ or 990-EZ ⁸ | Yes, if for certain Sec. 501(c)(3) purposes |
| 501(c)(11) | Teachers' Retirement Fund Associations | Teachers' association for payment of | Letter ⁶ | 990 ¹ or 990-EZ ⁸ | No ² |



Most Common 501(c) Statuses

501(c)(3) - Organizations *organized and operated exclusively* for the following exempt purposes: charitable, religious, educational, scientific, literary, testing for public safety, amateur athletic organizations, and organizations that prevent cruelty to children or animals.

- 501(c)(3) private foundations - Every organization that qualifies for tax exemption as an organization described in section 501(c)(3), is a private foundation unless it falls into one of the categories specifically excluded from the definition of that term (referred to in section 509(a)). There are several restrictions and strict requirements on private foundations.
- 501(c)(3) public charities - These entities benefit the community at large, and, generally, receive funding from diverse public sources. Examples: Youth athletic organizations, churches, schools, historical societies, environmental groups.
- 501(c)(3) supporting organizations – These entities carry out their exempt purposes by supporting other nonprofits, usually other public charities. This type of classification is important because it allows 501(c)(3)s to avoid becoming private foundations, a classification that subjects a charity to more restrictive rules and regulations. An example of a supporting organization is a separate foundation formed in order to support a church or camp. The supporting organization raises money, holds real property, and/or controls major investments on behalf of the church or camp. All supporting organizations must pass an organizational test, an operational test, a control test and a relationship test. Supporting organizations are classified as Type I, Type II or Type III supporting organizations based on how they satisfy the relationship test.



Difference between (c)(3) and (c)(4)

501(c)(3) organizations are nonprofit organizations that are exempt from paying federal income tax and that provide a tax deduction to the donor.

501(c)(3) organizations may only engage in “insubstantial” political activity – they may appeal directly to legislative bodies and representatives and may support issue-based legislation, but only on a very limited basis.



Most Common 501(c) Statuses

501(c)(4) - Civic Leagues, Social Welfare Organizations, and Local Associations of Employees

501(c)(4) organizations are generally civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare; or local associations of employees, the membership of which is limited to employees of a particular municipality and the net earnings are devoted exclusively to charitable, educational, or recreational purposes. Examples: Volunteer Firefighter's Relief Associations, Homeowner's Associations.



Difference between (c)(3) and (c)(4)

- If a nonprofit corporation does not meet the statutory tests to become a 501(c)(3), or has too much political activity, the corporation may choose to become a 501(c)(4).
- Contributions to 501(c)(4) organizations are usually not deductible; however, 501(c)(4) organizations are, like 501(c)(3) organizations, exempt from federal income tax.
- 501(c)(4) organizations may engage in more political activity than 501(c)(3)s – up to 49% (just can't be the primary purpose) versus “insubstantial”



Most Common 501(c) Statuses

501(c)(5) - Labor, Agricultural, and Horticultural Organizations

501(c)(5) organizations generally come in two varieties:

1.) Labor organizations: An association of workers who have combined to protect or promote the interests of the members by bargaining collectively with their employers to secure better working conditions, wages, and similar benefits.

Examples: labor unions, councils, and committees.

2.) Agricultural/horticultural organizations promote the interests of persons engaged in raising livestock, harvesting crops or aquatic resources, cultivating useful or ornamental plants, or similar pursuits. Examples: groups that genetically preserve and/or breed animals.



Most Common 501(c) Statuses

501(c)(6) - Business Leagues, Chambers of Commerce, Real Estate Boards, etc.

501(c)(6) organizations generally have members with common business interests, and the purpose of the entity is to promote the members' common business interests as well as help small businesses or trades advance their industry or geographic area. These organizations are often called nonprofit associations. Examples: Business leagues or associations, chambers of commerce, real estate boards.



Most Common 501(c) Statuses

501(c)(7) - Social and Recreational Clubs

501(c)(7) organizations are social clubs organized for pleasure, recreation, and other nonprofit purposes. Generally, social clubs are membership organizations primarily supported by dues, fees, charges or other funds paid by their members. Examples: Car clubs, alumni associations.



Choose which Form to File

Exemption Under Section 501(c)(3) of the Internal Revenue Code: Organizations file this form to apply for recognition of exemption from federal income tax under section 501(c)(3)

- Form 1023EZ “Shortform”: A streamlined version of the application for recognition of tax exemption. You must complete the Form 1023-EZ Eligibility Worksheet in the Instructions for Form 1023-EZ to determine if you are eligible to file this form. If you are not eligible to file Form 1023-EZ, you can still file Form 1023 (or Form 1023, Interactive) below. <https://www.pay.gov/public/home>
- Form 1023 “Longform”:
 - Form 1023 Interactive: Interactive version of Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, includes helpful hints and links to help applicants submit a complete application. <http://www.stayexempt.irs.gov/Starting-Out/Interactive-Form-1023-Prerequisite-Questions>
 - Form 1023 Standard: Standard PDF version of the *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. It does not include helpful hints and links to information on IRS.gov. <http://www.irs.gov/pub/irs-pdf/f1023.pdf>
 - Form 1023 Accessible: Accessible version of Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*. http://www.irs.gov/pub/irs-access/f1023_accessible.pdf

Exemption Under any other subsection of 501(c) of the Internal Revenue Code:

- Form 1024: Organizations use this form to apply for recognition of exemption under section 501(a) or to receive a determination letter of IRS recognition of their section 501(c) status (501(c)(2), (4), (5), (6), (7), (8), (9), (10), (12), (13), (15), (17), (19), (25)). <http://www.irs.gov/pub/irs-pdf/f1024.pdf>



Super Tip #1

501(c)(3) status does not exempt it all....

- 501(c)(3) status only provides a charity with the ability to avoid paying income tax (and donors get a tax deduction).
- Sales and use tax exemption is a separate application to the state's department/bureau of taxation.
- Property tax exemption is a separate application – sometimes this is county-by-county, other times it is municipal or to the state body.
- Charitable gambling is a separate application to the state's regulatory body (Gambling Control Board, Attorney General's Office, etc.)
- Employment taxes are tricky (i.e., have to pay most, but 501(c)(3)s exempt from FUTA and can opt out of state unemployment insurance).
- And, watch out for Unrelated Business Income Tax (UBIT)



Chapters and Affiliates:

- Sometimes a nonprofit corporation will become a parent, and choose to spread its programming through chapters (not separately incorporated entities) or affiliates (separately incorporated entities).
- Language for parent's Articles: "If Corporation should add chapters (not separately incorporated) or affiliates (separately incorporated) to its corporate structure, Corporation will be the parent according to the following terms:
 - The parent organization and its subordinates will all have similar structures, purposes, and activities;
 - The parent organization will set governance and fiscal policies in a uniform governing instrument that each of its subordinates will adopt and follow;
 - The parent organization will supervise each of its subordinates, and each of its subordinates will agree to be partnered with the parent;
 - Subordinates agree to share financial information with the parent organization at all reasonable times (at least quarterly if requested), and to file Form 990s with the IRS if required."
- If the parent chooses the chapter model, there is only one (1) corporate entity and the parent's 501(c)(3) status automatically applies to the entire group.
- If the parent chooses the affiliate model, there are now a whole bunch of corporate entities with the parent as the lead entity. The parent's entity will be the only one with 501(c)(3) status, and the parent will need to apply for "group exemption" with the IRS to cover its subordinate entities with its umbrella.

Thank you!!!



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