

Forming a North Carolina Nonprofit – Process Overview

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Important: *The information provided in this document is intended to be for educational purposes. As laws are constantly changing, the reader should be aware of legislative, administrative and judicial developments that may have occurred since preparation of this document. Professional legal or tax advice should be sought for guidance with respect to a particular organization.*

There is a considerable monetary and human resource cost required for the creation and ongoing administration of a nonprofit organization. Resources committed to administration are resources diverted from vital mission activities. It is therefore in the best interest of the charitable sector and those contemplating the startup of a new nonprofit to consider all available options for bringing their philanthropic vision to life.

A fundamental difference between a private for-profit entity and a nonprofit is a public expectation of shared governance and public accountability. Much of a founder's control over the organization present during the startup phase will need to be quickly passed on to an independent board of directors if the nonprofit is to attract broad public support and achieve best practices of governance and accountability.

There is a wide range of circumstances that make formation of a new nonprofit entity the best choice, but it should not be assumed that every philanthropic vision requires a new organization. As successful nonprofit leaders will attest, the nonprofit sector has the potential to accomplish more as a whole through the potential synergies afforded by partnership or collaboration.

It is common for a visionary to seek to place his or her unique footprint on a new organization. Independent entrepreneurial spirit is the impetus that often propels a philanthropic vision from dream to reality. Prior to the decision to create a new organization, however, the founder(s) should consider any reasonable alternative. There may be more than one way to bring the mission to life while providing the founder with the level of control necessary to lead and shape the vision.

To illustrate, the desired mission activity might be initially assumed as a separate program of an existing nonprofit with a compatible mission, commonly referred to as fiscal sponsorship. Resource savings may also be achieved by alternatively forming a nonprofit eligible to be covered under an existing IRS group exemption. This requires a mission closely aligned or identical with the exempt purposes of the central organization. For example, local chapters of a national nonprofit are typically covered under an IRS group ruling.

After due consideration has been given to alternative structure and the decision has been made to form a new organization, the following actions comprise the minimum requirements necessary to form a North Carolina nonprofit and be considered exempt under Section 501(c)(3) of the Internal Revenue Code:

- Recruit and assemble an initial board of directors consisting of persons with affinity to the philanthropic vision. The startup board should ideally represent a diversity of skill sets and be sufficient in size so that a majority of directors consist of unrelated persons.
- Form a mission statement. It should be brief (1 or 2 sentences), concise, and clear. This goes to purpose for existence, i.e. why is this new nonprofit needed? It does not concern activity but rather the expected outcome of the activity, i.e. what difference will it make?
- Prepare a strategic and operational plan. This is the road map for implementing the mission statement. The financial projections and marketing plan are usually the most important elements.
- Form a nonprofit organization. Caution: It would be prudent to consult legal counsel before deciding to take any of the following steps individually. (Note: It is assumed that a nonprofit corporation formed under Chapter 55A of the NC Statutes, Nonprofit Corporation Act, is the desired form of exempt entity.)
- File articles of incorporation with the NC Secretary of State. The required fee is \$60. Form N-01 can be obtained from the NC Secretary of State/Corporations website. The articles of incorporation must include certain additional organizational provisions as set forth in Section 501(c)(3) of the Internal Revenue Code in order to be later recognized by the IRS as tax exempt. Refer to IRS Publication 557 and the instructions to IRS Form 1023.
- After the articles of incorporation have been filed and accepted by the Secretary of State (usually within 2 weeks), obtain a federal employer identification number by completing IRS Form SS-4 online using the EIN Assistant. There is no fee. This is needed for the IRS exemption application, financial accounts, and various government filings.
- Prepare bylaws. The bylaws are the rules and governing procedures for operating the nonprofit. They put flesh on the skeleton articles of incorporation. If the bylaws are not prepared by legal counsel, it may be prudent to submit the draft bylaws to counsel for review.
- Conduct a board meeting on organizational matters. This would typically include adoption of the bylaws and appointment of corporate officers, identification of key written policies to be prepared, and other initial business of the corporation.

- Board and executive staff should familiarize themselves with the various federal compliance requirements as set forth in IRS Publications 1771 - Charitable Contributions-Substantiation and Disclosure Requirements and Publication 4221 - Compliance Guide for 501(c)(3) Tax exempt Organizations. *Legal and Tax Issues for North Carolina Nonprofits*, by Dennis Walsh CPA provides a concise summary of common compliance issues and a helpful internal review questionnaire.
- Apply for recognition of exemption from the IRS using Form 1023, or Form 1023-EZ if eligible. If Form 1023 is submitted within 27 months, then recognition of exemption will be retroactive to the date of entity formation.
- It is not necessary to apply for recognition of exemption until average annual receipts (including in-kind support) exceed \$5,000. For the initial years of operation, recognition of exemption is not required if:
 - First year gross receipts (all sources of support) do not exceed \$7,500.
 - Combined gross receipts for the first two years do not exceed \$12,000.
 - Combined gross receipts for the first 3 years do not exceed \$15,000.
- The user fee that must accompany Form 1023 is currently:
 - \$600 if applying on Form 1023
 - \$275 if eligible to apply on Form 1023-EZ
- Regarding the IRS processing of Form 1023, it is likely to require anywhere from 3 to 12 months (possibly longer) to receive a determination letter. This will depend on the nature and complexity of the organization and current IRS workload. It is not unusual to receive questions from the Exempt Organizations Division in the process. If a major grant or contribution is contingent upon furnishing a determination letter by a certain date, a request for expedited processing may accompany Form 1023.
- Register with the North Carolina Secretary of State Charitable Solicitation Licensing (CSL) Section prior to soliciting contributions. The annual license fee ranges from \$0 to \$200 based on total applicable contributions. Registration may be performed online at the NC Charitable Solicitation License (CSL) website. Once subject to licensing, a special disclosure statement must be displayed on all fundraising materials and confirmations to donors.
- Before remitting compensation to officers or key employees, the board should undertake to set reasonable compensation, i.e. compensation that is reasonable in relation to the value of services to be performed, and document its decision process in accordance with IRS regulations

- Before remitting payroll for the first time, register with the North Carolina Department of Revenue to obtain an employer's account for depositing state income tax withheld from wages. State unemployment compensation coverage and workers compensation insurance may also be applicable. An accountant, bookkeeper, or other qualified person familiar with employment matters should be consulted to familiarize the organization with tax deposit procedures and employment related responsibilities.
- If the nonprofit plans to sell taxable goods or services subject to the collection of North Carolina State and county sales taxes it must register as a seller with the NC Department of Revenue. Exceptions exist for certain fundraising related sales.
- Establish eligibility to receive refund of North Carolina State and county sales and use taxes paid on qualifying purchases. Once eligible, file Department of Revenue Form E-585 semi-annually to claim such refunds.
- In order to claim exemption from property tax for property used wholly and exclusively for charitable purposes, file NC Department of Revenue Form AV-10 with the local county assessor in January of the year in which property is placed in qualifying service.
- File applicable IRS Form 1099 series returns annually for any reportable payments totaling \$600 or more per year to any single recipient. Common reportable payments include rent, professional services, services of trade contractors, and services of persons properly classified as independent contractors (as opposed to employees).
- File the required annual exempt organization information return with the IRS - Form 990-N ("e-Postcard"), 990-EZ, or 990, depending on total gross receipts and total assets. The required Form 990 must also be filed by the regular due date while recognition of exemption is pending.

The preceding list covers the most basic organizing and recurring filing requirements, but is by no means exhaustive. Nonprofit staff should always be within reach of advisors skilled in nonprofit legal and tax compliance matters in order to identify additional obligations and opportunities specific to a particular organization.

Free Resources Helpful for Starting and Operating a Nonprofit

Core publications:

- ✓ Guidebook for Boards of Directors of North Carolina Nonprofits - from the NC Bar Association
- ✓ State Taxation and Nonprofit Organizations, available from the North Carolina Department of Revenue
- ✓ Fact Sheet #17A: Minimum wage & overtime exemptions Under the FLSA, available at the U.S. Department of Labor website

Also available from the Internal Revenue Service at www.irs.gov:

- ✓ Publication 557 Tax exempt Status for Your Organization
- ✓ Publication 598 Tax on Unrelated Business Income of Exempt Organizations
- ✓ Publication 15 Employer's Tax Guide
- ✓ Publication 15-A Employer's Supplemental Tax Guide
- ✓ Publication 1771 Charitable Contributions-Substantiation and Disclosure Requirements
- ✓ Publication 4221 Compliance Guide for 501(c)(3) Tax exempt Organizations

Other technical resources:

- ✓ GuideStar USA – Database of IRS Forms 990 and other organization specific data - www.guidestar.org
- ✓ Idealist.org – The Nonprofit FAQ - <http://www.idealist.org/if/idealist/en/FAQ/Nonprofit/Home/default>
- ✓ Form 990 Online - National Center for Charitable Statistics – <http://efile.form990.org>

Serving Nonprofit Organizations:

- ✓ Guilford Nonprofit Consortium – serves Guilford County nonprofits www.guilfordnonprofits.org
- ✓ NC Center for Nonprofits – Statewide nonprofit membership organization offering 1 hour pro bono legal and accounting assistance program www.ncnonprofits.org
- ✓ WNC Nonprofit Pathways – serves western NC www.nonprofitpathways.org

Personal development:

The Duke University Certificate Program in Nonprofit Management offers low-cost classes in a wide range of practical subjects, in various regional locations. Led by skilled nonprofit practitioners, classes may be taken individually or toward certificate completion. Visit <http://learnmore.duke.edu/nonprofit>.