



NOT-FOR-PROFIT WORKSHOP

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What you will learn today...

- **What** is a not-for-profit (“NFP”)?
- **Why** would one form a not-for-profit?
- **How** would one form a not-for-profit?
- What are the **legal obligations** when operating a not-for-profit?

Oversight and Governing Law

- **Non-Profit Corporations Law** (NPCL) grants authority to Attorney General to regulate charities
- **Nonprofit Revitalization Act 2013** (NPRA) simplified certain provisions of the NPCL
- **Attorney General** has oversight of NFPs in New York
 - Charged with protecting the interests of the general public which charities serve
- **Charities Bureau** protects against fraudulent fundraising, self-dealing, conflicts of interest, irresponsible investments, and other unlawful practices.
- **Estate Powers and Trusts Law** (EPTL) grants AG jurisdiction over charitable gifts

Corporate Formation

- ✓ A Not for Profit (NFP) is a type of corporation
- ✓ When you form a corporation, you create a **separate legal entity** that operates separately from its founders, trustees, officers, and stockholders
- ✓ Generally, the corporate form will shield you from individual liability for the corporation's obligations and debts (the "corporate shield" or "corporate veil").
- ✓ Forming a corporation is a necessary step in obtaining federal tax exempt status.
 - **Only corporations** can be granted 501(c)(3) status.

Myths!

- X A NFP **cannot** make a profit.
- X If I start a NFP, **I own** the NFP
- X It is okay to start a nonprofit so that I can make money from my **artwork**.
- X If I decide not to continue operating my NFP, I can just **walk away** from it and cease operations.



Decide Between Forming a For-Profit or NFP Company

Form a for-profit if...

- **PROFIT MOTIVE** is a significant motivation
- **INVESTORS** are a primary source of initial funding
- **CONTROL** by one or two individuals
- **HIGHER COMPENSATION**



Decide Between Forming a For-Profit or NFP Company

Form a not-for-profit if...

- Motivated by a **SERVICE MISSION**
- They understand a **BOARD OF DIRECTORS** will govern
- The Company fills a **COMMUNITY OR PUBLIC NEED**
- The company is supported by **CONTRIBUTIONS**



Key NFP Factors to Consider

1. No one **owns an NFP**
2. Exists to **benefit the public**
3. NFP **founder can be voted out** by NFP Board at anytime
4. The NFP is a “**fictitious person**” under the law
5. Upon **dissolution**, all of the NFP’s assets must be distributed to **another NFP** or to **NY state**
6. A NFP provides **limited liability** to its directors, officers, or trustees



How “Limited” is liability?

Generally, directors of a non-profit corporation have limited liability. Not-for-Profit-Corp. Law § 720-a. But:

- Only an uncompensated director, officer or trustee of a corporation, association, or organization is immune.
 - If compensation is received, other than reimbursement for expenses, any damages assessed in such actions cannot exceed the last 12 months of their compensation.
- No limit on liability for conduct that is **grossly negligent, willful misconduct, or for liability** to the **NFP itself**.

Three Steps to Forming a NFP

1

File for **Incorporation** with the New York Department of State

2

File for **Federal Tax Exemption** with the IRS

3

File for **State Tax Exemption** with the State

Step 1: to incorporate, you must:

1. Choose a **Corporate Name (3 options)**

Must be a corporation NOT an LLC (name ends in “Corp.”, “Inc.”, or “Ltd.”)

2. File **Certificate of Incorporation**

3. Draft **Bylaws**

4. Conduct Initial **Organizational Meeting of the Board**

Certificate of Incorporation (“COI”) Includes:

- Corporate (not-for-profit) **purpose**
- Designation of charitable or **non-charitable** organization
- County **location** of main office
- Names of **initial members** of the Board of Directors – at least 3
- Registered **Agent** – usually Secretary of State
- Names of **Incorporators (founders)**



COI: What is a “NFP purpose”?

“Charitable” purposes according to 501(c)(3) of the IRC and as according to Section 102 of the NPCL:

- educational,
- religious,
- scientific,
- literary,
- cultural, or
- for the prevention of cruelty to children or animals.



COI: Corporate Purpose



A comprehensive corporate purpose will answer the following questions:

- **Why** is the NFP being formed?
- **What** does the NFP intend to accomplish?
- **Who** will directly or indirectly benefit?

COI: Corporate Purpose



- More **detail** than a general philosophy
- Do **not** use **vague** or **general** descriptions
 - Should be **specific** and **unique**
- Do **not** use “**including but not limited to**” when describing the purpose
- **All purposes** should be enumerated
- Must indicate that your corporation is for the **public benefit**
- How will the corporation **achieve** its purpose?
 - State intended activities – not required but helpful

Example of Corporate Purpose: Theatre Ensemble

To develop a way of working based on the teachings of [a famous theatrical figure] and to encourage public interest in their contributions to the art and technique of acting.

State the **intended activities** of the organization:

- *In furtherance of the general purpose, the Corporation may do any of the following:*
 - Undertake **ensemble development**
 - Work with **other artists** on classes, workshops and other similar activities for artists of varying ages, disciplines and levels of experience to explore ensemble theatre
 - Work with **non-artists** to bring acting and performing arts experiences to members of the **general public** through classes, workshops and other activities

Example of Corporate Purpose: Music Organization



To provide free and low-cost after school music enrichment to children from elementary school through high school in underserved school districts, where there is no music program.

State the **intended activities** of the organization:

- *In furtherance of the general purpose, the Corporation may do any of the following:*
 - Provide **instrumental lessons**
 - Engage musicians to conduct **master classes** with students and conduct classes, workshops and other similar activities for students to explore different genres of music
 - Hold bi-annual **recitals** or opportunities for public performances to showcase the musical development of students

COI must include the following affirmative provisions:

1. No **private inurement**
2. NFP will **not campaign** for political candidates
3. Lobbying for **legislation** is not a “substantial part” of NFP’s activities
4. Upon **dissolution**, the NFP must transfer assets to another 501(c)(3) or the state



COI: Additional Sample Language

- *The undersigned, a natural person of 18 years or over, desiring to form a corporation under the provisions of the NPCL certifies that [name of NFP]:*
- *Is a corporation as defined by Section 102 of the NPCL and shall be a **charitable corporation***
- *Is formed for **charitable purposes** under §102(3)(b) of the NPCL (or noncharitable purposes under §102(9)(a))*
- *Will not engage in any activity or for any purpose without obtaining **required consent** of or approval of any state official, department, board, agency or other body*



COI: Additional Sample Language

- *The Corporation shall have all of the general powers enumerated in Section 202 of the NPCL and the power to including without limitation, **solicit grants and contributions** for any corporate purpose and the power to maintain a fund or funds of real/personal property in furtherance of such purposes.*
- *Notwithstanding any other provision of these articles, the Corporation is **organized exclusively for charitable and educational purposes** and intends to at all times to qualify and remain qualified as exempt under IRC §501(c)(3).*



COI: Additional Sample Language

*The Corporation shall not be conducted and is not formed for nor operated for **pecuniary benefit** and **no part of its assets, income or profit shall be distributed or inure to the benefit of any private individual**, provided that nothing herein shall prevent the Corporation from paying reasonable compensation to any person for services rendered to or for the Corporation in furtherance of one or more of its purposes.*



COI: Additional Sample Language

*No substantial part of the activities of the Corporation shall be devoted to the carrying on of propaganda or otherwise attempting to **influence legislation**, except as to the extent permitted by law and no part of the activities of the Corporation will be devoted to participating or intervening in any **political campaign**.*



COI: Additional Sample Language

*In the event and upon **dissolution** of the Corporation, all remaining assets and property of the Corporation shall be distributed to organizations that qualify under IRC §501(c)(3), or to the Federal Government, State or local governments for a public purpose subject to approval, after payment of all necessary expenses and to creditors of the Corporation.*



NFP Start-Up Costs in New York

Reservation of Name with NYS (optional): **\$20** per 60-days

Certificate of Incorporation with NYS: **\$75**

Register with Charities Bureau if a charity: **\$25**

Register with NY Department of Education: **\$10**

IRS: **\$600/\$275** (short form filers get lower fee)

Total: \$730/\$405



Expediting the Certificate of Incorporation in NY

In addition to the \$75 filing fee:

- Within **24 hours** of request: **\$25**
- On the **same day** of request: **\$75**
- Within **2 hours** of receipt of the request **\$150**

NFP Corporate Governance

- Corporate Structure
- Bylaws
- Fiduciary Duties
- Intellectual Property



NFP Corporate Structure:

- **Board of Directors**
- **Officers of the Board**
- **Members (Optional)**



NFP Corporate Structure: Board of Directors

Choose Directors who will:

- Support the **NFP's mission**
- Have **special expertise** in a particular area
- Take their corporate and legal responsibilities to the NFP **seriously**
- Keep the Board **size manageable**
- Be considered **independent**

What is an “Independent Director”?

A Director who:

- Is NOT a current **employee** of the NFP, and has not been one in the last 3 years
- Has NOT received more than \$10,000 in direct compensation from the NFP
- Does NOT have **a substantial financial interest** in an entity that has made payments to or received payments from the NFP for property or services with a value over \$25,000 or 2% of the NFP’s gross revenue (2016 Amendments implement a new sliding scale to determine when such payments are significant enough to affect an individual’s qualification as an independent director)
- Who does not have a **relative** described above

NFP Corporate Structure: Board of Directors & Officers

The **Board of Directors** (BOD) holds the ultimate authority to take and approve actions, amend the bylaws; elect, re-elect, and remove Directors and Officers.

- The actions of the BOD can only be overridden by the NY Secretary of State, AG, or by court intervention
- There must be at least three directors on the BOD
- The Chair must not be an employee of the organization unless approved by at least 2/3 of the BOD



Board of Directors & Officers, cont'd.

Officers normally possess authority in running the NFP, together with key persons (employees), as delegated by the bylaws and at the direction of the BOD.

The Officers are accountable to the rest of the BOD

NFP Corporate Structure: Members (Optional)

For Charitable Organizations – Members are **optional**

- The Bylaws and Certificate of Incorporation should state **whether the NFP will have members**
- All members are like shareholders in a for-profit corporation, but they **own no shares** in the NFP and do not receive any dividends from profits.
- **Two types of members:**
 - Members **with** voting rights
 - Members **without** voting rights (Organizational members)

NFP Corporate Structure: Members (Optional) (cont'd)



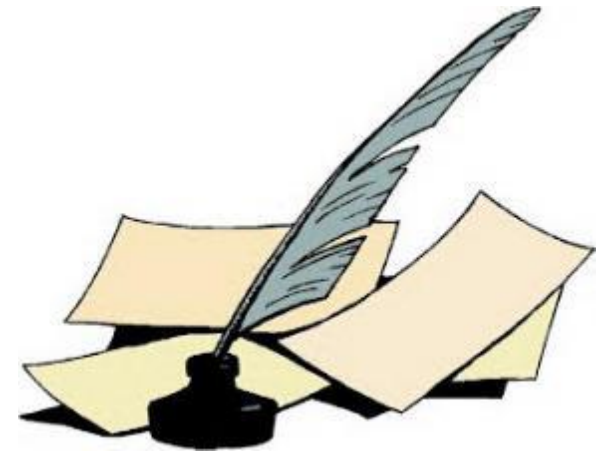
Voting members have **voting authority**

- They can amend the bylaws; elect, re-elect, and remove Directors and Officers
- They also get notices of meetings and right to inspect records.
- This structure requires additional administrative paperwork. Most small NFP's do not have voting members.
- Such members can also bring a **lawsuit against the Board** as permitted by law.

Organizational members are for marketing and fundraising purposes (membership to a museum, a zoo, VLA), have benefits such as discounts to classes, special events, exclusive access to products.

NFP Corporate Bylaws

- Internal **rules** of the NFP that set out procedures for making strategic and institutional decisions
- Required by **IRS** to apply for tax-exempt status
- Enacted at **Initial Organizational Board Meeting**



NPCL's Default Bylaw Provisions

A NFP's Bylaws can **alter the NPCL's default provisions**, but NPCL governs if NFP's Bylaws are silent

- NPCL's Bylaw default provisions:
 - Minimum of 3 Directors on BOD
 - Quorum of BOD consists of a majority of Directors
 - Officers' term of office is for 1 year
 - Directors must be at least 18 years old

NFP Bylaws: Officers & Employees

Should set out:

- **Board Officers** – president, secretary, vice president, treasurer
- Powers and Duties of **President, VP, Secretary**, and **Treasurer**
- **Voting** and **decision-making procedures**
- **Elections** and **term of office (staggered elections?)**
- Process for **removal/resignation**
- How to fill **vacancies**
- **Employees** – as determined by the Board + compensation
- Standing **Committees** – Audit, Compensation, Development, Education, Fundraising, etc.

NFP Bylaws: Board of Directors

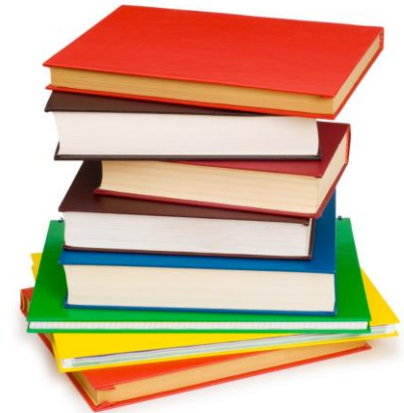
- **Location** and **time** of meetings?
- Proper **notice** of a meeting?
- What is a **Quorum**?
- **Unanimous** consent?
- **Amending** the Bylaws? Must there be a majority vote?



NFP Bylaws: Contracts, Checks, Accounts, Investments; Office & Books

The Board shall:

- Designate which officer has authority to **sign** contracts, checks, and other documents on behalf of the NFP
- Select **bank** to hold funds in cash or **invest** as Board thinks is desirable
- Choose **main office location**
- Designate where are the **books and records** of the NFP will be kept, and who is responsible for them



New York Charities Bureau (NYCB)

- Charitable organizations operating in NY (with a budget over \$25,000) **must register** with and **provide annual reports** to the NYCB before soliciting public donations in NY
- Check other states' requirement for registration if NFP fundraises in **other states**.
- In the registration (**CHAR 410**), include:
- Information of the NFP's **activities**
- Whether the NFP is using **fundraising professionals**
- Attachment of organizing **documents**
- Signed by 2 Board Members
- \$25 filing fee

NOTE: This registration is **open to public inspection**

Charitable Solicitations

- A NFP must **register with the Charities Bureau** in the state in which it solicits public donations if required by that state
- 40 States + D.C. **require registration**
- States that do not require registration = **AZ, DE, IA, ID, IN, MT, NE, SD, VT, WY**



Charitable Solicitations

- There are organizations that can help you with registering with other states:

labyrinthinc.com

fundraisingregistration.com

harborcompliance.com/information/charitable-registration

cogencyglobal.com/blog/which-states-require-charitable-solicitation-registration-for-nonprofits

NY Charitable Registration: Exemptions

- **Certain Educational Institutions**
- **Fraternal, patriotic, social, alumni, law enforcement support organizations and historical societies**
- Persons requesting any contributions for the relief of any **individual** if all of the contributions collected are paid to benefit the **named beneficiary**
- **Law enforcement agencies & veterans organizations**
- Charitable organizations that receive all or substantially all funds from a **government body**
- Charitable organizations raising less than \$25,000 during a fiscal year if none of its fundraising is carried on by **professional fundraisers**



Fiduciary Duties



What is a “fiduciary”?

- A **fiduciary duty** is a legal obligation to act in another’s **best interest**, so those who control and operate a NFP are obligated to act in the NFP’s best interest.
- Directors must be aware of these duties and their **possible liabilities** if they breach them.
- A Board of Directors benefits from a rebuttable presumption that its actions are made in its **best judgment**.

Directors' Fiduciary Duty of Care

All decision-making must be done in good faith, with diligence, attention, skill, and care

Directors must use “that degree of diligence, care and skill which **ordinary prudent people** would exercise under similar circumstances in like positions”

Decisions must be **“informed”**



Duty of Care: Informed Decisions

Informed decision-making requires Directors to:

- Attend regular Board **meetings**
- Review minutes and **written materials** distributed to Directors
- Carefully review **financial statements**
- Consult with outside **experts** such as accountants or attorneys
- Take opportunities to hear **presentations** by management
- Spend time considering any other information that is relevant to **operating** the organization

Directors' Fiduciary Duty of Loyalty

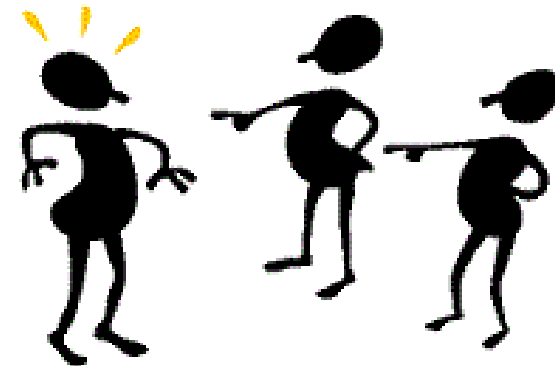
Directors must:

- Refrain from improperly using their positions to obtain a **personal benefit or advantage** that may properly belong to the NFP
- Not engage in **self-dealing** or **conflict of interest** – cannot vote on matters that involve self-interested dealing
- Make decisions **objectively** and solely in the best interest of the NFP
- Disclose **potential conflicts of interests**, which may impair the Director's ability to remain objective

(Conflicts arise when a Director stands to receive a **personal benefit** at the expense of the organization)

Directors **MAY** be held personally liable for a **Breach of the Duty of Loyalty** for:

- Distributing NFP's **cash or property** to members, directors, officers, except as otherwise permitted by law
- Distributing NFP's assets after dissolution without adequately providing for **all known creditors** of the NFP
- Making **improper loans** to a director or officer of the NFP (private inurement)



To **Avoid Breaches of the Duty of Loyalty:**

- Establish **clear procedures** for compensating your employees
- Elect a majority of Directors who have **no financial stake** in the NFP (“Independent Directors”)
- Develop a written **Conflict of Interest Policy** that details how a transaction with related parties will be considered that sets forth standards of permissible conduct

Directors' Fiduciary Duty of Obedience

- Particular to **NFPs**
- Directors must:
 - Follow and carry out the **purpose of the NFP** as expressed in the Certificate of Incorporation
 - Avoid the phenomenon of “**mission drift**”

New York Nonprofit Revitalization Act of 2013 (NPRA)

Effective July 2014



Goal of the NPRA

- Enhance **oversight and governance**
- Reduce **unnecessary and outdated burdens**
- Eliminate **Letter Types** to be replaced with “Charitable” and “Noncharitable” classification.
- **IMPORTANT:** There are amendments every year – please stay current to stay in compliance with the law.

NPRA: Important Changes

- The **Chairman of the BOD cannot be an employee** of the NFP – e.g., Chairman can't be Executive Director **UNLESS** 2/3 of the board votes to approve
- Notices by Directors can be given by **email**
- The Board can give **unanimous** written consent for resolutions by **email** in lieu of an in person meeting
- **Video Conferencing** is allowed, as long as all Board members can hear each other and participate, unless Bylaws state otherwise

NPRA: Related Party Transactions

- **Definition:** Any transaction, agreement or other arrangement in which a “Related Party” has a financial interest and in which the NFP is a participant
- New requirements under NPRA created to curtail self-dealing
- **Related Party Transactions** are prohibited unless the Board deems the transaction **fair, reasonable, and in the NFP’s best interests** at the time of the transaction
- “**Related Party**” – Any director, officer or key person, or any relative of such persons, or any entity in which a person has a 35% or greater ownership or beneficial interest
- “**Relative**” – spouse/domestic partner, ancestor, sibling, child, grandchild, great-grandchild and their spouses
- “**Key Person**” – any person in a position to exert **substantial influence** over the affairs of the corporation (whether or not an employee)

NPRA: Related Party Transaction Analysis

When the Related Party Transaction is between a NFP and a person with a substantial financial interest in the transaction, the Board must:

- Consider **alternatives** to the transaction
- Approve the transaction by **no less than a majority vote** (related party transactions may be reviewed and approved by an authorized committee of the board)
- Simultaneously document in writing the **basis for approving** the related party transaction including the analysis of available alternatives to the transaction (2016 Amendment now provides for retroactive approval)

NPRA: Related Party Transaction Analysis

2016 Amendment – NOT considered related:

1. Transactions that are considered *de minimis* or of limited monetary value;
2. Transactions that would not usually be reviewed by the board in the ordinary course of business and are available to the public on the same or similar terms; and
3. Transactions that would constitute a benefit to a related party solely because the related party is a member of the charitable class of people normally served by the nonprofit as a part of its mission, provided that the benefit is available to other people in the same class on the same terms.

NPRA: Conflict of Interest Policy

- **ALL NFPs** must draft and follow a conflicts of interest policy
- Directors must annually report any **potential conflicts**
 - Failure to disclose could result in the Director's removal
- Policy must include:
 - Circumstances that **constitute** a conflict
 - Procedures for **disclosing** a conflict
 - Statement that **conflicted Director cannot participate** in deliberations regarding the conflict
 - Document procedures detailing the **existence and resolution** of the conflict
 - Procedures for disclosing and addressing **related party transactions**

NPRA: Whistler Blower Policy

- Required for all NFPs with **20 or more employees** and an annual budget of over **\$1 million**
- Must state that no Director, Trustee, Officer, Employee, or Volunteer who in good faith reports any illegal or suspected illegal action will suffer **intimidation, harassment, or other retaliation**
- Organization must designate someone to oversee the policy and distribute it

Sexual Harassment Policy

Required for all New York Corporations

NPRA: Audit Committee



Required for all NFPs that

- Register with the AG to solicit charitable contributions **AND**
- Have an annual revenue that exceeds \$500,000

Audit Committee can only be comprised of **independent directors**

- Board can perform audit committee functions only if **independent directors** deliberate and vote on audit committee matters

NPRA: Audit Committee Duties

- Oversee **accounting and financial reporting process** and the audit of financial statements
- Annually retain or review the retention of an **independent auditor**
 - Review and discuss upon audit completion any **material risks and weaknesses** in internal operations, disagreement between auditor and management over adequacy of accounting and financial reporting process
 - **Report** on the Audit Committee's activities to the Board
- Oversee the adoption and implementation of **conflicts of interest policy** and **whistleblower policy**

NPRA: NYS Dept. of Education Consent

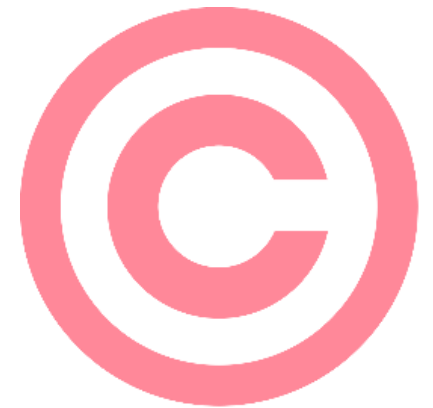
- Prior to the NPRA, many arts NFPs, were required to obtain consent from NYS Dept. of Education before incorporation.
- Now, **only** NFPs that operate a school, college, university or other entity providing post-secondary education; library; or museum or historical society must first seek the consent of the NYS Dept of Education. [NPCL §404(d) General educational purposes including purposes for which a corporation might be chartered by the Board of Regents].
- However, such corporation must provide a certified copy of its certificate of incorporation to the Commissioner within 30 business days after the corporation receives confirmation from the Department of State that the certificate has been accepted for filing.

Intellectual Property



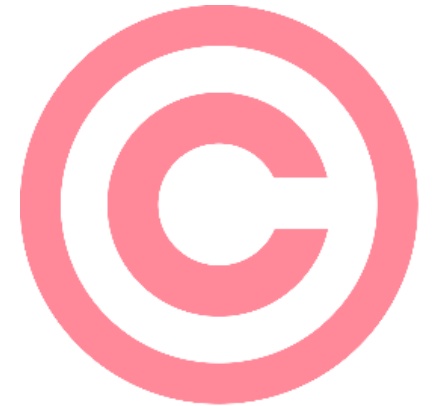
Intellectual Property

- If founding artist wishes to **promote her own work**, NFP is not best vehicle
- NFP should **own** most, if not all, of the intellectual property produced under its name
- Work-for-hire agreements



Work for Hire

- Work “**made for hire**” is a **work** subject to copyright that is created by an employee as part of his job.
- To be certain that any such work created for the NFP remains the property of the NFP, employment agreements with both employees and independent contractors should include this language



Step 2: Federal Tax Exemption



Alternative to Forming your own NFP: Fiscal Sponsorship

Fiscal Sponsor is a recognized 501(c)(3) organization that can accept donations and grants on behalf of sponsored projects and re-grant the contributed funds to the sponsored project, minus an administrative fee (typically between 5 and 10%)

- Must provide certain oversight of the funds to ensure compliance with requirements of the federal tax code

Points to Consider Regarding Fiscal Sponsorship

- The fiscal sponsor must exercise **sufficient supervision** over the funds being donated to support your organization
- The funds must be used by your organization **only** for **charitable purposes** that further the exempt purposes of the fiscal sponsor
- Fiscal Sponsors are **not** fundraisers, so your organization should **not rely** on a fiscal sponsor to fundraise
- Verify their **financial soundness** – You do not want to do business with a fiscal sponsor that is not financially sound

Fiscal Sponsorship Agreement

Some fiscal sponsors require a written agreement that sets forth the parties' duties to each other. This agreement is important:

- Memorializes the process for **approval** of expenditures, reporting, and other essential terms of the arrangement
- Show funders, state regulators, and the IRS that the organizations have a **mutual understanding**, and have put forth a good faith effort to follow the law

Agreement provisions:

- Parties' **duties and obligations** – recordkeeping and reporting obligations
- Ownership of **IP rights** created during the term
- Restriction of project activities to **sponsor's mission** and charitable activities
- Term, Termination, liability and indemnification

Benefits of 501(c)(3) Tax-Exempt Status

- Donations are **tax deductible**
- **Grantors** often require that an organization have 501(c)(3) status to be considered for funding
- Avoid **state sales tax** for items the NFP purchases
- NFP organizations pay **no taxes**, except for:
 - **Real estate taxes** on property owned by the NFP and **not** used for the NFP purposes (NYS Real Property Tax Law § 420-a)
 - **Payroll taxes** for employees
 - **Consult an accountant or tax attorney!**
- NFPs can obtain a **bulk mailing rate**

Remember the **Obligations** of **501(c)(3) Organizations!**

Must be organized exclusively for a **tax-exempt purpose**

- No part of net earnings (i.e. after paying salaries) **benefit any individual**, outside of bona fide charitable purposes

Tax-Exempt Status Generally

- An organization will not be treated as tax exempt until it receives a “**Determination Letter**” from the IRS informing it that its application has been approved
- NFPs should keep their Determination Letter together with copies of the **organizing documents**
- To obtain the Letter, the organization must file **IRS Form 1023**

Employer Identification Number (EIN)

- NFPs **must apply** for an EIN from the IRS
- A nine-digit number assigned by the IRS that is used to **identify the tax accounts** of employers
- Allows NFP to open a bank account

New NFP may keep an old EIN if it was previously incorporated as an NFP and only:

- Changed its business **name**
- Changed its **location** and/or added other locations

Newly incorporated NFP must change its EIN if it:

- Was operating as a **DBA** and is now incorporated

Expediting Tax Exemption Application

- Applications are processed in **order received**
- Granted at **IRS' discretion**
- Expedited process must be made in **writing**
- Expedited only for a “**compelling reason**” including:
 - A newly created organization providing **disaster relief** to victims of emergencies.
 - IRS **errors** have caused **undue delays** in issuing a determination letter.
 - A **pending grant**, where failure to secure the grant will have an adverse impact on the organization's ability to continue operating.

Provide the following **information:**

- **Name** of the person or organization giving grant or asset
- **Amount** of grant or the value of asset
- **Date** grant will be forfeited
- **Impact** on the organization's operations if it does not receive grant/asset
- **Signature** of a principal officer or authorized representative

IRS Form 1023: Considerations

Form **1023**
(Rev. December 2013)
Department of the Treasury
Internal Revenue Service

- Application itself is **28 pages** – instructions are an additional 38 pages
- Takes about 20 hours to complete
- Must include:
- All past, present, and future **activities** in detail
- Where and how NFP will get its **financial support & conduct fundraising**
- Detailed **budget** for 3 years

Form 1023: Overview

- **Names** of Directors, Officers, Employees, and ICs and their amount of compensation
 - How **compensation** will be determined
- Any **related** Directors or Officers through family or business?
- How will NFP **purchase** goods, services or assets from Directors, Officers, Employees, and ICs?
- Will NFP **sell** goods, services, assets to Directors, Officers, Employees, or ICs?
- Any **leases, contracts or loans** with Directors, Officers, Employees, or ICs?
- Any leases, contracts, loans or other contracts with **any organization** in which Directors, Officers are also directors or officers or have more than a 35% interest?
- List the **goods, services or funds** that the NFP provides to individuals and other organizations

Form 1023: Fundraising

- Does NFP intend to formally engage individuals or organizations to **raise funds on NFP's behalf**?
- Will NFP fundraise for **other orgs**?
- List all state and local jurisdictions **where** NFP fundraises
- Will you engage in any of the following fundraising **activities**?
 - Mail/email/phone/personal solicitations
 - Vehicle donations
 - Foundation/Government grant solicitations
 - Website donations

Form 1023: Intellectual Property

If the NFP will publish, own or have the rights to Intellectual Property:

- Who **owns** the IP?
- Will **fees** be charged?
- How are fees **determined**?
- What **materials** will be produced, distributed and marketed?

(bad news) & **Good News!**

The IRS has a **backlog** of >60,000 Form 1023 applications

Starting July 2014, small NFPs with gross receipts of \$50,000 or less and \$250,000 or less in assets, can instead complete **Form 1023EZ** – a new, 3-page, streamlined application.

- Must first complete the 20-page instructions and complete an online **eligibility worksheet** attached to the instructions
- Must be completed and submitted **online**
- Filing fee is **\$275**

Form 1023EZ Requires:

- **Contact Information** for the organization and the Directors
- Information about the **organizational structure**
- Whether **you** are **reapplying** after having had your tax exempt status revoked
- Whether you are a **Public Charity** or a **Private Foundation**
- You must attest that there is a **tax exempt purpose**
- NFP is organized under a of 501(c)(3)
- Upon **dissolution**, NFP's remaining assets will be transferred to another NFP or the State
- Only an **insubstantial amount of time** will be spent in activities other than for your exempt purpose

Form 1023EZ: Provide Information about Activities

- Will you attempt to **influence legislation**?
- Will you **pay** Directors or **donate funds** to specific individuals?
- Will you **provide grants** to individuals and/or organizations?
- Will you engage in **financial transactions** with any of your directors or officers, or any entities they own?
- Will you have **Unrelated Business Income** of \$1,000 or more?

27-Month Retroactivity

- If the NFP files Form 1023 **within 27 months** of filing the Certificate of Incorporation, IRS' grant of 501(c)(3) status will be retroactive to the NFP's **date of incorporation**
- If filed after 27 months, tax exemption will only be retroactive to **1023's filing date**

NFP Tax Return: Form 990

Hire an accountant!

NFPs with gross receipts of:

- \$200K or more or total assets of \$500K or more file **Form 990**
- \$200K or less and total assets of \$500K or less file **Form 990EZ**
- \$50K or less file **Form 990N** (e-postcard)

NFPs must file a Form 990 **in expectation** of receiving its IRS Determination Letter

- Indicate that the return is being filed under the belief that the NFP is exempt, but that it has not yet received its IRS Letter

NFP Tax Return: Form 990

Form 990 is IRS' main way of determining whether or not charities are **compliant** with the IRC, so it may request the following information:

- Summary of the organizations' **activities**
- Disclosure of **assets, revenue** and **expenses**
- Information about **governance, management** and **disclosures**
- If **managerial duties** are delegated to third party
- **Document retention** Policy
- **Conflict of Interest** Policy
- **Whistleblower** Policy
- If **compensation determination** for key persons is subject to review and approval by independent Directors
- Whether the **governing documents** are available to the public

Form 990: Disclosure of Compensation is Important

- Whether any **officer or director** is compensated
- Compensation for:
 - Five highest paid **employees**
 - **Former officers or trustees** who received more than \$100,000 in compensation
 - **Former directors or trustees** who received more than \$10,000
 - Total number of **Independent Contractors** who received more than \$100,000, including a description of their services and their contact information

Form 990: Public Inspection Requirement

- Forms 990 and 990EZ must be made available for **public inspection**
- Upon specific request, the NFP must **provide a copy** of the return for the 3 most recent tax years to anyone who requests to inspect them
- Comply within **30 days** of the request if it is in writing and **immediately** if made in person
- Reasonable **fees** may be charged for copying and postage
- \$5,000 **penalty** for failure to comply plus \$20 per day up to \$10,000

NFP is not required to comply with a public inspection request if:

- Its 990 is already **widely available** (as through Guidestar.org)
- The NFP informs the IRS, and the IRS determines that the request is meant to **harass the NFP**

Form 990: Failure to File = Revocation

Failure to file the 990 for **3 consecutive years** will result in automatic revocation of the NFP's 501(c)(3) status

- 3 years is calculated from the formation of the NFP, not since the organization received tax-exempt status

IRS will **not** reinstate the 501(c)(3) status for revocation resulting from failure to file – the NFP must **re-apply** for tax exempt status!

- IRS publishes a list of NFPs whose tax-exempt status has been revoked, listing the NFP's name, EIN, last known address, effective date of revocation

Unrelated Business Income Tax (UBIT)

- If NFP receives income for activities unrelated to its mission, it must pay UBIT
- Applies to income from a **trade or business** which is **regularly conducted** and **not substantially related** to the organization's tax-exempt purpose, except that the organization uses the profits derived from this activity
- **“Trade or business”** – any activity carried on for the production of income from selling goods or performing services
 - Museum regularly **publishes a magazine** that carries advertising having nothing to do with its mission of art education and preservation

UBIT: “Regularly Conducted”

- Show a **frequency and continuity**, and are pursued in a **manner** similar to comparable commercial activities of nonexempt organizations
- Theatre group that:
 - Provides concession services to other theaters for weekly performances?
 - Sells refreshments at one of its performances?

UBIT: “Not Substantially Related”

A business activity is **not** substantially related to an organization's exempt purpose if it **does not contribute importantly to accomplishing that purpose** (other than through the production of funds)

Whether an activity contributes importantly depends in each case on the **facts** involved

- ✓ Admission to a performance by students of a NFP theater school – important contribution to NFP purpose

UBIT: Exceptions

- **Volunteer Labor** - Substantially all the work of the business is carried on by volunteers (hospital gift shop)
- **Convenience** - The business is carried on for the convenience of students, members or employees (school cafeteria)
- **Donated Merchandise** - Substantially all the merchandise is donated (thrift shop)
- **Bingo** – Game conducted according to state laws: a game of chance played with cards that are generally printed with 5 rows of 5 squares each

UBIT example

What do we think about a NFP whose purpose is to foster public interest in the fine arts through exhibitions, and cultural events, **leases studio apartments** to artist tenants and **operates a dining hall** primarily for these tenants...

- Do these two activities **contribute importantly** to accomplishing the NFP's exempt purpose?
- Do they fall into one of the exemptions?

Step 3: State Tax Exemption

Exemption from most NYS taxes depends in large part on obtaining federal 501(c)(3) status

- To obtain corporate franchise tax exemption, submit the New York State Department of Taxation and Finance **Form CT-247**, with the corporation's Articles of Incorporation, Bylaws and the 501(c)(3) Determination Letter
- To obtain state and local sales tax exemption, NFP must file **Form ST-119.2** to the NYS Department of Taxation and Finance. To be presumed tax-exempt from NYS and local sales tax, NFP must:
 - Be organized and operated exclusively for **religious, charitable, scientific, literary or educational** purposes
 - Not have net earnings that inure to the benefit of **private individuals**
 - Not, as a substantial part of its activities, attempt to **influence legislation**
 - Not participate in **political campaigns** for or against any candidate for public office



Volunteer Attorneys will assist with drafting and filing:

1. Certificate of Incorporation
2. Necessary consents
3. Bylaws
4. Required Policies
 - Conflicts of Interest and/or
 - Whistleblower
 - Sexual Harrassment
5. Charitable Registration(s)
6. Application for Tax Exemption
7. Application for State Tax Exemption



NFP Clients must provide:

1. 3 different **names for the NFP** organization (include suffix!!!)
2. 3 names and street mailing addresses of NFP's **initial board members**
3. About ¼ to ½ page **mission statement**
4. Detailed **3-year projected budget**





\$785 NFP Package Includes:

- **This NFP Incorporation & Tax-Exempt Status Workshop** – Attendance is a PREREQUISITE to your consultation with VLA staff and Case Placement with a pro bono attorney.
- **Legal Consultation** – A VLA staff member meets with you privately to confirm completion of prerequisites and to discuss your specific circumstances prior to attempted placement with a volunteer attorney.
- **Caselist** – VLA will seek a volunteer attorney to handle the incorporation and tax-exempt application process for your organization.
- **VLA Membership** – One-year organizational membership, including access to VLA Legal Clinics and discounts to VLA workshops and seminars.



THANK YOU! QUESTIONS?

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