Starting a 501 (c) 3 Nonprofit in Texas

by

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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. **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.

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.
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
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 title 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)3 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 171.002 of the Texas Tax Code, and more detailed information can be found in Comptroller’s Rules 3.322, 3.161 and 3.641.

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 law provides an exemption from sales taxes on goods and services purchased for use by organizations exempt under Section 611(c)(3), (4), (6), (10) or (12). 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), (9), (10) or (25).

4. 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 does not recognize any federal exemptions.

The laws, rules and other information about exemptions are online at:

www.state.tx.us/taxinfo/exempts

Send the completed application along with all required documentation to:

Comptroller of Public Accounts
Exempt Organizations Section
P.O. Box 13829
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 exemption status.

If you have questions or need more information, contact our Tax Assistance staff at (800) 252-6585 or, in Austin at (512) 463-4600.

You have certain rights under Chapters 350 and 758, Government Code, to inverse, request, and correct information we have on file about your Comptroller and/or information that will be made available to you by the Comptroller and/or information that will be made available to you by the Comptroller under the provisions of Chapter 350, Government Code.
Sales Tax License
  - If selling goods

  - www.tano.org/texas-statutes
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
- 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
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

www.tanoc3.org
For assistance:

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

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