

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 away 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.

As of 2007 there were approximately 1.1 million charitable nonprofits recognized under Internal Revenue Code Section 501(c)(3) –approximately 1 charity for every 300 Americans. 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 most 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 enough to be understood by a child. This goes to purpose for existence, i.e. why is this new nonprofit necessary? 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 regarded as the most important elements.
- Form a nonprofit organization. **Caution:** It would be wise to consult legal counsel before deciding to take any of the following steps individually. (Note: It is assumed for purposes of this document that a nonprofit corporation formed under Chapter 55A of the NC Statutes, Nonprofit Corporation Act, is the desired form of organization.)
- File articles of incorporation with the NC Secretary of State. The current fee is \$60. Form N-01 can be filled out online at www.secretary.state.nc.us/corporations/Forms. The articles of incorporation must include certain additional 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, as explained in 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 about one week), obtain a federal employer identification number by completing IRS Form SS-4 online. 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 initial 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, either immediately or when average annual receipts (including in-kind support) exceed \$5,000. The \$5,000 'average' is computed on a rolling 3-year basis. 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.
 - For year 4 and later, the \$15,000 limit is applied to the combined gross receipts of the current and 2 preceding years.
- The user fee that must accompany Form 1023 is currently:
 - \$850 if average annual gross receipts (all sources of support) are expected to be \$10,000 or more, or
 - \$400 if expected to be less than \$10,000
 - The IRS plans to launch its new “Cyber Assistant” software in 2010, an online tool for completing Form 1023. When this resource becomes available, the user fees for exemption applications processed through Cyber Assistant will be \$200 for all size organizations and \$850 for all organizations not using Cyber Assistant.
- Regarding the IRS processing of Form 1023, it is likely to take 6 to 12 months (possibly longer) for the nonprofit to receive its federal determination letter. It is not unusual to receive at least one round of additional questions from IRS in the process. If a major grant or contribution is contingent upon furnishing a federal determination letter by a certain date, a request for expedited processing (at IRS discretion) may accompany Form 1023. It is not known at the time of this writing the extent to which Cyber Assistant may reduce the time required for processing of Form 1023.
- Register with the North Carolina Secretary of State prior to soliciting contributions for the first year that more than \$25,000 of applicable

contributions are expected. The annual license fee ranges from \$0 to \$200 based on total applicable contributions. The registration form can be filled out online at the NC Charitable Solicitation License (CSL) website. Once subject to licensing, a special disclosure statement must be displayed on all fundraising material and confirmations to donors.

- Before paying compensation to officers or key employees, the board should 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 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. An exception exists for products sold as part of an annual fundraising event, provided that the products are received by the buyers within 60 days.
- 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 refund.
- In order to claim exemption from property tax, 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 charitable service.
- Annually file IRS Forms 1099 for any reportable payments. Common reportable payments include payments for rent, professional services, services of trade contractors, and services of persons properly classified as independent contractors (as opposed to employees).
- Annually file IRS Form 990-N ("ePostcard"), 990-EZ, or 990 depending on total gross receipts.

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 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 - www.wfu.edu/~palmitar/Books/Guidebook-2ed.pdf
- ✓ State Taxation and Nonprofit Organizations is available from the North Carolina Department of Revenue at www.dornc.com/publications/nonprofit.html
- ✓ U.S. Department of Labor Fact Sheet #17A: Minimum wage & overtime exemptions Under the FLSA Is available at www.dol.gov/whd/regs/compliance/fairpay/fs17a_overview.pdf
- ✓ 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:

- ✓ Foundation Center – What are bylaws & Where can I find them? - <http://foundationcenter.org/getstarted/faqs/html/samplebylaws.html>
- ✓ GuideStar USA – Database of IRS Forms 990 and other organization specific data - www.guidestar.org
- ✓ Idealist.org – The Nonprofit FAQ - <http://www.idealists.org/if/idealists/en/FAQ/Nonprofit/Home/default>
- ✓ National Center for Charitable Statistics – www.nccs.urban.org
- ✓ Nonprofit Genie (FAQs) - www.compasspoint.org/askgenie/index.php
- ✓ Nonprofit Resource Center, Glenwood Branch Library – <http://www.greensboro-nc.gov/departments/Library/nonprofits/>
- ✓ SCORE Business Toolbox –Free templates for startup planning http://www.score.org/business_toolbox.html

Serving Nonprofit Organizations:

- ✓ Guilford Nonprofit Consortium – serves Guilford County nonprofits
www.guilfordnonprofits.org
- ✓ Nonprofit Connections – serves northwest Piedmont region - www.nonprofit-connections.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

Free e-Subscriptions:

- ✓ Blue Avocado – Practical articles relevant to small community based nonprofits, bi-monthly – www.blueavocado.org
- ✓ Philanthropy Journal Online, Published Weekly with NC specific news & features – <http://nonprofit.chass.ncsu.edu/pjone.php>

Nonprofit financing:

- ✓ Self-Help Credit Union – A nonprofit community development organization that makes loans to businesses and nonprofits, including SBA guaranteed loan programs www.self-help.org/

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 and may be taken individually or toward certificate completion. Visit <http://learnmore.duke.edu/certificates/nonprofit/>

CPAs Recommended by Guilford Nonprofit Consortium Members

As a resource to help identify CPAs experienced in nonprofit needs, the following list was compiled from an informal January 2010 member survey. These accounting practitioners are neither recommended nor endorsed by Dennis R. Walsh CPA or the Guilford Nonprofit Consortium.

- Costello and Hill - Greg Ashley
- Davenport, Marvin, Joyce & Co, Greensboro, NC - Ms. Stacy West, (336- 275-9886), Amy Thabet, and Haynes Strand
- Ron Davis CPA
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336-852-9260
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336-285-6513 (fax)
- Gilliam, Coble, and Moser –
Matt Bouldin
- Michael Henry, CPA, Greensboro
336-855-3026
-
- Tim A. Nethery, CPA
336-288-2105 office,
336-312-1777 cell
- Apple, Koceja and Associates -
Brett Koceja
- Leeper Kean and Rumley (LKR) -
Dave Leeper 336-274-3700
- McGladrey & Pullen
(Greensboro)
- Marie W. Schettino, CPA
Robertson Neal & Company, LLP
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