



Starting a 501 (c) 3 Nonprofit in Texas

by

Barry Silverberg

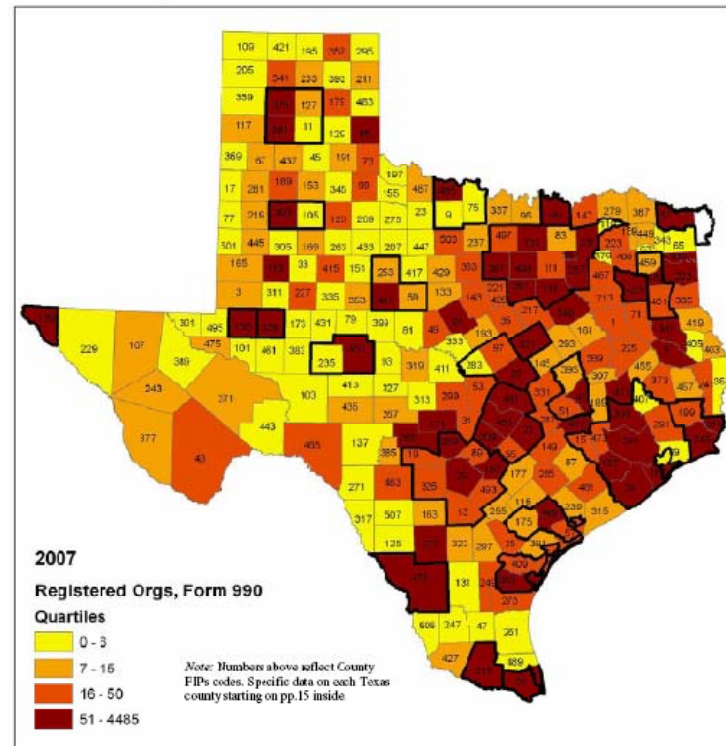
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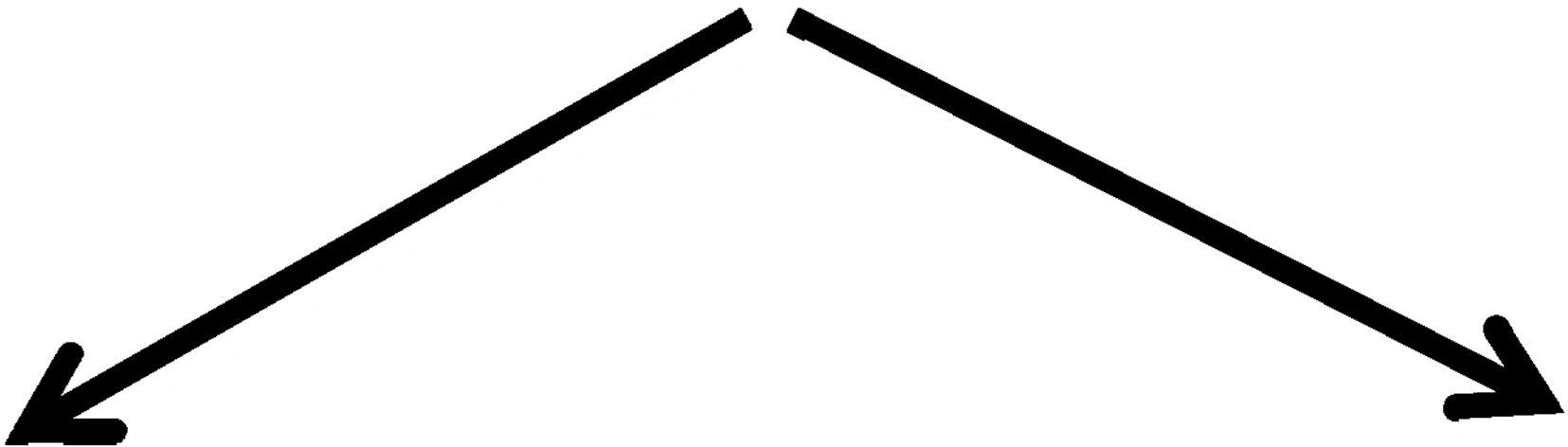
Aren't there enough nonprofits already?



TANO Objective

Helping create and sustain

EFFECTIVE
nonprofits!



TANO C3 Consulting Services

- **Incorporation & 501 (c) 3**
- **Financial Mgmt & Accounting**
- **Strategic Thinking Gathering**
- **Grant Writing**
- **TANO Member Discounts**
- **Consultations to date:**
<http://www.austincc.edu/npo/about/servicesprovided.php>



1. Timeline

1. **Certificate of Formation** via Secretary of State
2. **Texas Application for Exemption - Charitable Organizations** via Comptroller
3. **Employers Identification Number** via IRS
4. **Bylaws**
5. **IRS 1023 form & addendum preparation**
6. **IRS Notification of receipt**
7. **IRS "Black hole"**
8. **IRS further questions**
9. **IRS 501 (c) 3 determination**
10. **State & Federal reporting requirements**



2. What is a Nonprofit Corporation?

Defining the Nonprofit Sector

Key Characteristics of a Nonprofit Entity

Private Inurement

Stakeholders

Differences from Other Sectors

America's Three Sectors

➤ Private Sector

- Business and industry

➤ Public Sector

- Government and public educational systems

➤ Nonprofit Sector

- Charitable organizations, membership associations, professional societies



Defining the Sector

- **Chapter 22 of the Texas Business Organization Code**
(aka Texas Nonprofit Corporation Law (NCL))
 - Replaces Nonprofit Corporation Act Effective Jan 1, 2011 but used by many as of 1/1/06

- **Internal Revenue Code 501 (c)**
 - identifies 28 types of non-profit organizations exempt from some federal income taxes
 - ★ **Public Charities** – 501 (c) 3 – serving the public good/ benefiting the public
 - ★ **Civic Leagues** - 501(c) 4 - operated exclusively for the promotion of social welfare, or local associations of employees.
 - ★ **Associations** – 501 (c) 6 – benefiting its members



Key Characteristics of Nonprofits

Purpose

Ownership

Control

Accountability



Stakeholders

- A stakeholder is anyone who has the power to exert an influence on your organization or who is strongly influenced by your organization in some significant way.
- A stakeholder may be a single person, a group of individuals, or another large organization or institution.
- Each has a unique involvement with your organization and differing interests, priorities, and expectations.

Namus, Burt, *Visionary Leadership, Creating A Compelling Sense of Direction For Your Organization*, Jossey-Bass Publishers, San Francisco, 1992, pp.62-63



Defining the Sector

- entities that are organized for public purposes
- do not distribute surplus revenues as profits
- *No equity*
- independent of government and business, although they may be closely related to both
- are self-governed
- 501 (c) 3 contributors get tax deduction



Differences Between Sectors

- Willingness of people to volunteer
- Governance by a diverse volunteer board of community members
- Mission-driven rather than profit-driven (or by a quest for political power or votes).
- Accountability to the public, not stockholders.



Starting 501 (c) 3 Nonprofit in



3. Key Starting Questions

General purpose & mission

Due diligence/ Decision Tree

is there need?

others doing it?

regulations to consider?

sufficient initial resources?

sufficient public interest?

Self-Interest

Why doing this?

Control needs?

Capacity Requirements

Reasons NOT to create a nonprofit

Advantages & Disadvantages 

- **Is proposed project something a nonprofit can legally do**
- **Is there demonstrated need**
- **Can you state your mission clearly**
- **Considered partnership with existing organization?**



- **Can you describe what success looks like**
- **Can you describe how will pursue goal (steps to success)**
- **Will others commit time & resources to cause**
- **Do you/ supporters have skills to start proposed org**



Self-Interest Issues

- What are your **CONTROL** needs?

- Why are you doing this?



Reasons NOT to start a Nonprofit

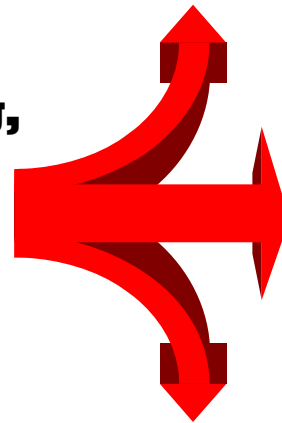
- To support a needy individual
- Think there is lot of grant money available
- Have service/ product want to provide below cost or donate- want tax deduction
- Feel your current work not meaningful
- Want to do things your own way & not be fettered by rules & bureaucratic procedures

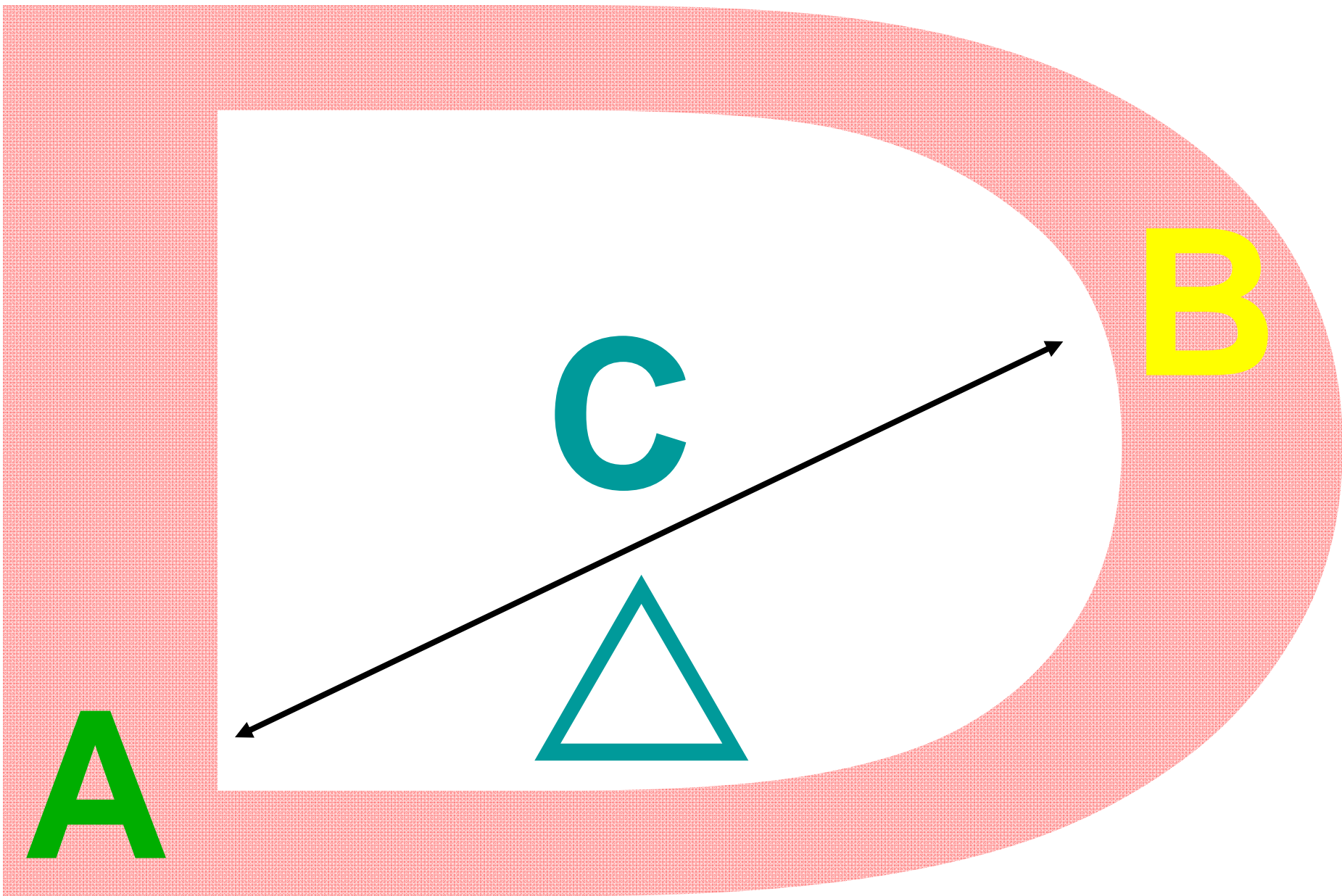


- **Do you/ supporters have understanding of the fundamentals of how nonprofits are structured and function?**

**If you don't know where you're going,
any path will take you there**

Sioux Proverb





An effective nonprofit fulfills its mission if it:

- Communicates its vision and mission,
- Plans for the future,
- Achieves and measures results,
- Manages an active and informed governance structure
- Secures resources appropriate to its needs,
- Engages and serves its community

(Chicago Grantmakers for Effective Organizations - CGEO)



Establishing a Nonprofit

➤ Advantages

- Limited liability
- Structure
- Accountability
- Perpetuity
- Legally recognized authority
- Ancillary benefits
 - ★ lower postage rates
 - ★ access to media
 - ★ Volunteers
 - ★ Collegial decision-making

➤ Disadvantages

- Loss of **control**
- Regulation/
Paperwork
- Start up time &
expense
- Different than for-profit



4. Dual Process

State

Business Organization Code - Title 2: Chapter 22.
Nonprofit Corporations

Certificate of Formation

Sales & Franchise Tax Exemption

Sales Tax License

Federal

Employers Identification Number

IRS form 1023



5. Certificate of Formation

Texas Application for Exemption -
Charitable Organizations


Sales Tax License



Certificate of Formation

Form 202 at www.sos.state.tx.us

- Art 1—Entity Name and Type
- Art 2—Registered Agent & Registered Office
- Art 3—Management
- Art 4—Members
- Art 5—Purpose
 - Reference to IRS 501 (c) 3
- Supplemental Provisions
 - Dissolution Clause

<p>Form 202 (Revised 10/07)</p> <p>Return in duplicate to: Secretary of State P.O. Box 13697 Austin, TX 78711-3697 512 463-5555 FAX: 512/463-5709 Filing Fee: \$25</p>	<p style="font-size: small;">This space reserved for office use.</p> <div style="text-align: center;">  Certificate of Formation Nonprofit Corporation </div>
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Article 1 – Entity Name and Type

The filing entity being formed is a nonprofit corporation. The name of the entity is:

Article 2 – Registered Agent and Registered Office
(Select and complete either A or B and complete C)

A. The initial registered agent is an organization (cannot be entity named above) by the name of:

OR

B. The initial registered agent is an individual resident of the state whose name is set forth below:

<i>First Name</i>	<i>M.I.</i>	<i>Last Name</i>	<i>Suffix</i>
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C. The business address of the registered agent and the registered office address is:

<i>Street Address</i>	TX	<i>State</i>	<i>Zip Code</i>
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Article 3 – Management

The management of the affairs of the corporation is vested in the board of directors. The number of directors constituting the initial board of directors and the names and addresses of the persons who are to serve as directors until the first annual meeting of members or until their successors are elected and qualified are as follows:

A minimum of three directors is required.

Director 1				
First Name	M.I.	Last Name	Suffix	
Street or Mailing Address	City	State	Zip Code	Country

Director 2				
First Name	M.I.	Last Name	Suffix	

Form 202 5



Texas State Tax Exemption

ap-205 at www.cpa.state.tx.us

TEXAS APPLICATION FOR EXEMPTION FOR CHARITABLE ORGANIZATIONS



SUSAN COMBS • TEXAS COMPTROLLER OF PUBLIC ACCOUNTS

Nonprofit charitable organizations should use this application to request exemption from Texas sales tax, hotel occupancy tax and franchise tax, if applicable. To receive a state tax exemption as a charitable organization, a nonprofit charitable organization must devote all or substantially all of its activities to the alleviation of poverty, disease, pain and suffering by providing food, drugs (medicine), medical treatment, shelter, clothing or psychological counseling directly to indigent or similarly deserving individuals for little or no fee. The organization's funds must be derived primarily from sources other than fees or charges for its services. Exemption from federal tax as a 501(c) organization is not required to qualify for exemption from state tax as a charitable organization.

The exemption for charitable organizations is provided for in Sections 151.310, 156.102 and 171.062 of the Texas Tax Code, and more detailed information can be found in Comptroller's Rules 3.322, 3.161 and 3.541.

Some organizations will not qualify for an exemption as a charitable organization as that term is defined in Texas' law and rules, even though their activities may be charitable in nature. Such an organization might still qualify for exemption from Texas sales taxes and franchise tax, if applicable, based on their exemption under certain sections of the Internal Revenue Code (IRC).

Texas tax law provides an exemption from sales taxes on goods and services purchased for use by organizations exempt under Section 501(c)(3), (4), (8), (10) or (19). However, exempt organizations are required to collect tax on most of their sales of taxable items. See *Exempt Organizations - Sales and Purchases*, Publication 96-122.

Texas law also provides an exemption from franchise taxes for corporations exempted from the federal income tax under IRC Section 501(c)(2), (3), (4), (5), (6), (7), (8), (10), (16), (19) or (25).

If your organization has been granted federal tax exemption under one of the qualifying sections listed above, your organization will be granted an exemption from Texas sales tax, or sales and franchise tax, on the basis of the Internal Revenue Service (IRS) exemption, as required by state law. Organizations that qualify for exemption based on the federal exemption are not exempt from hotel occupancy tax because the hotel occupancy tax law does not recognize any federal exemptions.

The laws, rules and other information about exemptions are on-line at

window.state.tx.us/taxinfo/exempt

Send the completed application along with all required documentation to:

Comptroller of Public Accounts
Exempt Organizations Section
P.O. Box 13528
Austin, Texas 78711-3528

We will contact you promptly after receipt of your application to let you know the status of your application. We may require an organization to furnish additional information to establish the claimed exemption. After a review of the material, we will inform the organization in writing if it qualifies for exemption. The Comptroller or an authorized representative of the Comptroller may audit the records of an organization at any time during regular business hours to verify the validity of the organization's exempt status.

If you have questions or need more information, contact our Tax Assistance staff at (800) 252-5555 or, in Austin at (512) 463-4600.

You have certain rights under Chapters 552 and 559, Government Code, to review, request, and correct information we have on file about you. Contact us at the address or toll-free number listed on this form.

AP-205-1 (Rev. 6-07/05)

AP-205-2
(Rev. 6-07/05)

TEXAS APPLICATION FOR STATE TAX EXEMPTIONS FOR CHARITABLE ORGANIZATIONS

• TYPE OR PRINT
• Do NOT write in shaded areas.

Page 1

SECTION A

1. ORGANIZATION NAME
(Legal name as provided in the formation document, or if unincorporated, the governing document. For non-Texas corporations, name must match the corporate name as filed in the home state of charter.)

2. ORGANIZATION MAILING ADDRESS
Street number, P.O. Box, or rural route and box
City State/province ZIP code County (or country, if outside the U.S.)

3. Texas taxpayer number (if applicable)

4. Corporations ONLY:
a) Enter filing information issued by the Texas Secretary of State File Number File Date
OR
b) Check this box if this is a non-Texas corporation without a Certificate of Authority.

5. Federal Employer Identification Number (EIN)
(Required if applying for exemption on the basis of a federal exemption)

6. Earliest date organization provided services

7. Name, address and daytime phone number of the person submitting this application.
Name Title
Firm or Company Name Daytime Phone (Area code and number) Extension
Address City State Zip
If address provided is not the same as the organization's mailing address, indicate to which address our response should be mailed:
 To organization mailing address To mailing address of submitter

SECTION B

Please review the information below. If your organization is applying for exemption on the basis of an IRS exemption, complete Item 8. If your organization is applying for exemption as a charitable organization under Texas law and rules, complete Item 9.

Item 8. Check here to apply for an exemption on the basis of a federal exemption.

Return the completed application with a copy of the entire IRS determination letter and any addenda. The organization name on the IRS determination letter must match the organization's legal name as listed in the Articles of Incorporation or governing document. If the IRS determination letter was issued more than four years prior to the current date, include a copy of a current IRS verification letter. To obtain a current letter, contact the IRS at (877) 829-5500.

Item 9. Check here to apply for exemption as a charitable organization.

The following documents must be included with your application. Information may be in the form of a bulletin, brochure, written statement or Web site:

- A copy of your organization's actual or proposed two-year budget; a detailed description of all of the organization's activities; any amount of charges for services, how the charges are determined, and the criteria the recipients must meet to receive the services. Include a written statement or brochures, pamphlets or Web site addresses that describe the activities of the organization.
- A copy of any application used to determine eligibility for the organization's services.
- A copy of the IRS determination letter. If your organization is exempt under a qualifying section of the Internal Revenue Code or if the organization is affiliated with a parent entity that has a federal group exemption under one of the qualifying IRC sections, attach a letter of verification from the parent entity that confirms the organization is a recognized subordinate under its federal group exemption. If the parent organization has not yet obtained exemption from Texas franchise tax and/or sales tax, provide a copy of the parent's organization's entire IRS group exemption ruling letter along with the letter of affiliation.
- Special note to unincorporated entities: include your organization's governing documents, such as the bylaws or constitution.
- Special note to non-Texas corporations: include a file-stamped copy of your organization's formation documents AND a current Certificate of Existence from the Secretary of State or equivalent officer in your home state.

➤ Sales Tax License

- If selling goods

➤ Business Organization Code – Title 2. Chapter 22. Nonprofit Corporations

- www.tano.org/texas-statutes



6. Employers Identification Number (EIN)

SS-4 via IRS online at

<http://www.irs.gov/businesses/small/article/0,,id=102767,00.html>

or do via PDF at www.irs.gov

- Federal Tax ID
- Requires Social Security Number



7. ByLaws

Conflict of Interest Policy



Bylaws

- **constitute the code of rules adopted by the Corporation for the regulation and management of its affairs**

- **Policies and procedures:**
 - **Membership rights and responsibilities**
 - **Membership meetings**
 - * **Quorum**
 - **Board of Directors composition**
 - **Board of Directors meetings**
 - * **Quorum**
 - **Committees**
 - **Officers**



Bylaws

➤ Policies and procedures:

- Rules of Procedure
- Executive Director
- Indemnification
- Operations
 - * Execution of Documents
 - * Disbursement of Funds
 - * Procurement policy
 - * Records
 - * Fiscal Year
 - * Audit
 - * Etc.
- Conflict of Interest policy
- Amendment procedure
- Dissolution procedure



8. Organizational Meeting

Adopt Bylaws

Elect Board & Officers

Approve Bank account

Schedule Board meetings

Organizational Board Meeting

- I. Adopt Bylaws**
- II. Elect Board of Directors**
- III. Elect Officers**
- IV. Adopt Schedule of Meetings**
- V. Approve Registered Agent**
- VI. Fiscal Matters**
 - I. Authorize Opening a Bank Account**
 - II. Designate Bank Signatories**
- VII. Constitute Committees Necessary to Further Establish and Execute the Mission**
- VIII. Other Issues Requiring Attention/Adjourn**



11. 501 (c) 3 Federal Tax Exemption

IRS Form 1023

- **Basic familiarity with nonprofits**
- **Present planned activities and budget**
- **Control**
- **Conflicts of Interest**

Application for Recognition of Exemption

Form 1023 via www.irs.gov

- Extensive instructions
- Need Addendum
- Name & EIN on EVERY document
- Consistent information
- Attention to details

Form 1023 <small>(Rev. June 2006) Department of the Treasury Internal Revenue Service</small>	Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code	<small>CMB No. 1545-0056</small> <small>Note: If exempt status is approved, this application will be open for public inspection.</small>
<p>Use the instructions to complete this application and for a definition of all bold items. For additional help, call IRS Exempt Organizations Customer Account Services toll-free at 1-877-829-5500. Visit our website at www.irs.gov for forms and publications. If the required information and documents are not submitted with payment of the appropriate user fee, the application may be returned to you.</p> <p>Attach additional sheets to this application if you need more space to answer fully. Put your name and EIN on each sheet and identify each answer by Part and line number. Complete Parts I - XI of Form 1023 and submit only those Schedules (A through H) that apply to you.</p>		
Part I Identification of Applicant		
1 Full name of organization (exactly as it appears in your organizing document)		2 c/o Name (if applicable)
3 Mailing address (Number and street) (see instructions)	Room/Suite	4 Employer Identification Number (EIN)
City or town, state or country, and ZIP + 4		5 Month the annual accounting period ends (01 - 12)
6 Primary contact (officer, director, trustee, or authorized representative) a Name:		b Phone: c Fax: (optional)
7 Are you represented by an authorized representative, such as an attorney or accountant? If "Yes," provide the authorized representative's name, and the name and address of the authorized representative's firm. Include a completed Form 2848, <i>Power of Attorney and Declaration of Representative</i> , with your application if you would like us to communicate with your representative. <input type="checkbox"/> Yes <input type="checkbox"/> No		
8 Was a person who is not one of your officers, directors, trustees, employees, or an authorized representative listed in line 7, paid, or promised payment, to help plan, manage, or advise you about the structure or activities of your organization, or about your financial or tax matters? If "Yes," provide the person's name, the name and address of the person's firm, the amounts paid or promised to be paid, and describe that person's role. <input type="checkbox"/> Yes <input type="checkbox"/> No		
9a Organization's website:		
b Organization's email: (optional)		
10 Certain organizations are not required to file an information return (Form 990 or Form 990-EZ). If you are granted tax-exemption, are you claiming to be excused from filing Form 990 or Form 990-EZ? If "Yes," explain. See the instructions for a description of organizations not required to file Form 990 or Form 990-EZ. <input type="checkbox"/> Yes <input type="checkbox"/> No		
11 Date incorporated if a corporation, or formed, if other than a corporation. (MM/DD/YYYY) / /		
12 Were you formed under the laws of a foreign country? If "Yes," state the country. <input type="checkbox"/> Yes <input type="checkbox"/> No		
<small>For Paperwork Reduction Act Notice, see page 24 of the instructions. Cat. No. 17133K Form 1023 (Rev. 6-2006)</small>		



you rely on operation of state law for your dissolution provision and include the state.

Part IV Narrative Description of Your Activities

Using an attachment, describe your *past, present, and planned* activities in a narrative. If you believe that you have already provided some of this information in response to other parts of this application, you may summarize that information here and refer to the specific parts of the application for supporting details. You may also attach representative copies of newsletters, brochures, or similar documents for supporting details to this narrative. Remember that if this application is approved, it will be open for public inspection. Therefore, your narrative description of activities should be thorough and accurate. Refer to the instructions for information that must be included in your description.

Compensation and Other Financial Arrangements With Your Officers, Directors, Trustees

Describe your *past, present, and planned* activities in a narrative. If you believe that you have already provided some of this information in response to other parts of this application, you may summarize that information here and refer to the specific parts of the application for supporting details. You may also **attach representative copies of newsletters, brochures, or similar documents for supporting details to this narrative.** Remember that if this application is approved, it will be **open for public inspection.** Therefore, your narrative description of activities should be thorough and accurate.



The IRS guidelines suggest: *"Describe completely and in detail your past, present, and planned activities. Do not refer to or repeat the purposes in your organizing document. You may refer to other parts of the application rather than repeat information provided elsewhere"*

- *For each past, present, or planned activity, include information that answers the following questions:*
- *What is the activity?*
- *Who conducts the activity?*
- *When is the activity conducted?*
- *Where is the activity conducted (for example: Los Angeles and San Francisco, California)?*
- *How does the activity further exempt purposes?*
- *What percentage of your total time is allocated to the activity?*
- *How is the activity funded? (This should agree with the financial data in Part IX.)*
- *List any alternate names under which you operate, including any "aka" (also known as) or "dba" (doing business as) names.*



Issues within IRS 1023

- **Compensation & Other Financial Relationships (Part V)**
- **Member and Other Benefits (Part VI)**
- **Organization History Part VII)**
- **Your Specific Activities (Part VIII)**
- **Financial Data (Part IX)**





Issues within IRS 1023

- **Financial Data - Statement of Revenues & Expenses**
 - *If in existence 4 or more years provide 4 tax years.*
 - *more than 1 year but less than 4 years provide all in existence + budget to = 3 yrs*
 - *less than 1 year - provide projections of likely revenues and expenses for the current year and the 2 following years, based on a reasonable and good faith estimate of your future finances for a total of 3 years of financial information*



Issues within IRS 1023

- **Public Charity Status (Part X)**
 - To determine if private foundation or public charity

- **Appropriate Schedules**

- **Fees**
 - \$750 if revenue \$10,000 + on average of 3 years
 - \$300 if revenue less than \$10,000 on average of 3 years

- **Submit with payment**



TANO (c) 3: Consulting Services

- Incorporation & 501 (c) 3
- Financial Mgmt & Accounting
- Strategic Thinking Gathering
- Grant Writing

14.

www.tanoc3.org



For assistance:

- **Outline of Incorporation & 501 (c) 3 Services attached to handouts**

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& Director, Center for Community-Based & Nonprofit Organizations at Austin Community College

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