

ALTERNATIVES TO STARTING A NEW NONPROFIT

While many people are tempted to incorporate first, there are a number of options for undertaking a new activity without starting a new organization.

Because most people thinking about starting a nonprofit have more passion for the purpose than the paperwork, it is wise to understand the ongoing reporting and record keeping requirements for nonprofits. These obligations represent substantial time and financial requirements and can be an obstacle to success and an unwanted distraction for people wanting to spend their time directly involved in serving people, creating art, or promoting a cause.

Since many nonprofits are formed with high hopes and a few dedicated people and never get off the ground, investing time on the front end to determine the level of interest and availability of funds can help you better understand whether a new organization is needed.

Here are five alternatives to starting a new organization:

- Join an existing effort — Study the list of nonprofits already active in the same subject and geographic area and join their efforts as a volunteer, a board member or even as staff.
- Create a special program of an existing effort — Analyze the list of nonprofits already active in the same area, identify the three most compatible with your ideas, and meet with them to explore creating a special project or initiative and negotiate your involvement. You may have ideas that they would welcome, including resources that may be available to finance the new undertaking. Your activity could be a sponsored project with a level of independence, but without the need for separate books, government reporting and boards and committees.
- Start a local chapter of a national or regional organization — Explore the list of national organizations in the subject area of your interest, and see if a local chapter is needed in your geographic area.
- Maintain an informal organization — This is a viable option for groups with annual revenues under \$25,000 with no employees. If your effort will be quite local and small, consider forming an unincorporated association or club -- have meetings and activities but skip the ongoing reporting requirements. Informal organizations can operate as a nonprofit, however, donations to an informal organization are not tax-deductible.

However, those that choose to remain informal may undertake risk to board members and founders by not incorporating the organization. By incorporating, the organization becomes a legal entity and can only be liable for the assets of the organization. An incident involving an unincorporated organization may put personal assets of board members, volunteers, or others, at risk.

- Find a fiscal sponsor for your organization — If you are considering creation of a group to finance activities or needs of others, plan to work on a limited-time project, or want to test a program idea first, exploring fiscal sponsorship. Fiscal sponsorship, sometimes referred to as fiscal agency, is a way to receive tax-deductible contributions by using the tax-exempt status of another organization as an umbrella.

Fiscal sponsors often provide more than the use of their tax-exempt status. They often co-locate, provide accounting and administrative services, and strategic planning guidance. The sponsored organization will pay a fee to the sponsor for their services, generally around 10 percent of the organization's revenues.

Fiscal sponsorship is a complex, individualized process. Organizations considering working with a sponsor should first identify several possible sponsors with missions in sync with that of the new organization. Work with each of these organizations to find the best fit in terms of missions, working style, and location. Will the sponsorship be structured to re-grant monies to the new organization? Will the sponsored organization purchase services from its sponsor? At what cost? How will both be assured against tax fraud. It is recommended that both parties consult with legal professionals to ensure their interests are being met in the sponsorship agreement.

STAGES OF DEVELOPMENT

It is common for organizations to go through four distinct stages during start up. While it may seem easiest and most efficient to complete the entire start-up process at the onset of the new organization, many new nonprofits find it more manageable to grow slowly into their nonprofit status.

1. Many organizations start out as an informal organization. Your organization can continue with programs and activities informally as long as revenues do not exceed \$25,000 per year and the organization does not employ anyone.
2. As donations and activities grow, the organization may find a fiscal sponsor to aid with reporting requirements, administrative tasks, and to lend their tax-exempt status. This allows the organization to continue to focus its attention on programs.
3. An organization may then incorporate at the state level and maintain fiscal agency, or begin to establish itself on its own.
4. Finally, the organization may apply for tax-exempt status from the Internal Revenue Service. If accepted, the organization is now able to accept tax-deductible donations and is responsible following regulations set by the IRS and the state, and for reporting annually to the IRS, Secretary of State's Office, and Attorney General's Office.

As an organization goes through these stages of development, it may stop at any point and choose not to go further. Following these stages can allow your new organization to grow and succeed at its own pace.

STEPS TO BECOMING A NONPROFIT

Starting a new nonprofit is neither an easy nor a swift task. Staying legal through the process can be difficult if you are not prepared. Below is an outline of the major steps necessary to start a nonprofit in the state of Minnesota. These steps are meant to be used as a general guide and may not apply to all situations. In some more complex situations, legal assistance may be necessary.

VISIONARY STAGE

Step 1: Determine if you really need to start a nonprofit.

Is starting a new nonprofit organization really the best way to accomplish the goals you have set forth? Other alternatives, including collaborating with an existing nonprofit organization, establishing an informal club or association (a viable option for groups with annual budgets under \$25,000), finding a fiscal sponsor, or forming a for-profit business, may achieve your objectives quicker, more efficiently, and for the best benefit of your target audience.

Step 2: Decide on the purpose and mission.

The purpose of a charitable nonprofit must be for the public interest and common good. It should establish a single mission and a set of goals and programs that will accomplish that mission.

This is a step where a new nonprofit should analyze what it wants to do, to whom it wants to reach, and how it wants to impact society. A mission statement should be brief, timeless, and descriptive of what the organization is trying to accomplish. This statement will guide the organization through its initial formation, program development, growth and change.

Step 3: Recruit board members.

The initial board of directors will assume much of the responsibility in starting a new nonprofit. They will determine the direction and goals of the organization and set forth precedents for future board members. The first board writes the articles of incorporation and approves the original bylaws, does much of the initial fundraising and hires staff as the organization takes shape and becomes an entity in and of itself. This initial all-volunteer period can prove to be very challenging for new organizations.

Step 4: Check for availability and reserve a name.

Not only is it Minnesota law, it is crucial to your new organization's identity to obtain a unique name under which to operate. Any potential names for a new business or nonprofit can be checked through the Minnesota Secretary of State's Office for duplications. Organizations should reserve a unique name through the Minnesota Secretary of State's Office. Once a name is reserved, no other organization may use that name. To reserve your organization's name, use the "Request for Reservation of Name Form" available from the Minnesota Secretary of State. The filing fee for this form is \$35.

PLANNING STAGE

Step 5: Write the articles of incorporation.

The founders of the organization should write its articles of incorporation. This document formally names the entity, its location, and its purpose. This document is the legal record of how the organization is to be managed. The Minnesota Nonprofit Corporation Act, Section 317A of the Minnesota Statutes, lists laws that govern Minnesota nonprofit corporations. It is important to remember when drafting the original articles of incorporation that parts of the Minnesota Nonprofit Corporation Act state the default laws that nonprofits must follow, unless their articles or bylaws state otherwise.

It is necessary to write and file the articles of incorporation prior to applying for tax-exempt status from the Internal Revenue Service. The IRS requires specific language to be used describing the charitable purpose of the organization, and the requirements it must follow for exemption. The sample articles of incorporation provided by the Secretary of State's Office do not include this information.

Step 6: Incorporate as a nonprofit organization.

The main purpose of incorporating an organization is that of risk management. Filing articles of incorporation with the Minnesota Secretary of State's Office provides a limited liability for the governing body of the organization. If directors act in a responsible, reasonable way, they can avoid personal liabilities to creditors of the organization. However, this does not include debts to the Internal Revenue Service for due payments, or due to fraudulent activities.

Incorporating an organization also provides stability during personnel changes, eases future relationships with funders, contractors and employees, and provides the means to apply for tax-exempt status through the IRS. Once the articles are filed, the organization will receive a "Certificate of Incorporation" from the Minnesota Secretary of State's Office. This certificate includes a charter number unique to that organization. The charter number is used only internally by the Secretary of State. To incorporate, send your organization's Articles of Incorporation to the Minnesota Secretary of State, Business Services Division. The filing fee is \$70.

Step 7: Create a business plan with a budget

Creating a thoughtful business plan during these beginning stages of a new nonprofit can provide a sense of direction to the organization as it develops. A plan should include what the organization's goals are, what programs it will operate, where it will get funding, will it conduct events, will the organization have staff, volunteers, and more. It should also include a budget plan. Where will funding come from? Will programs rely on grants, individual donations, state or federal contracts? What expenses will the organization incur?

A business plan and budget are not only useful in thinking through the structure of the organization, but they are required as part of the narrative section of IRS Form 1023, Application for Tax-Exempt Status.

Step 8: Draft the corporate bylaws.

The bylaws will serve as the rule book for the nonprofit. Section 317A of the Minnesota Statutes is the basis for Minnesota's nonprofit law, and the organization's bylaws should follow this law. There is substantial flexibility to writing the organizational bylaws to fit the uniqueness of an organization. They are flexible and relatively easy to amend as the organization changes and grows.

Bylaws are much easier to amend than the articles of incorporation and should be reviewed frequently. This document should be more detailed than the articles of incorporation and address the following organizational issues:

- Membership — if the organization will have members, who they are, how/when membership meetings will occur, what notice is required for meetings, requirements of a special meeting, quorum, and voting.
- Board of directors — number, election process, meetings, length of term, number of terms allowed, vacancies, removals, quorum, officers, and standing committees.
- Fiscal management — fiscal year, and committee/officer responsibilities, compensation of directors, reporting requirements and dues.
- Amendments — how will amendments be made and approved.

Step 9: Hold first meeting of the board.

The first official meeting should consist of the initial board members or incorporators. This gathering marks the official start to the organization.

At the first meeting of the board, the initial board members must approve the drafted bylaws and adopt its principles. The new organization will also vote on new board members and officers as it is called for in its bylaws. Once these activities are accomplished, the board should begin tackling the mission and start the process of obtaining tax-exempt status.

FEDERAL FILING

Step 10: Apply for Federal ID Number (EIN).

Nonprofit organizations should have an EIN, often referred to as a Federal ID Number, even if it has no employees. The EIN acts similarly to the social security number for individuals and may be requested when opening a bank account or in other fiscal operations. Organizations must receive their EIN before filing Form 1023. Use IRS Form SS-4 — Application for Employer Identification Number (EIN). Organizations must be incorporated prior to applying for an EIN. There are no filing fees. Processing can take up to five weeks if application is through mail or fax; it's immediate through Tele-TIN telephone filing. Minnesota organizations should mail their application to: IRS, Attn. Entity Control, Stop 6800, 2306 E Bannister Rd, Kansas City, MO 64999. For more information, call 1-866-816-2065 between 7:30 a.m. and 5:30 p.m.

Step 11: Obtain income tax exempt status from the IRS.

Once the organization's articles of incorporation have been filed and the bylaws have been approved by the initial board of directors, the next step for a new nonprofit is applying for federal tax exemption from the Internal Revenue Service. A common myth is that all nonprofits are automatically tax-exempt.

There are several steps and filing requirements an organization needs to complete before receiving exemption. And even then, not all organizations qualify for the same exemptions. The following applies for 501(c)(3) status from the IRS, the most common type of tax-exempt organization.

First, obtain IRS Publication 557— Tax-Exempt Status for Your Organization. This 55-page document includes no forms to file, but lays out the federal laws regulating tax-exempt organizations. It is available free and serves as a useful reference guide for filing requirements, employment issues, lobbying expenditures, and many other complex nonprofit issues regulated by IRS codes.

Second, get copies of IRS Form 1023 and Form 8718 — Application for Recognition of Exemption under 501(c)(3) of the Internal Revenue Code. Form 1023 applies for for a ruling or determination letter on an organization's exempt status under Section 501(c)(3). This package of forms contains both Form 1023 and Form 8718 (User Fee for Exempt Organizations Determination Letter Request). Form 8718 is used to process the fee for applying for tax-exempt status and must be included when filing Form 1023. Organizations applying for exemption under another 501(c) section should file IRS Form 1024.

The filing fee is \$500 for organizations anticipating gross receipts averaging more than \$10,000 during its first four years and \$150 for organizations anticipating gross receipts averaging less than \$10,000 during its first four years.

IRS Form 1023 and 8718 must be submitted together. Processing time varies, but can take six months. Mail the forms to IRS, PO Box 192, Covington, KY 41012-1092.

MINNESOTA FILING

Step 12: Apply for sales tax exemption from the state.

Some (not all) nonprofits qualify for exemption from sales tax on purchases through the Minnesota Department of Revenue. This exemption allows purchases on office supplies, furniture, vehicles, computer equipment and other taxed items to be purchased without a 6.5 percent (7 percent in Minneapolis and St. Paul) sales tax. Most exemptions are given to purely educational or direct service organizations. To find out if an organization may be eligible for sales tax exemption, contact the Minnesota Department of Revenue Sales and Usage Tax Division at 651-296-6181 or 1-800-657-3777.

To apply for sales tax exemption, organizations must complete and submit Form ST-16 — Application for Certificate of Exempt Status. Submit the form to Minnesota Department of Revenue, MS 6330, St. Paul, MN 55146.

Step 13: Receive tax identification number, if needed.

If the organization will sell products or services subject to Minnesota sales tax, withhold Minnesota income taxes from employees, pay Minnesota Care taxes or special taxes, or are a vendor of goods or services to a state government agency, the organization must receive a tax identification number from the Minnesota Department of Revenue.

To obtain a tax identification number, complete and submit Form ABR (Application for Business Registration). Organizations must submit this form if they register for at least one type of tax, including sales and withholding taxes, income tax, and excise and gross receipts taxes. The package also includes registration forms for each of these taxes and instructions. There are no filing fees. Mail the completed form to: Minnesota Department of Revenue, MS 4410, St. Paul, MN 55146.

Step 14: Register as a charity.

The Charitable Solicitation Act, Chapter 309 of the Minnesota Statutes, states that nonprofits must register as a charity with the Attorney General's Office, Charities Division. An organization does not need to register only if it meets one of the following three conditions:

1. does not hire staff or a professional fundraiser and does not plan to receive more than \$25,000 in total contributions;
2. is a purely religious organization; or
3. is a private foundation that does not solicit contributions more than 100 persons during a fiscal year.

An organization must register with the Attorney General before soliciting contributions. Do so by filing a Charitable Organization Registration Statement with a copy of the organization's articles of incorporation, IRS determination letter, and most recent financial statement. The filing fees are \$25. Mail the Statement, attachments, and fee to: State of Minnesota, Office of the Attorney General, Charities Division, Ste 1200 NCL Tower, 445 Minnesota St., St. Paul, MN 55101.

ANNUAL FILING

Step 15: File annual registrations.

Annual reporting ensures nonprofits are held accountable for their charitable fundraising and annual expenditures. Qualifying organizations must submit the following three types of documentation annually.

1. IRS Form 990 — Return of Organizations Exempt from Income Tax

Even though a nonprofit organization may be tax exempt, it must file an annual tax return with the Internal Revenue Service. Generally, charities with more than \$100,000 in gross revenues and more than \$250,000 in total assets must file the Form 990; smaller charities may file the EZ Form.

This is the most detailed and most misunderstood filing for nonprofits. It is the most complete documentation of an organization's financial history and is often used to hold the organization accountable for its past actions and future decisions. Recent rulings by the Internal Revenue Service state that nonprofit organizations must make their Form 990 and applications for tax-exempt status widely accessible and available to anyone who requests. The Form 990 is available in the back of this book.

There are no filing fees but severe penalties apply for filing late or failing to file. IRS Form 990 should be mailed to: Internal Revenue Service, Ogden, UT 84201-0027.

2. Charitable Organization Annual Report Form

The Charitable Solicitation Act states that an annual report must be filed with the Attorney General by the 15th day of the 7th month after the close of the organization's fiscal year. An organization must also include a copy of IRS Form 990 and an audited financial statement, if applicable. The filing fees are \$25 and should be mailed with the annual report form to: State of Minnesota, Office of the Attorney General, Charities Unit, Ste 1200, NCL Tower, 445 Minnesota St., St. Paul, MN 55101.

3. Nonprofit Corporation Annual Registration

After an organization has filed for incorporation, it must continue to register annually with the Minnesota Secretary of State. Failure to register by December 31 each year will result in the dissolution of the organization, and a \$25 fee will apply to reinstate the organization's corporate existence.

The Secretary of State's Office will send the incorporated nonprofit its registration form each year with the organization's name and address already completed. If that information has changed, the organization will also need to amend its articles of Incorporation. There is no filing fee if the annual registration is filed on time. There is a \$25 fee to reinstate corporate registration the form is filed late. The form should be mailed to: Secretary of State, Records Processing Division, 180 State Office Building, 100 Constitution Ave., St. Paul, MN 55155-1299.

CHECKLIST OF FORMS, PUBLICATIONS AND FEES

| Form | Fee | Submit to | Description |
|---------------------------------|----------------|-----------------------|--|
| Publication 557 | None | N/A | An IRS publication that details the rules and procedures for seeking to obtain exemption from federal income taxes |
| Request for Reservation of Name | \$35 | Secretary of State | Reserves a unique name for the organization. |
| Articles of Incorporation | \$70 | Secretary of State | Legally incorporates the nonprofit. |
| Form SS-4 | None | IRS | Applies for Employer Identification (Federal ID) Number. |
| Form 1023 and Form 8718 | \$500 or \$150 | IRS | Applies for federal tax exemptions under Section 501(c)(3) of the IRS tax code. Must accompany Form 8718 (User Fee for Exempt Organizations Determination Letter Request). |
| Form ST-16 | None | Department of Revenue | Applies for exemption from Minnesota sales taxes. (Not all 501(c)(3) organizations qualify for this exemption.) |
| Form ABR | None | Department of Revenue | Registers for tax ID number for organizations collecting tax on |

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| | | | products or services, or withholding taxes for employees. |
| Charitable Registration | \$25 | Attorney General | Registers the organization for charitable solicitation. |
| Form 990 | None | IRS | Files tax return for tax-exempt organizations. |
| Annual Report | \$25 | Attorney General | Files annual financial statements. |
| Annual Registration | None | Secretary of State | Maintains organization incorporation status. Organizations must pay a \$25 fee to reinstate its incorporation. |

HOW TO START A NONPROFIT: FAQs

Q: What's the difference between the articles of incorporation and the bylaws?

A: The articles of incorporation set up the basic terms of the corporation, such as its purpose and board of directors. The bylaws are the rules the organization adopts by which to govern itself. The articles serve like the organization's declaration of independence and the bylaws are like its constitution and laws.

Q: We are just a small group, do we need bylaws?

A: No. Bylaws are not required but can help define the organization and its governance structure. If questions arise down the road, bylaws can help future staff and board members determine the actions that must occur. Organizations that do not have bylaws must legally default Minnesota Statute 317A, known as the Nonprofit Corporation Act.

Q: Why should I incorporate my organization?

A: Benefits to incorporating include the ability to purchase property, accept donations, enter into contracts, and dissolve when appropriate. Incorporating also provides limited protection to the governing body of the organization, as long as no wrongdoing by the board has occurred, they cannot be held liable.

INFO CENTRAL: MISSION AND VALUES

A nonprofit is founded for public benefit and operates to accomplish a well-defined, articulated mission. Its programs effectively and efficiently work toward achieving that mission and it is committed to continuous quality improvement. Based on the values of quality, responsibility, and accountability, nonprofit board members, volunteers, and employees act in the best interest of achieving the organization's mission at all times.

A. Mission

1. A nonprofit's purpose -- the answer to the question, "Why?" as defined and approved by the board of directors -- should be formally stated in writing. The organization's activities should be consistent with its stated purpose.
2. A nonprofit should, at least biennially, revisit its mission to determine if the need for its services continues to exist. The organization should evaluate whether the mission needs to be modified to reflect societal changes; whether the organization's current programs should be revised or discontinued in light of the existing or newly defined mission; or whether new services need to be developed.
3. A nonprofit should have defined, replicable procedures in place for evaluating (both qualitatively and quantitatively) its processes and outcomes in relation to its mission. These procedures should address the efficiency and cost-effectiveness of processes and outcomes.

B. Program Service and Quality

1. A nonprofit should act with the utmost professionalism and treat all persons equally and with respect.
2. A nonprofit should regularly monitor the satisfaction of service participants as well as other parts of the organization's constituencies and provide a grievance procedure to address complaints.
3. A nonprofit should practice continuous quality improvement that includes evaluation and tracking of information.

C. Values

1. A nonprofit should act with integrity, openness, and honesty in all relationships, dealings, and transactions. A nonprofit should strive to earn and convey trust through integrity, openness, and honesty.
2. A nonprofit should keep faith with the public trust through efficient, cost-effective, and compassionate stewardship of resources. A nonprofit should be mindful that its mission is accomplished through the generosity of others.
3. A nonprofit should ensure that policies and procedures of human relations are legally grounded, of high quality, and respectful of the dignity and rights of individuals.

D. Commitment to Diversity, Accessibility, and Social Justice

1. A nonprofit should respect all people's race, religion, ethnicity, gender, age, socioeconomic status, sexual orientation, and ability and should not allow differences to affect a person's opportunities.
2. A nonprofit's board, staff, volunteers, and contractors should reflect the diversity of the organization's constituencies and the broader community.
3. A nonprofit should conduct its work in facilities that allow reasonable access to persons of all ability levels.
4. A nonprofit should act in ways that further the equality of opportunity among individuals and communities.
5. A nonprofit should act in ways that promote a sustainable environment.