neo LAW GROUP

Nonprofit & Exempt Organizations

Legal Issues Facing Nonprofit Start-Up Organizations

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Should I start a nonprofit organization?

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Commonly Heard Reasons

- Job
- Paycheck
- Want control over their own business
- To attract tax-deductible donations
- Good intentions

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Nonprofit Sector

- Over 1.5 million registered nonprofits w/ the IRS
- Estimated one-third do not survive past five years
- Estimated one-third of registered nonprofits operate in the zone of insolvency
- IRS recently revoked exempt status of 275,000 nonprofits

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Terminology

"Nonprofit"	"Tax-Exempt"
• State corporate law • No owners/no distribution to owners	• Federal & state tax law • Exempt from corporate income tax on certain income

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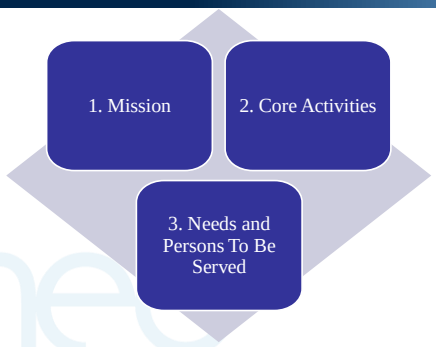
10 Considerations Before Starting a Nonprofit



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Mission – Consistent with 501(c)(3)

- Most common* 501(c)(3) exempt purposes: charitable, scientific, and educational

** Religious organizations not addressed in this presentation*

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Core Activities – Consistent with 501(c)(3)

The organization must be primarily operated for one or more exempt purposes.

It's not enough that the revenue generated from such activities would be put toward charitable uses.

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Needs/Persons Served – Consistent w/ 501(c)(3)

A 501(c)(3) organization cannot be organized or operated for the benefit of private interests.

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Existing Orgs. with the Same or Similar Mission

- How is this organization different or does it replicate an existing organization?
- Where are the existing organizations with the same or a similar mission geographically located?
- Are there potential opportunities for collaboration?

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Funding Strategy

- Where is the initial funding coming from?
- Where will future funding come from (e.g., donations, grants, fees for services or goods, etc.)?
- What is the timeline for receipt of the funding?
- Does the strategy give a good chance at sustainability?

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Attracting Sufficient Resources

- To govern the organization
- To run the charitable programs
- To handle administration and compliance work
- To fundraise
- To provide expert counsel or advice

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Business Plan

- Flexible but thoughtful
- SWOT analysis
- Marketing plan
- 3-year budget

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Relevant Nonprofit Laws

- Directors' fiduciary duties of care and loyalty
- No private benefit or private inurement
- Charitable trust doctrine
- Filing and reporting requirements
- Conflict of interest rules
- California's 49% interested directors rule

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Alternatives to Formation

- Work with an existing nonprofit
- Fiscal sponsorship
- A donor-advised fund

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Legal Form

- Unincorporated v. incorporated
  - Limited liability
  - Separate legal existence
  - Formality and structure
  - Fundraising
- Voting membership v. non-membership

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12 Key Steps to Formation

1. Define the mission and develop the plan.
2. Recruit and educate a qualified board.
3. Refine the mission and the plan.

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12 Key Steps to Formation (continued)

4. Draft and file the Articles of Incorporation.
5. Obtain a FEIN.
6. Draft the Bylaws.
7. Draft the Conflict of Interest Policy.
8. Hold & document first board meeting.
9. Register with the AG's Registry.

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12 Key Steps to Formation (continued)

10. Prepare and file IRS Form 1023.
11. Prepare and file FTB Form 3500A.
12. File the Statement of Information w/ SOS.

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Possible Additional Steps

- Local business registration
- Property tax exemption
- Documenting loans from founders
- Intellectual property registrations

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Common Early Issues for New Nonprofits

- Governance
- Fundraising
- Managing Exposure to Liability
- Benefits to Certain Individuals

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Governance

- Governing Documents
  - E.g., generic, inconsistent, ignored, and/or out of date.
- Board of Directors
  - E.g., lack of ongoing training, continuing education, and/or strategic recruitment.

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Fundraising

- Charitable solicitation state registrations
- Charleston Principles

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Managing Exposure to Liability

Insurance

- Period of coverage – e.g., claims-made v. occurrence-based
- Type of coverage – e.g., Commercial General Liability; D&O Insurance

Employees

**Majority of suits against directors are employee-related.*

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Benefits to Certain Individuals

- E.g., excessive executive compensation

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Other Issues for New Nonprofits

- Lobbying and Electioneering
- Delegating Management
- Social Media
- Unrelated Business Income
- Intellectual Property Ownership
- Additional Governance Policies

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