



A How-To Guide for Incorporating a Nonprofit Organization

By
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About First Nations Development Institute

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Founded in 1980, First Nations Development Institute is a national American Indian-led 501(c)(3) nonprofit organization. Through a three-pronged strategy of educating grassroots practitioners, advocating systemic change, and capitalizing Indian communities, First Nations Development Institute is working to restore Native control and culturally-compatible stewardship of the assets they own – be they land, human potential, cultural heritage, or natural resources – and to establish new assets for ensuring the long-term vitality of Native communities.

First Nations is a nonprofit organization that helps Native communities build sound, sustainable economies. The strategy coordinates local grassroots projects with national program and policy development initiatives to build capacity for self-reliant communities. For more information, visit www.firstnations.org

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Foreword

The purpose of this booklet is to provide information about nonprofit corporations to help you determine whether or not incorporating as a nonprofit is a good fit for your organization. The materials set forth in this booklet are provided as a guide only, and should not be construed as legal advice or as a substitute for legal advice. Any reference to Internal Revenue Service (IRS) articles or publications were made relating to materials available at the time the booklet was developed. Individuals should always refer to the most recent information and forms available on the IRS website at www.irs.gov.

Introduction

Nonprofits

You would be hard pressed to find any aspect of American life that is untouched by the efforts of past generations who assembled through nonprofit organizations. In fact, some of the greatest social advances over the last hundred years were spearheaded by nonprofit groups. The women's suffrage movement, the Social Security Act, the Civil Rights Act of 1964, the Voting Rights Act of 1965, the Indian Child Welfare Act of 1978, and the Violence Against Women Act of 1994 and reauthorization in 2013, the Affordable Care Act of 2010, and countless others were all influenced by the voices of regular people raised and amplified through the voice and service of nonprofits organizations. According to the National Center for Charitable Statistics, as of May 31, 2013, there were more than 1.5 million tax-exempt organizations registered in the United States. In 2010, nonprofits accounted for 9.2% of all wages and salaries paid in the U.S., with nonprofits representing 5.5% of the gross domestic product (GDP). It is accurate to say that nonprofits are vital to our country and its economy, just as the role of nonprofits in our communities has been vital to increasing our quality of life and providing protections and rights to our people.

Every nonprofit organization begins with a vision and desire to make the world a better place to live. Each nonprofit organization starts in a very similar manner: a small group of people gathered together with a common goal or idea. Some nonprofits start small and stay small, while others, such as the American Red Cross, have grown to be such large organizations that it is hard to imagine a time when they were merely a shared vision of a few people.

All aspects of the journey toward incorporating as a nonprofit organization should be carefully weighed and considered. Incorporating and maintaining a nonprofit organization comes with many responsibilities. The road to nonprofit incorporation will involve large amounts of paperwork and government forms, both at the state and federal level. You should not underestimate the time and energy the organization's founders will be required to expend and the dedication required in forming, maintaining and growing the nonprofit. Once incorporated, you will be required to operate your organization according to the various state and federal laws for nonprofits. It should be viewed as, and it is, a big step for your organization and its members. It is important to fully understand all aspects of the nonprofit world including what constitutes a nonprofit, the steps towards incorporation, the benefits of the nonprofit, and the assumed and inherent responsibilities. By incorporating as a nonprofit you agree to improve the quality of life for a particular group of people. Having a strong vision and good intentions alone will not guarantee the success of your nonprofit. However, your desire to make the world a better place and your involvement within a nonprofit organization, setting out to do exactly that, will provide you with purpose and value beyond measure.

Benefits to Nonprofit Incorporation

Many groups may accomplish their goals and nonprofit purposes without incorporating as a nonprofit. However, there are many benefits to nonprofit incorporation. Incorporation opens the door to many governmental incentives afforded nonprofits that perform important services to society. The Internal Revenue Service sets forth more than 20 sections of exempt organizations under Section 501(c). Tax exemption under Internal Revenue Code Section 501(c)(3) for charitable, religious, educational, and scientific organizations will be discussed in greater detail in a later section. With tax-exempt status, nonprofits are exempt from federal income taxes and some charities and civic groups are exempt from state and local taxes as well. Further, many nonprofits are eligible for lower postage rates on bulk mailings, and the federal government offers a tax deduction to individuals who make donations to public charities and private foundations. Protecting the members of your group from personal liability is another important reason to consider nonprofit incorporation. Once incorporated, your directors, officers, employees and members usually will not be held personally liable for corporate debts or judgments against the organization. Nonprofits are also the exclusive beneficiaries of free radio and television public service announcements (PSAs) provided by local media outlets. Additionally, nonprofit employees often receive reduced membership rates at many businesses and are often eligible to participate in job training, work-study, and other federal, state and local employment incentive programs. Last, because a corporation is a legal entity separate from the people that work for it, the nonprofit corporation continues to exist as a legal entity despite changes in management or personnel.



Pre-Incorporation Stage

Before moving into the actual incorporation discussion, you should be aware of and focus some time and energy on several organizational issues that arise during the early, pre-incorporation stages of forming a nonprofit organization.

Because the real benefits of being a nonprofit result from 501(c)(3) tax-exempt status, it is vitally important that you review Internal Revenue Service Form 1023: *Application for Recognition of Exemption*, so that you may be knowledgeable of what language and document requirements are needed for the corporation to be eligible for nonprofit status. You should not submit your application for federal tax exemption until all of the required documents and procedures have been met and, in fact, submitting your tax exemption application prior to having the required documents may likely result in a

disfavorable determination. If you are knowledgeable of what will be required for tax-exempt status, you will likely have all of the requirements in place which will in turn increase the likelihood that you will be granted federal tax exemption. Additionally, looking over the federal tax exemption form will give you a sense of the amount of organizational and financial work that lies ahead for your organization.

Mission Statement

Each nonprofit organization exists to make distinct differences in the lives of the individuals they serve and in society as a whole. Your mission is your organization's very purpose and reason for existing. Of the 1.5 million plus nonprofit organizations in existence today, they may all have very different missions; however, changing lives is always the crux for each and every nonprofit. Your mission should be something you believe in, feel passionate about, and know is right. A good mission is short, focused, deliberate and concise. The mission statement of the Joyful Heart Foundation is a nice example of this, "To heal, educate and empower survivors of sexual assault, domestic violence and child abuse and shed light into the darkness that surrounds these issues."

Your mission statement is a necessary tool for raising funds, recruiting directors, volunteers and staff, and planning activities and programs for your organization. Your board, staff, volunteers and members should all be able to support the organization's mission fully and say "Yes, I want to be part of this change. I want to be part of this organization." Your organization's mission should be inspirational.

Peter F. Drucker, founder of the The Drucker Institute and the Peter F. Drucker Foundation for Nonprofit Management, suggests that your mission fit on a t-shirt and should be able to pass the "elevator test," reflecting the idea that it should be possible to recite your organization's purpose - your mission - in the time span of an elevator ride, or approximately 30 to 60 seconds. The "elevator test" term itself comes from a scenario of an unexpected meeting with someone important or influential in an elevator. If the conversation inside the elevator in those few seconds is interesting and value adding, and if you can speak passionately about your purpose/service, the conversation will continue after the elevator ride or end in the exchange of business cards.

Your mission should not only guide the work that you do, but should, perhaps more importantly, guide you away from participating in work or activities that are not in line with your mission. For example, if you are offered funding or an opportunity to participate on a project that deviates or is unrelated to your mission, you should not compromise your principles. This is called mission drift. As tempting as it may be to accept funding outside the scope of your mission, stay true to your mission. It is a best practice to never subordinate the mission in order to obtain funding.

Strategic planning can be extremely helpful in fleshing out a mission statement for your nonprofit organization. Strategic planning is an organization's process of defining its strategies and/or direction, and making decisions on allocating resources to pursue the strategy. Strategic planning often explores the questions "What do we do?," "Who are our customers?," "What do our customers value?" and "What are our results?" By discussing in open dialogue what it is that your organization will do, and

by identifying who your primary customers (persons whose lives are changed) and secondary customers (persons who have a choice to support your work and organization) are you can likely determine the value of your work and what success or progress will look like to your organization.

During this visionary stage of the strategic planning, you should also look at your community and research the market you are seeking to enter. Are there other organizations in your community providing the programs and services you seek to provide? If so, will your organization be meeting a new or unmet need, or serving an underserved population? If there is already an organization in existence in your community, providing similar services to the same customers you intend to serve, you may want to look into merging with the existing organization, rather than incorporating as a stand-alone organization.

Business Name

You will want to give careful consideration to selecting a name for your organization. If you are currently operating under a business name but not incorporated, you may want to keep that name because it is already associated or branded with your business and what you do. However, you might also take this opportunity to change your organization's name to something more appropriate. You will need to check with the secretary of state to determine whether the name you are considering is available for use. Although the details vary from state to state based upon state law, ordinarily the name of a nonprofit organization: may not be the same as or substantially similar to another corporation on file with the state; must contain the words "Corporation" or "Incorporated" or an abbreviation of one of these words, i.e. "Corp." or "Inc."; and must not contain words that suggest an association with certain specialized entities like the federal government (such as "Federal," "National," or "United States") or a restricted type of business (such as "Bank," "Lawyer," or "Doctor") or a special legal entity (such as "Cooperative," "Reserve," or "Trust"). Another area to consider with regard to your corporate name is whether or not your name, or perhaps its acronym, is an available web domain name.

Once you have decided on a corporate name, you should reserve that name with the secretary of state while you work on the remainder of the incorporation paperwork. Most states charge a nominal fee to reserve a name. Although you are not required to do so, once your Articles of Incorporation have been completed and filed, you should consider registering your business name as a federal and/or state trademark. Further information on tradename protection can be obtained by contacting your secretary of state and the United States Patent and Trademark Office, www.uspto.gov.

Board of Directors

Unlike for-profit businesses and corporations, nonprofit organizations are not "owned" by an individual. Instead, they are "owned" by the community and chartered by the government to serve a public purpose. Your board of directors is the group of people that will represent the interests of the "owners" — the community. The board of directors will be tasked with protecting that public purpose to ensure that funds are used responsibly and as effectively as possible.

When setting up a nonprofit, the founder(s) of the nonprofit form the first board for the organization. It is advisable to start with a small but committed group. In most states, state law dictates the minimum size for nonprofit boards with the minimum usually being three. However, in some states only one or two board members are required. It is important to consider that laws regulate the minimal legal requirements, but the laws should not determine what your optimal goal should be. When determining the size of your board, you should consider what your board needs to accomplish in its current stage in the board's lifecycle. Many nonprofits elect to have an odd number of board of directors so as to avoid any possibility of gridlock with a tie vote.

Early in your formation, a smaller board may be more effective as they and current stakeholders are tasked with developing the mission, strategic plan, corporate organizational documents and policies and procedures that will guide the organization. As the organization matures, the nature and composition of the board will likely also change. It is advisable to elect a board president and board officers such as a vice president, treasurer and secretary. Further, job descriptions for the board officers should be created to clarify the officer roles.

Your first board will also inherit the important role of selecting and evaluating the principal staff member to provide leadership for the organization and to recommend and implement the policies and programs approved by the board. While the board should not manage the organization, it should be satisfied that the organization is managed effectively. To achieve that goal, the board should ask questions to satisfy itself that qualified staff members are assigned to key tasks, resources are allocated through a realistic budget consistent with the mission, internal controls are in place to prevent fraud or noncompliance, proper ethical and governance standards are followed, and the programs of the organization have clearly defined purposes and are successful in achieving those purposes.

Because the first board is the foundation for the organization, when recruiting the board, it is important to engage individuals beyond your immediate circle of friends and acquaintances. It will prove useful to seek board members with the skills and expertise necessary to get the organization started. You should consider:

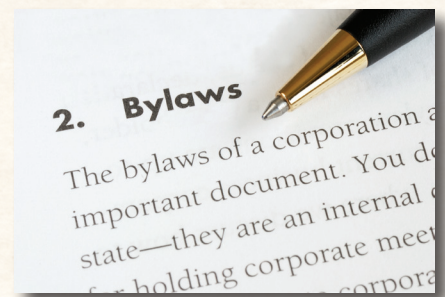
- Including people who are familiar with your constituents and their needs.
- If you are dependent on grant funding, involving someone who can assist in the grant writing and shaping.
- Finding someone who understands your field or mission area.
- Including someone who is comfortable with technology for items such as Facebook and/or a website.
- Accepting only leaders to secure the board's future leadership.
- Involving innovative people who have new ideas.
- Making sure all board members can work as a team.

Most individuals who already serve on a nonprofit board need no outside justification for being a board member. Some of the basic reasons that board members choose to serve are because they know their skills are needed, they believe the nonprofit will benefit from their contributions, they are committed to the change the organization seeks to effect, they enjoy collaborating with people of similar interests and vision, and they want to serve and give back to their community. Serving as a board member is a challenging and rewarding assignment. While appointment or election to a board is an honor, board members, primarily the first board of directors, have important legal and fiduciary responsibilities that require a commitment of time, skill, and resources.

Funders often pay special attention to the governance of the organizations they consider funding. In the eyes of funders a good board adds value to the organization by improving its accountability, demonstrating leadership, and ensuring proper oversight of operating funds. In addition to making available a list of your board members, you might want to include information to: emphasize the diversity and inclusiveness of your board; demonstrate that your board has a good sense of the mission and direction of the organization; show how board members are personally involved in promoting your organization and in the financial oversight of the organization; demonstrate that the board has chosen a strong chief executive to manage the organization; and show how the board and the chief executive form a solid partnership.

Bylaws

Bylaws are the written rules by which the organization is governed and should be drafted and adopted by the board early on in the organization's development. The development of the bylaws can be accomplished during the pre-incorporation stage or after the actual incorporation. However, the bylaws will need to be in place prior to applying for federal tax exemption as they are a required attachment.



Bylaws should address matters relating to the operation of the nonprofit such as board elections requirements, term limits, roles and responsibilities, resignation and removal of board officers and organization directors, meeting requirements, quorum standards, membership standards, conflicts of interests policies, indemnification of officers, and other matters as may need to be addressed in bylaws. Bylaws determine which staff and board members have authority and decision-making responsibilities and often how those responsibilities should be carried out. They create the framework for the organization, and aid in resolving internal disputes and conflict.

With regard to board conflicts of interest issues, it is probably impossible to find a board member who will never have any conflicts of interest. An active board member often has numerous professional and personal affiliations and, undoubtedly, some of them will cross paths with your organization. This may be particularly true in smaller communities. However, if these associations develop into conflicts of interest and become an obstacle to fulfilling the duty of loyalty of the board member, it may be necessary

to re-evaluate a board member's suitability for current board service. A conflict of interest policy is a requirement of the federal tax exemption. The IRS provides a sample policy on their website for consideration.

Bylaws are often described as the second most important document to an organization. In terms of the legal hierarchy, Articles of Incorporation are the primary laws of an association and bylaws are subordinate, yet complementary to an organization's Articles of Incorporation. Bylaws ensure the organization operates efficiently and effectively, and ensures legal, ethical and financial compliance to regulations guiding the nonprofit corporation. Your organization's board of directors and staff are expected at all times to honor and follow the bylaws. Bylaws are not public documents, however making them readily available increases the corporation's accountability and transparency and encourages your board to pay closer attention to them.

Prior to developing your bylaws you should review IRS Form 1023 and related instructions to determine what information will be required to be included and submitted with your federal tax exemption application. Including the required information in your bylaws will help satisfy the IRS eligibility requirements and help avoid delays in your determination for federal tax exemption status.

Further, by looking at IRS 990 annual nonprofit return and instructions, it becomes evident what the IRS likes to see addressed in bylaws, such as:

- The avoidance of excess benefit and conflict of interest transactions;
- The contemporaneous recording of nonprofit minutes of meetings and written consents;
- Independent or non-compensated board members;
- A documented written whistleblowing policy allowing the ability of nonprofit insiders to report wrongdoing;
- A written document retention and destruction policy; and
- Public disclosure of the organization's exemption application and annual tax returns.

Bylaws should be adopted by the board of directors and a copy kept with your official corporate records. Again, a copy of your bylaws will be required to be submitted with your application for federal tax exemption. Your bylaws may need to be amended throughout the course of the nonprofit organization. One particular reason that amendments to your bylaws may be necessary is to include special provisions or conditions required by federal or state funders. Bylaws may be amended during the course of any meeting of the board of directors. Again, any amended, adopted bylaws should be maintained in your official corporation records.

Record Keeping

As previously suggested, certain corporate documents should be maintained in your corporation's official records. In fact, state law often mandates and sets forth the records which are to be kept in official files. Contact your appropriate state agency or the laws pertaining to nonprofits in your state for more information. Records that are likely required to be preserved include your corporate documents including board meeting minutes, bylaws, Articles of Incorporation, financial reports and other official organization records. It is a best practice to also provide your board officers with a photocopy of these corporate documents to assure they are familiar with and have access at all times to the records as needed.

Accounting System

There are no laws requiring nonprofits to have a specified amount of money to begin operation. However, starting a nonprofit organization without any financial backing may prove challenging. Start-up money can be raised through grants and donations; though, you should note that donations made to the nonprofit organization prior to receiving your official tax-exempt status recognition by the Internal Revenue Service are not tax-deductible. However, the Internal Revenue Service will allow you to accept tax-deductible donations while your application for 501(c)(3) is being considered based upon the assumption that you will be afforded tax-exempt status. During the early stages of your organization, board members may need to reply upon their own personal monies.

Regardless of the amount of operating money an organization has, it is of utmost importance for the organization to have in place a system of controls when establishing the organization's accounting practices. Nonprofits are accountable to the public, its funders, and in some circumstances, government granting bodies. Responsible stewardship of the organization's finances requires the establishment of an accounting system that meets the organization's present and anticipated needs. The organization will need to open a bank account and determine whether it will use the accrual or cash methods of accounting. You must keep corporate funds separate from any personal funds by depositing corporate funds into, and writing corporate expenses out of at least one corporate banking account. Your board should determine the number of persons who are authorized to sign corporate checks. If your board does not include someone with financial or accounting experience, you may want to consult with a certified public accountant that specializes in nonprofit accounting. Additionally, the board will need to develop strong financial policies and procedures to assure that the corporation's financial controls are well-documented and followed.

Incorporating Your Nonprofit

This section will address how to proceed in the actual incorporation of a nonprofit. For the most part, you will be filling in the blanks on a standard incorporation form provided by your secretary of state.

Locating Your State's Corporate Filing Office

To find your state's corporate filing office, go to www.statelocalgov.net. Once the website loads, you will want to enter some criteria in the menu items located on the left side of the page. Under the "select topic" menu, pull down and select "SOS" for secretary of state. A page will then load with web links to each state's secretary of state website. Click on your state's secretary of state link provided, and you will be redirected to your secretary of state's webpage wherein you will likely find the forms and instructions for incorporating as a nonprofit. Your secretary of state website may also provide information on the state nonprofit tax exemption forms and other information that you will find beneficial.

Preparing Your Articles of Incorporation

Most secretaries of state provide samples or fillable forms for articles of incorporation that meet their state's statutory requirements on their websites. Most forms come with comprehensive instructions of how to complete the form and instructions on filing. If you have completed the pre-incorporation activities you will likely have all of the information needed to complete the form.

Name of Corporation: The first article of incorporation normally states the name of the corporation. If you have decided upon, conducted a search relating to the availability of the name you seek to use, and have reserved that name with your secretary of state, you should be mindful to use the exact spelling of the reserved name in your articles.

Registered Agent and Office: Most states require the name and address of the nonprofit corporation's registered agent in the state of incorporation. Please be certain to use a physical address and not a post office box. The purpose of the registered agent is to provide a legal address for service of process in the event of a lawsuit. The registered agent is also where the state government sends official documents such as tax notices and annual reports. If your nonprofit corporation incorporates in the same state where you do business, an officer of the nonprofit corporation can usually serve as the registered agent. If your nonprofit corporation incorporates in a state other than where it does business, then you will have to hire a registered agent in the state of incorporation. You can find registered agent service companies through a simple internet search.

Statement of Purpose: Here you must state the purpose(s) for which the nonprofit corporation is formed. You should use language to satisfy both your state corporate law and language that would also satisfy the federal 501(c)(3) tax exemption requirements. The following is the standard IRS approved language:

Said corporation is organized exclusively for charitable, religious, educational, and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under section 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future federal tax code.

While the IRS standard language will satisfy the IRS requirements, you may elect to be more specific by identifying one or more of the actual purposes, i.e. charitable, religious, educational, and/or scientific, as your actual purpose(s).

Some states also ask for a Statement of Lawful Purpose and a Statement of Specific Purpose. A sample “Statement of Lawful Purpose” might state, “The purpose of the corporation is to engage in any lawful act or activity for which corporations may be organized under the laws of the State.” A sample “Statement of Specific Purpose” might state, “The specific purpose for which this corporation is organized is to develop and operate a website providing information to the public on domestic violence and sexual assault.”

In addition, the following items are important for making the nonprofit status clear and in obtaining tax exemption from the IRS. You should include separate statements indicating that the organization is not for profit. Such a statement might read:

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 in the Statement of Purpose hereof. The property of this corporation is irrevocably dedicated to the exempt purpose of the corporation and no part of the net income or assets of this corporation shall ever inure to the benefit of any director, officer, or member thereof, or to the benefit of any private individual.

Names, Addresses and Number of Directors: Some states require you to list the persons who will actually serve on the first board of the corporation, while with other states it is optional. If your state requires this information you should list your initial board of directors by name along with their address, again using only street addresses and no post office boxes.

Names and Address of Incorporators: The incorporator of a corporation is the person or persons who are forming the corporation by signing and filing the articles of incorporation. You may choose to list only one incorporator or multiple individuals to assume this responsibility. Any person may be designated as the incorporator; however, it will likely be one of the initial directors of the corporation.

Duration of the Corporation: Some states ask how long the nonprofit corporation will be in existence. Unless you know specifically that your corporation will end on a date specific, you should answer “perpetual,” meaning that the nonprofit corporation will continue into the indefinite future.

Membership Provisions: Some states require information in the articles of incorporation pertaining to the corporation's membership. If the nonprofit corporation does not wish to set up a formal membership structure, you could enter "no members" if this clause is a required element in your state's articles of incorporation. However, if you intend on adopting a formal membership structure and your state's articles of incorporation form requests disclosure of that information, you could best respond by stating, "The membership provisions of this corporation are stated in the bylaws of the corporation." This language will afford you a great deal of flexibility in that bylaws can easily be changed over time by your board as needed, whereas amendments or changes to your articles of incorporate would require additional filing, and associated fees, with your secretary of state.

Additional Provisions: Many states offer an "additional provisions" section on their state's articles of incorporation form. It is within this section that you could add language that would help demonstrate eligibility for the federal tax exemption, provided that it is not already addressed in previous sections of the articles of incorporation. For example, to be eligible for the 501(c)(3) tax exemption, the assets of the corporation must be devoted to exempt purposes. This clause is often referred to the dissolution clause. Accordingly, you might add additional provision to address this issue using the language provided in IRS Form 1023, as follows:

Upon the dissolution of the corporation, its assets remaining after payment, or provision for payment, of all debts and liabilities of this corporation, shall be distributed for one or more exempt purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code, or shall be distributed to the federal government, or to a state or local government, for a public purpose.

If your state does not specifically ask to you address what will happen to the assets of the corporation in the event the corporation is dissolved, it is still a best practice to include it as it will help avoid delays in your 501(c)(3) determination.

You may also elect to include language in the "additional provisions" section, if offered and if not already included in the articles of incorporation form provided by your secretary of state, relating to limitations on political activities and private inurement. Sample language on these paragraphs is provided below.

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. Notwithstanding any other provision of these articles, this corporation shall not, except to an insubstantial degree, engage in any activities or exercise any powers that are not in furtherance of the purposes of this corporation.

No part of the net earnings of this corporation shall inure to the benefit of, or be distributable to, its members, directors, officers, or other private persons, except that this 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 in these articles.

A general limitation specifically setting forth the nonprofit activities is also suggested for inclusion in your articles of incorporation if it is not already addressed in earlier sections. The following language, extracted from the IRS Form 1023, may be used:

Notwithstanding any other provisions of these articles, this corporation shall not carry on any other activities not permitted to be carried on (1) by a corporation exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code or (2) by a corporation contributions to which are deductible under Section 170(c)(2) of the Internal Revenue Code.

The language inclusions suggested have been obtained directly from and/or adapted from the Internal Revenue Service's Form 1023. When preparing your articles of incorporation it is strongly suggested that you refer to and use the specific language from the current IRS Form 1023 which may be found on the IRS website, www.irs.gov.



Filing Your Articles of Incorporation

Once your articles of incorporation have been prepared, you will file them with your secretary of state following exactly the instructions provided by the secretary of state's website. Some states allow you to submit your articles of incorporation online whereas other states require you to file by U.S. mail. If you are filing by U.S. mail, you will want to pay close attention to whether or not you submit only an original, or the original and a prescribed number of copies. Be certain to include any filing fees mandated. You should check the secretary of state's instructions carefully to make sure your total fee payment is correct. Otherwise, your articles will likely be returned to you unfiled.

Your next step is to wait. The secretary of state's office will make sure your corporate name is available for use and that your articles of incorporation conform with state law. If there are no problems with your articles, the secretary of state will provide you a certificate of incorporation. If there are problems with your articles, the secretary of state will usually return your articles to you with a list of the items that need correction. A file-stamped copy of your articles of incorporation and certificate of incorporation should be maintained with your official corporate records. If you file your articles of incorporation online you will likely receive your certificate in less than 24 hours. If you file your articles of incorporation by U.S. mail, you will receive your certificate by U.S. mail.

Any revisions to articles of incorporation are required to be filed with the secretary of state and will likely involve additional filing fees.

Your articles of incorporation and any amended filings should be maintained in your official corporate records.

Federal Tax Exemption

Nonprofit status is a state law concept. Nonprofit status may make an organization eligible for certain benefits, such as state sales, property and income tax exemptions. Although most federal tax-exempt organizations are nonprofit organizations, organizing as a nonprofit organization at the state level does not automatically grant the organization exemption from federal income tax. Instead, you must apply for and demonstrate that your organization is in compliance with the requirements and requisites set forth in the Internal Revenue Service Code under Section 501(c)(3). To qualify as exempt from federal income tax, an organization must meet requirements set forth in the Internal Revenue Code and apply for exempt status under Form 1023.

The logic behind the federal tax exemption status is that many nonprofit organizations provide services or benefits that would otherwise have to be provided by the government. Through tax exemption, the government recognizes your service and provides an indirect subsidy to your nonprofit and in return receives a direct benefit. By defining yourself as and organizing your activities as eligible for 501(c)(3) status, you agree to certain limitations on profits and benefits and political activities. However, as previously mentioned, the federal tax exemption exempts you from paying federal income taxes and offers a tax deduction to individuals who make donations to your nonprofit.

It should be noted that receiving exemption status from the IRS does not automatically make you exempt from state sales tax. Further, exemption from federal, state, and local taxes, does not excuse a nonprofit corporation from filing employment withholding taxes or paying taxes on unrelated business income.

The IRS will recognize an organization as tax-exempt if it meets the requirements of the Internal Revenue Code. Although the IRS has revised Form 1023 to make the application process easier to understand and complete, it is still a very involved, time consuming process with the average time to complete the form estimated at 10 hours with additional time required to gather the documentation needed to support the application.

Most organizations must file Form 1023 by the end of the 15th month after they were created, with a 12-month extension available. When the IRS determines that an organization qualifies for exemption under section 501(c)(3), it will be classified as a private foundation unless it meets the requirements to be treated as a public charity.

Before starting your Form 1023, Application for Recognition of Exemption (and instructions) (for charitable organizations) make sure you have the most current version of the form which can be located on the IRS website. You can search under publications for “Form 1023.”

Employer Identification Number

Organizations applying for tax-exempt status must submit two applications: First, if they have not previously received an Employer Identification Number (EIN), they must apply for one, and second, an application for recognition of exemption. Employer Identification Numbers (EINs) are merely a unique identifier for a business which is similar to a Social Security number for an individual. Applying for and receiving an EIN says nothing about the organization's tax status; however, your organization will need an EIN to apply for tax exemption. An organization may not file Form 1023 unless it already has an Employer Identification Number (EIN).

You can apply for an Employer Identification Number online, over the telephone, via fax or through the U.S. mail. IRS Form SS-4, Application for Employer I.D. Number, explains the process in detail.

Requirements

Organizations organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals are eligible to file Form 1023 to obtain recognition of exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code.

Form 1023 is not necessary for churches, temples and mosques, church auxiliaries or associations or organizations that have gross receipts in each taxable year of normally not more than \$5,000. Even though churches, temples mosques, etc. are not required to file Form 1023, they may elect to do so in order to receive a determination letter that recognizes their tax-exempt status and specifies whether contributions to them are tax-deductible.

There are two key requirements for an organization to be exempt from federal income tax under section 501(c)(3). A 501(c)(3) organization must be organized and operated exclusive for one or more exempt purposes. First, an organization must be organized as a corporation (including a LLC), trust or unincorporated association. The organizing document (articles of incorporation if you are a corporation, articles of organization if you are a LLC, articles of association or constitution if you are an association, or trust agreement or declaration of trust if you are a trust) must limit the organization's purpose(s) and permanently dedicate its assets to exempt purposes. Secondly, an organization must operate to further one or more of the exempt purposes stated in its organizing document. Certain other activities are prohibited or restricted. Hopefully you will recall that information from the section on articles of incorporation.

As previously mentioned, there are several activities that are prohibited or restricted, by an organization seeking 501(c)(3) tax-exempt status. Specifically, according to the Internal Revenue Service, a 501(c)(3) organization must:

- Absolutely refrain from participating in the political campaigns of candidates for local, state or federal office.
- Absolutely ensure that its assets and earnings do not unjustly enrich board members, officers, key management employees, or other insiders.
- Not further non-exempt purposes (such as purposes that benefit private interests) more than insubstantially.
- Not operate for the primary purpose of conducting a trade or business that is not related to its exempt purpose(s).
- Not engage in activities that are illegal or violate fundamental public policy.
- Restrict its legislative activities.

If a substantial part of your organization's activities is attempting to influence legislation, your organization does not, and will not, qualify for exemption under Section 501(c)(3). According to the IRS, "legislation" includes action by Congress, a state legislature, a local council, or a similar governing body, with respect to acts, bills, resolutions or similar items (such as legislative confirmation of appointive offices). Legislation also includes action by the public in a referendum, ballot initiative, constitutional amendment, or similar procedure. Legislation generally does not include actions by executive, judicial, or administrative bodies.

However, organizations may involve themselves in issues of public policy without being engaged in legislative activity. For example, organizations may conduct educational meetings, prepare and distribute educational materials, or otherwise consider public policy issues. For example, an organization may appear before a government body to offer testimony or information about an issue related to the organization's purpose. For instance, an organization operating as a tribal coalition against domestic violence and sexual assault may be asked to address its state legislators about the rates of domestic and sexual violence affecting individuals within their state or specific communities. While the testimony may have bearing on whether or not state statutes are changed to more effectively address these crimes, the purpose of the testimony is to educate the legislators on a particular issue.

Unlike the articles of incorporation, an organization may use a mailing address including a post office box in Part I, Line 3 of Form 1023 instead of a street address. This may be desirable to protect its privacy and that of its employees and clients, given that Form 1023 is subject to public disclosure. This would be particularly important to nonprofit organizations who seek to keep their location hidden such as a domestic violence shelter.

Fees

You must pay a user fee when you submit your Form 1023 tax-exemption application. The fee is determined according to the amount of gross receipts your group has or expects to receive annually, averaged over a four-year period. The user fee varies between \$400 and \$850.

The Process

Applications for Form 1023 tax exemption are processed by the Internal Revenue Service in the order in which they are received. The process can be delayed, however, for reasons ranging from simple errors to issues concerning the eligibility or qualification of the organization for exemption.

Answering all questions fully and completely and submitting all required documentation will undoubtedly help ensure that the agent(s) reviewing your application are able to process the application as quickly as possible. Completing the checklist on the last two pages of the Form 1023 will help you submit a complete and error-free application. If you cannot check off an item on the checklist, it is suggested that you obtain the required information and submit the application when it is complete.

Expedited Requests

Although applications are processed in the order received by the IRS, sometimes the IRS will work a case outside the regular order. For expedited processing to be granted, however, there must be a compelling reason to process the case ahead of others who submitted their applications before you. Examples of what the IRS determines compelling circumstances include the following:

1. A pending grant, where failure to secure the grant will have an adverse impact on the organization's ability to continue operating.
2. A newly created organization providing disaster relief to victims of emergencies.
3. IRS errors have caused undue delays in issuing a determination letter.

A request for expedited processing must be made in writing and must fully explain the compelling reason. If you are requesting expedited processing for your application based upon a pending grant, you should include the following information in support of your request for expedited processing including (a) the name of the person or organization committed to giving the grant; (b) the amount of the grant; (c) the date the grant will be forfeited if the nonprofit determination is not received; and (d) the impact on the organization's operations if the grant is not awarded. The request or expedited review should be signed by the principal officer or authorized representative of the corporation. Granting expedited processing is at the discretion of the IRS and is not guaranteed.

After the Determination

If your application is approved, you will not be issued a special nonprofit number, but instead the IRS will issue a favorable determination letter telling you that you are exempt from federal corporate income taxes under Section 501(c)(3) of the Internal Revenue Code, as a public charity. Unless you filed late and were not entitled to an extension, your tax exemption and public charity status will be effective retroactively to the date when your articles were filed with the secretary of state.

Please note that your exemption application is subject to public disclosure once it has been finally approved or denied. A charitable organization must make available for public inspection its approved application for recognition of exemption with all supporting documents and its last three annual income tax returns, and provide copies of these documents upon request without charge (other than a reasonable fee for reproduction and copying costs).

In accordance with state, county and municipal law, following your federal tax exemption determination, you should apply for exemption from income, sales and property taxes. For more information on the procedures for applying for these other exemptions, check with your state, county or municipal department of revenue.

Tax exemption under section 501(c)(3) is a matter of federal law. After receiving your federal tax exemption, you may also be required to register with one or more states to solicit for contributions or to obtain exemption from state taxes. The National Association of State Charity Officials (NASCO) maintains a website and provides informational links to the various states for these purposes. It can be accessed at www.nasconet.org.

Last, if your organization's strategic plan includes fundraising, be aware that many states regulate organizations that solicit funds within that state. Your county or city may also have fundraising regulations in existence. Compliance usually involves obtaining a permit or license and then submission of annual reports and financial statements. Your state attorney general's office and/or secretary of state can provide additional information on regulations that exist and the procedures for compliance.

Conclusion

Forming a nonprofit can be a daunting task and is a detailed operation. It involves a great deal of paperwork, time, effort and devotion by its founders, founding board and initial stakeholders. However, the satisfaction of contributing to an organization and being part of a change movement can be extremely rewarding. Hopefully this booklet has provided you with information to consider in the beginning phases in the life of a nonprofit organization and has helped to familiarize you with the process and requirements involved in both the incorporation and obtaining tax-exempt status. While this booklet does not address every detail, it is designed to guide you through the legal and procedural hoops and over the hurdles of incorporating as a nonprofit. Congratulations on your first steps. May you have great success in your nonprofit endeavor.



Checklist

The following checklist is designed assist you on your nonprofit incorporation journey. Use the boxes to the left of the items to check off tasks as you complete them. Add to the list items and activities that you decide are needed.

PRE-INCORPORATION

- Mission Statement
- Business Name
- Recruit Board of Directors
- Draft Bylaws
- Record Keeping Procedure Identified
- Determine Your Accounting System
- Open a Bank Account

INCORPORATION STAGE

- Locate Your State's Corporate Filing Center
- Prepare Your Articles of Incorporation
- File Your Articles of Incorporation
 - Correct Number of Copies
 - Correct Fee Included

FEDERAL TAX EXEMPTION

- Obtain your Employer's Identification Number
- Requirements
- Correct Fee Included



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