
STEPS TO BECOMING A NONPROFIT

Minnesota Council of Nonprofits

Starting a new nonprofit is neither an easy nor a swift task. One of the first steps is establishing an Advisory Committee, which may become the founding board, to guide the organization through the following 11 steps. 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. These steps are 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 affect 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.

It is crucial to your new organization's identity to obtain a unique name under which to operate. You can check any potential names for duplications through your Secretary of State's Office. Once a name is reserved, no other organization may use that name. Generally, you must file an official "Request for Reservation of Name Form".

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. It is important to remember when drafting the original articles of incorporation that each state has 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.

Step 6: Incorporate as a nonprofit organization.

The main purpose of incorporating an organization is that of risk management. Filing articles of incorporation 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”. This certificate includes a charter number unique to that organization.

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. 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 initial board of directors has approved the bylaws, 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. 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.

Additional Activities include:

Staff leadership:

Identify an individual who can devote energy, skills and time to formalize the organization and may become the Executive Director

Staffing:

Assess the expertise and staff needed to get the organization through the beginning years
Generate alternatives for filling staffing needs (volunteers, interns, part-time staff, contracted personnel)
Develop basic orientation plan for staff

Financing:

Scout potential funding sources and target one or more sources for start-up
Develop a fundraising plan and cultivate relationships with donors

Administrative systems:

Decide where you will be housed
Locate a source of accounting expertise and/or a fiscal agent
Determine compliance requirements
Identify possible administrative needs and include in business plan
Identify legal counsel