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Not-For-Profit News

PragerMetis
Accountants & Advisors for Not-for-Profits

STARTING A NOT-FOR-PROFIT ORGANIZATION

Not-for-profit (NFP) organizations are started for a multitude of reasons by one or more people with an idea that they believe will benefit or enrich the lives of a small community, a large group or even the planet. Because their idea consists of doing or providing something that will be ongoing and continuous, as opposed to a one-shot activity, a formal structure is needed to convert their idea into a functioning and productive reality.

There are numerous ways and structures for creating and building a successful NFP organization and there is no single or perfect method. However, a lot of time and forethought should be put in, and fundamental steps first taken, before moving forward. And one should never assume that their idea is original or unique. Too many times, a new NFP is created only to find out quickly that there are one or more other organizations already providing the same or similar products or services to a group or the public.

Step 1

The first step after envisioning your idea and doing some research is to create a name for your organization. Like any commercial business, the name should be descriptive of the entity's mission but not so long that it becomes cumbersome. Names can be changed so too much time is not needed doing this task. After doing this the next step is to develop an action plan.

The plan will result in answering the basic 4W-H questions: What, Who, When, Where and How. What programs or activities will the organization perform or provide. Who will perform the programs or activities and who will manage the organization. When will the programs and activities begin and when will they be provided during the year. And lastly, how will the programs or activities be performed and how will support and revenue be obtained. The how will revenue and support be obtained is probably the most important question to be answered first because without money, there can be no organization.

Step 2

Although there are a number of legal structures an NFP organization can form and operate under, the Corporation form is by far the most prevalent. A Corporation is a legal entity and is a state creation. This means that one must follow the rules mandated by the state where the corporation is formed. Most states require that an application called a Certificate or Articles of Incorporation or similar name be filed with the state to form a corporation. It is very important to note that the Certificate or Articles of Incorporation for an NFP organization must contain a few very specific provisions such as its exempt purpose (which should be something other than simply to generate income and maximize a profit), as described below, and how the organization's assets will be disposed of if the organization should cease to exist and dissolve.

> The ORGANIZATION shall be a non-profit corporation organized for charitable, educational and scientific purposes, within the meaning of section 501(c)(3) of the Internal Revenue Code, as amended, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under 501(c)(3) of the Internal Revenue Code, as amended. Its additional purposes are……. (describe)"

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Step 3
Bylaws need to be created. Bylaws is a document that specifies in broad terms how the organization will operate and be governed. It states the general rules and regulations that the entity must follow such as: the number of board of directors (BOD), how board members are elected, how board members are removed, the voting rights of board members, number of board meetings, etc.

Step 4
After incorporating and creating Bylaws, the next step is typically to obtain a Taxpayer Identification Number (TIN) which is also referred to as an Employer Identification Number (EIN). This can be obtained online by going to the IRS website http://www.irs.gov/ and completing the SS-4 application form. A number will be provided immediately upon completion and submission of the form.

Step 5
Once you have incorporated and obtained a TIN/EIN, the next step is usually to open a bank account. Prior to opening an account, it should be decided who will have initial signatory rights, that is, rights to handle all bank-related transactions (e.g., sign checks). Usually this will be at least two of the following: president, chairperson, executive director, treasurer, or secretary.

Step 6
One of the most important things that a new NFP organization needs to do is apply for exemption from federal and state income taxes. A general misconception is that an NFP corporation is automatically tax exempt after it files to become a corporation. This isn't true. NFP corporate status only makes an organization "eligible" for tax exemption. To be income tax exempt, one of several federal forms must be completed and filed with the Internal Revenue Service (IRS). The IRS has a publication (Pub. 557-Tax -Exempt Status for Your Organization) to assist organizations seeking recognition of exemption from federal income taxes.

Depending on whether the organization intends to operate as a public charity or foundation (i.e., IRS code section 501(c)(3), or other type of exempt organization such as a civic league, membership organization, labor, fraternity, etc., (e.g., IRS code sections 501(c)(4) (5) (6), etc.), it must complete either Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, a simpler, streamlined form 1023-EZ for smaller NFPs with $50K of annual revenue, or Form 1024, Application for Recognition of Exemption Under Section 501(a) (for all other exempt organizations. All three forms can only be completed online at Pay.gov. Forms 1023 & 1024 are lengthy and can appear overwhelming.

Great care should be taken in preparing these applications and it is strongly advised that an experienced CPA or Attorney should be found to assist with the application. In addition to the federal government (IRS) requirement, many states require a separate registration be filed if an organization will be soliciting contributions from donors, using a fundraiser or operating an office within their State. It should be noted that too often new NFPs are unaware of any State requirements until it is too late.

Another misconception is that tax exempt applications must be filed right away. Not true. NFPs have 23 months from incorporating to file form these forms.

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Step 7 - Other Important Tasks

After the organization incorporates, obtains a TIN/EIN, opens a bank account and has filed all required federal and state tax exempt applications and registration, other tasks that should be considered include purchasing/configuring and using a bookkeeping program (e.g., QuickBooks, Sage, Xero, FreshBooks, etc.), setting up payroll (if having and paying employees), creating a financial annual budget, and creating a Website, just to mention a few.

It is very important that an NFP organization solicit the services or an experienced CPA who is knowledgeable about all the accounting, auditing and reporting requirements that must be comply with. In addition to helping the NFP comply with their accounting and reporting responsibilities, this expertise will be invaluable in assisting them in a myriad of ways (e.g., dealing with fiscal sponsors, Government agencies, etc.). Too many times, due to limited resources, NFPs hire a less experienced accountant or CPA.

The results almost always end with the Organization spending much more time and money later to correct serious problems including loss of income tax exemption.

Feel free to contact Laurence Scot, MBA, CPA at lscot@pragermetis.com if you have any questions about anything contained in this Newsletter or if you are interested in learning more about our Prager Metis' Not-For-Profit Advisory Services (NAS). If you would like to receive future Not-For-Profit news and updates, please click here to be added to our NFP mailing list:

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Larry aims to provide each of his Not-For-Profit clients with a high level of expertise in many technical areas which could affect their organizations, and to maintain timely, clear and concise communications with them. He prides himself on making his clients feel respected and comfortable with the service and advice they receive from him.

Laurence Scot is a noted industry expert and has been a prolific speaker and author of two Not-For-Profit reference books and numerous published articles, He has taught undergraduate and graduate classes at several colleges, and provided seminars to Not-For-Profit stakeholders, CPAs, bankers, and other professionals.

Contact