

Overview on How to Start a Not-For-Profit Organization

Not-for-profit (NFP) organizations are started for a multitude of reasons by one or more people who have an idea that they believe will benefit or enrich the lives of a small group of people, large group of people or that of the planet itself. Some NFPs are local in nature, while others provide programs on a national or international level. Because their idea consists of something that will be ongoing and continuous, as opposed to a one-shot activity or project, a structure needs to be created to convert their idea to a functioning reality. There are numerous ways and structures for creating and building a successful NFP organization and there is no one or perfect method. That being said, many (if not most) Originators create their organization by following these general steps (although not always in this order), which includes the creation of an entity as a special type of Corporation (other entities structures include a Limited Liability Company [LLC], Trust or unincorporated association).

A Corporation is a legal entity and is a state creation. This means that one must follow the rules mandated by the state where the corporation is formed. Most states require that a application called a "Certificate of Incorporation" or similar name be filed with the state to form a corporation. For example, to create a domestic corporation a Certificate or Articles of Incorporation must be filed with the Department of State for New York, the New Jersey Division of Revenue, Corporate Filing Unit for New Jersey and the California Secretary of State for California. The Certificate or Articles of Incorporation requires specific information including a unique name for the organization, a description of its exempt purpose (which should be something other than simply to generate income and maximize a profit as described below) and other information such as the name and address of the filer of the Certificate, the state the organization will operate in, and among other things, how the organization's assets will be disposed of if the organization should cease to exist and dissolve.

Example of Organizational Purpose Clause (for a 501(c)(3) public charitable organization)

The ORGANIZATION shall be a non-profit corporation organized for charitable, educational and scientific purposes, within the meaning of section 501(c)(3) of the Internal Revenue Code, as amended, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under 501(c)(3) of the Internal Revenue Code, as amended. Its additional purposes are..... (describe)"

Many organizations will also adopt (i.e. create) Bylaws at the same time that they file their Certificate or Articles of Incorporation or a short time thereafter. The Bylaws is a document that specifies in broad terms how the organization will operate and be governed. It states the general rules and regulations that the entity must follow such as: the number of board of directors, how board members are elected, how board members are removed, the voting rights of board members, minimum number of board members required for a quorum (number required to pass any resolution), number of minimum board meetings per year, titles and responsibilities of officers, the name and number of any required board committees, and any other guiding operating rules that the organization must follow.

After incorporating, the next step typically is to obtain a Taxpayer Identification Number (TIN) which is also referred to as an Employer Identification Number (EIN). This can be obtained online by going to the IRS web site <http://www.irs.gov/> and completing the SS-4 application form. A number will be provided immediately upon completing and submission of the form.

Once you have incorporated and obtained a TIN/EIN, the next step is usually to open a bank account. Prior to going to the bank, it should be decided who will have initial signatory rights, that is, rights to handle all bank related transactions (e.g., sign checks). Usually this will be at least two of the following: the president, chairperson, executive director, treasurer, or secretary.

Exemption Applications

One of the most important things that a new NFP organization does is apply for exemption from federal and state income and other taxes. A general misconception is that a NFP corporation or association is automatically tax exempt after it files to become a corporation or other type of entity. NFP corporate status only makes an organization “eligible” for tax exemption so various forms will need to be completed and submitted to various government agencies in order for it to be approved for exemption. The first form that must be completed is the federal tax exemption application. To qualify as being exempt from federal income taxes, a NFP organization must meet the exemption requirements set forth in the Internal Revenue Code. The IRS has issued a publication (**Pub. 557**) to assist organizations seeking recognition of exemption from federal income taxes. Depending on whether the organization intends to operate as a public charity or foundation (i.e. a IRC 501(c)(3) organization) or other type of exempt organization such as a civic league, membership organization, labor, fraternity, etc., (i.e. a IRC 501(c)(4) (5) (6), etc.), it must complete either **Form 1023**, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code* (for a IRC 501(c)(3) public charity or foundation) or **Form 1024**, *Application for Recognition of Exemption Under Section 501(a)* (for all other exempt organizations). Both forms are lengthy but Form 1023 is more comprehensive because it allows the organization to receive tax-deductible contributions from individuals, corporations, and other entities. Great care should be taken in preparing these applications. Since exemption from taxes is so integral to the operations of the NFP, professional assistance should be sought to properly prepare these applications.

In addition to the federal government (IRS) requirement, a number of states require that a separate application for exemption from state corporate income taxes also be filed. Examples include New York (CT-247), California (3500), DC (FR-164) and Texas (AP 204). Many other states including some of the states just mentioned also require a NFP registration if the organization plans on operating or soliciting funds through fundraising or gambling within their state. Examples include Maryland (COR-92), New York (CHAR410), Oregon (RF-C) and New Jersey (CRI-150I). Most states (but not all) allow an exemption from sales and use taxes for certain types of exempt organizations while others allow an exemption from other taxes such as property and utilities. NFP Organizers should check with their operating state for all exemptions available.

Other Important Tasks

After the organization incorporates, has a TIN, bank account and has filed all available tax exemptions and required state operating applications some other important tasks should be considered. These include finding a number of suitable individuals who are interested in the organization’s mission, can provide expertise or assistance with raising funds or organizing events and are willing to serve as members of the Board of Directors/Trustees. The organization should also find someone on a paid or unpaid basis to act as the organization’s

bookkeeper/accountant. This is a very important function for every organization in both the startup and normal operating phase.

In the startup phase, the organization needs to setup an accounting system to process its invoices and disbursements and to track and report its financial activity. This usually entails purchasing, installing and configuring an appropriate accounting software program (e.g. QuickBooks, Peachtree, Financial Edge), setting up procedures for depositing funds and paying bills, designing reports for internal management purposes and the Board of Directors/Trustees and for external stakeholders such as donors, grantors, IRS and other regulatory agencies. Many times, this “bookkeeping” function of tracking, monitoring and reporting financial activities is not properly addressed early on due to ignorance or lack of financial acumen. This causes the organization a great deal of problems going forward because of a lack of timely information about its financial resources and obligations.

It is recommended that the organization solicit the advice of a qualified NFP attorney to provide guidance on legal matters such as review of rent, leases, employment and other contracts and agreements and preparation of conflict of interest and other operating documents. Fortunately, many attorneys and legal firms provide a portion of their services on a pro bona basis so a little time spent investigating and finding a knowledgeable pro bono attorney could save the organization valuable resources that can be used for other activities or programs.

It is also recommended that once an organization is up and running it should solicit the services of a CPA who is experienced with NFPs and knowledgeable about all the accounting, auditing and reporting requirements that NFP organizations must comply with. In addition to helping the NFP comply with their accounting and reporting responsibilities this expertise will assist them in a myriad of ways to comply with their exempt mandate and mission.