



Alpha Rho Chi

National Professional Fraternity
Architecture and the Allied Arts



HOW TO

Establish a 501(c)3 Organization

by April Sommer Rabanera, Andronicus Alumna

How To – Establish a 501(c)(3) Organization

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NOTE: *The following information is provided as general information only and should not be interpreted as legal advice or used in place of competent legal counsel.*

Have you ever wondered: How do I start a non-profit organization? Or for that matter, what is all this talk about 501(c)s? The following is some basic information to consider before embarking on the process of establishing a non-profit corporation. For information, Alpha Rho Chi chapters and alumni associations are registered 501(c)(7), not-for-profit corporations. This “How-To” provides an overview of three types of 501(c) corporations, with a detailed explanation of the primary steps Andronicus Brother’s explored when establishing the Shankland-Andronicus Renovated Chapter House (S.A.R.C.H.). Next time you are in the Los Angeles metropolitan area, stop by and explore this living example of Alpha Rho Chi history and architecture in action.

Tax-Exempt Corporation Basics

What is a 501(c) organization?

A 501(c) is a tax-exempt, non-profit corporation or association per the United States Internal Revenue Code. While many people use the terms “non-profit” and “tax-exempt” interchangeably, strictly speaking they are not the same thing. State law decides non-profit status, while tax-exempt status is based on the Internal Revenue Code. Thus, not all non-profits might be tax-exempt, and not all tax-exempt organizations might be non-profits.

There are over 20 different sub-types of organizations that are exempt from some state and federal income taxes, the following are some of the types that could pertain to Alpha Rho Chi:

Holding Corporations and Social Clubs

What is a 501(c)(2) - Title Holding Corporation for Exempt Organization

Per the USIRC: Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt under this section.

With lawsuits engulfing many tax-exempt organizations, and liability concerns mounting, some tax-exempt organizations are looking for ways to protect their real estate and other assets. An effective management tool to consider is to transfer the organization's real estate to a subsidiary 501(c)(2) title-holding corporation. Such an entity provides a tax-free means of managing and protecting real estate and other assets. A title-holding 501(c)(2) corporation is exempt from federal tax.

The overriding reason why tax-exempt organizations transfer this real estate to a title holding 501(c)(2) subsidiary is to place their organization's property out-of-reach of any creditor's unfunded liability.

Donations to a 501(c)(2) organization are not tax deductible.

What's involved in organizing a 501(c)(2) title-holding corporation? There are three important elements:

1. Recognize that a title-holding organization is a non-profit corporation recognized by the IRS as a 501(c)(2) tax-exempt corporation.
2. The title-holding corporation must be organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount, less expenses, to its tax-exempt parent corporation.
3. The title-holding corporation should be established as a subsidiary corporation wholly controlled by its parent, also a tax-exempt organization.

501(c)(7) - Social Clubs

Per the USIRC: Clubs organized for pleasure, recreation, and other non-profitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder. Chapters & Alumni Associations are 501(c)(7) organizations.

Per <http://www.unclefed.com/IRS-Forms/2001/HTML/p5570404.html>:

If your club is organized for pleasure, recreation, and other similar non-profitable purposes and substantially all of its activities are for these purposes, it should file Form 1024 to apply for recognition of exemption from federal income tax.

Typical organizations that should file for recognition of exemption as social clubs include:

- College fraternities or sororities operating chapter houses for students,
- Country clubs,
- Amateur hunting, fishing, tennis, swimming, and other sport clubs,
- Dinner clubs that provide a meeting place, library, and dining room for members,
- Hobby clubs,
- Garden clubs, and
- Variety clubs.

Donations to a 501(c)(7) organization are not tax deductible.

Discrimination prohibited. Your organization will not be recognized as tax exempt if its charter, bylaws, or other governing instrument, or any written policy statement provides for discrimination against any person on the basis of race, color, or religion.

Private benefit prohibited. No part of the organization's net earnings may benefit any person having a personal and private interest in the activities of the organization. For purposes of this requirement, it is not necessary that net earnings be actually distributed. Even undistributed earnings can benefit members. Examples of this include a decrease in membership dues or an increase in the services the club provides to its members without a corresponding increase in dues or other fees paid for club support. However, fixed-fee payments to members who bring new members into the club are not an inurement of the club's net earnings, if the payments are reasonable compensation for performance of a necessary administrative service.

Support. In general, solely membership fees, dues, and assessments should support your club. However, if otherwise entitled to exemption, your club will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities.

Business activities. If your club will engage in business, such as selling real estate, timber, or other products or services, it generally will be denied exemption. However, evidence submitted with your application form that your organization will provide meals, refreshments, or services related to its exempt purposes only to its own members or their dependents or guests will not cause denial of exemption.

Gross receipts from non-membership sources. A section 501(c)(7) organization may receive up to 35% of its gross receipts, including investment income, from sources outside of its membership without losing its tax-exempt status. Of the 35%, up to 15% of the gross receipts may be derived from the use of the club's facilities or services by the general public or from other activities not furthering social or recreational purposes for members. If an organization has outside income that is more than these limits, all the facts and circumstances will be taken into account in determining whether the organization qualifies for exempt status.

Non-Profit Corporations

501(c)(3) — Religious, Educational, Charitable, Scientific, Literary, Testing for Public Safety, to Foster National or International Amateur Sports Competition, or Prevention of Cruelty to Children or Animals Organizations

Per USIRC: Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office. The Alpha Rho Chi Foundation & S.A.R.C.H. are 501(c)(3) organizations.

Of all the tax-exempt organizations, 501(c)(3)s are the most common. So, what is a 501(c)(3)?

It can be any organization that fits the following criteria:

1. It must fall exclusively under one of these categories:

- Religious
- Charitable
- Scientific
- Public safety
- Literary
- Educational
- National/international amateur sports
- Prevention of cruelty to children or animal

2. It can be any of the following structures:

- Corporation

- Community chest
- Fund
- Foundation

3. It must abide by the following restrictions:

- An individual person is not eligible for the 501(c)(3) designation
- The organization's earnings cannot benefit a private shareholder or individual
- The organization cannot be involved in *any* political campaign activity
- The organization is limited in the degree it can lobby

501(c)(3) organizations may receive grants from foundations, and donations to them are tax-deductible for the donors.

What's involved in organizing a 501(c)(3) charitable corporation?

1. **Formulate a mission statement.** As a non-profit organization, you exist to accomplish your mission, which should be crafted based upon your purpose, services and values. It addresses the question "Why does the organization exist?" The mission statement is a concise expression that covers in one or two sentences who the organization is, what it does, for whom and where. It should also be compelling, as it will be used in all published materials, funding requests and public relations. It should also portray how your organization is distinct from others.

At its most basic, a mission statement should include the following 4 parts:

A. Purpose

1. An infinitive that indicates a change in status, such as to increase, to decrease, to prevent, to eliminate.
2. An identification of the problem or condition to be changed.

An example of a purpose statement is "to eliminate homelessness." In defining purpose, it is essential to focus on outcomes and results rather than methods: How is the world going to be different? What is going to change? Thus, the purpose of a mental health counseling agency would never be simply "to provide counseling services," for that is describing a method rather than a result. Rather, the purpose might be "to improve the quality of life" for its clients.

B. Business

This statement outlines the "business(es)" (i.e., activities or programs) your organization chooses in order to pursue its purpose. Specifically, you must answer, "What activity are we going to do to accomplish our purpose?" For example, there are many ways to work on the problem of homelessness:

- To construct housing for homeless individuals
- To educate the public and advocate for public policy changes
- To provide job training to homeless individuals.

Each of these are different businesses, but they may be different means of achieving the same purpose.

Business statements often include the verb "to provide" or link a purpose statement with the words "by" or "through." For example: "To eliminate homelessness by providing job training to

homeless individuals."

A cautionary note: If the word "and" is in your purpose or business statement, ask yourselves, "Are we really committed to both ideas connected by the word "and," or have we simply not been able to accept that one idea is more important?"

C. Values

Values are beliefs that your organization's members hold in common and endeavor to put into practice. The values guide your organization's members in performing their work. Specifically, you should ask, "What are the basic beliefs that we share as an organization?"

Examples of values include: a commitment to excellent services, innovation, diversity, creativity, honesty, integrity, and so on. Values may include beliefs such as: "Eating vegetables is more economically efficient and ecologically responsible than eating beef." (Vegetarian Association)

Below is another example of a mission statement which includes all three elements:

The YMCA of San Francisco, based in Judeo-Christian heritage [values], seeks to enhance the lives of all people [purpose] through programs designed to develop spirit, mind and body [business].

D. Beneficiaries

Very simply, who are the specific beneficiaries of the organization's work?

Below is the mission statement/purpose for S.A.R.C.H.:

The specific purpose of this corporation shall be to promote and support preservation of historic buildings in general and, more particularly, support the preservation and maintenance of the historic Andronicus Chapter House, and to carry on other charitable and educational activities associated with this purpose as allowed by law.

2. **Form a Board of Directors.** Forming a board requires careful thought and extensive recruitment efforts. Each state has regulations that determine the minimum size of the board, typically three, but the optimum number of people who sit on the board should be determined by the needs of the organization. Based on what your organization would like to accomplish, you should decide what special skills and qualities you would require of the individuals on your board. Identify qualified individuals who are supportive of your mission and are willing to give of their talents and time.

There are different bases for staffing a Board, but for now you probably want to use a functional basis, which is recruiting Board members because of their unique expertise. For your first Board, select members who:

- Are very interested in the mission of your new non-profit.
- Can provide the time and energy to help you start the organization.
- Have useful expertise, for example, in planning, Boards, finances and perhaps fundraising. (Do not select Board members because they have passion only – that may only result in passionate meetings.)
- Ideally, the first members of your Board have been on Boards before, have strong understanding of the needs of your clients, and how those needs could be met. Ideally, too, they are independent Board members, that is, members who are not on the staff (if

the new non-profit has staff members yet), will have no business affiliation with the new non-profit, and are not very close and personal friends of the founder, especially of a CEO or Board Chair.

3. **Name the Organization.** It is crucial to your new organization's identity to obtain a unique name under which to operate. Any potential names for a new business or non-profit can be checked through the Secretary of State's Office for duplications. Organizations should reserve a unique name through the Secretary of State's Office. Once a name is reserved, no other organization may use that name.

What Should You Name the Non-profit?

This requires some careful thought on the part of your team now. Consider the following:

- The name should designate what services will be provided and to whom.
- Do not pick a name that is very similar to other organizations in your area.
- Remember you can change the name later on if you want to do so.
- Pick several names and then discuss them with your Board members and several potential clients of your organization.

4. **File Articles of Incorporation.** The articles of incorporation set up the basic terms of the corporation, such as its purpose and board of directors. Articles of Incorporation are official statements of creation of an organization filed with the appropriate state agency. They are important to protect both board and staff from legal liabilities incurred by the organization, making the corporation the holder of debts and liabilities, not the individuals and officers who work for the organization. The specific requirements governing how to incorporate are determined by each state. You can obtain the information you need to proceed with this step from your state Attorney General's office or your state Secretary's office. Before you spend your money, it is advisable to at least consult with an attorney who is experienced in the area of non-profit law so that you do not make one of the many major mistakes that people make when they try to incorporate by themselves.

5. **Draft Bylaws.** Bylaws are simply the "rules" of how the organization operates or the rules the organization adopts by which to govern itself. Although Bylaws are not required to file for 501(c)(3) status, they will help you in governing your organization. If questions arise down the road, bylaws can help future staff and board members determine the actions that must occur. Bylaws should be drafted with the help of an attorney and approved by the board early in the organization's development.

6. **Develop a budget.** Creating a budget is often one of the most challenging tasks when creating a non-profit organization. A budget is the expression, in financial terms, of the plan of operation designed to achieve the objectives of an organization. New organizations may start the budgeting process by looking at potential income – figuring out how much money they have to spend.

7. **Develop a record-keeping system.** Legally, you must save all Board documents including minutes and financial statements. It is necessary to preserve your important corporate documents, including board meeting minutes, bylaws, Articles of Incorporation, financial reports, and other official records. You should contact your appropriate state agency for more information on what records you are required to keep in the official files.

8. **Develop an accounting system.** If your board does not include someone with a financial or accounting background, it is best to work with an accountant familiar with non-profit organizations. Non-profits are accountable to the public, their funders, and, in some instances, government granting bodies, and it is vital to establish a system of controls (checks and balances) when establishing the organization's accounting practices. Responsible financial management requires the establishment of an accounting system that meets both current and anticipated needs.

9. **File for 501(c)(3) status.** To apply for recognition of tax-exempt, public charity status, obtain Form 1023 (application) and Publication 557 (detailed instructions) from the local IRS office. The filing fee depends upon the size of the organization's budget. The application is an important legal document, so it is advisable to seek the assistance of an experienced attorney when preparing it. Both of these documents can be downloaded from IRS web site. <http://www.irs.gov/charities>

10. **Apply for a federal employer identification number.** Regardless of whether or not you have employees, non-profits are required to obtain a federal Employer Identification Number (EIN) — also referred to as the federal ID number. Available from the IRS, this number is used to identify the organization when tax documents are filed and is used not unlike an individual's Social Security number. If you received your number prior to incorporation, you will need to apply for a new number under the corporate name. Ask for Form SS-4 when applying for your EIN. <http://www.irs.gov/businesses/small/article/0,,id=98350,00.html>

11. **File for state and local tax exemption.** In accordance with state, county, and municipal law, you may apply for exemption from income, sales, and property taxes. Contact your state Department of Revenue, your county or municipal Department of Revenue, local Departments of Revenue, and county or municipal clerk's offices for the appropriate forms and required steps.

12. **Fulfill charitable solicitation law requirements.** If your organization's plans include fundraising, be aware that many states and few local jurisdictions regulate organizations that solicit funds within that state, county, or city. Usually compliance involves obtaining a permit or license and then filing an annual report and financial statement. Contact the state Attorney General's office, the state Department of Commerce, state and local Departments of *Revenue and county or municipal clerk's offices to get more information.*

13. **Apply for a non-profit mailing permit.** The federal government provides further subsidies for non-profits with reduced postage rates on bulk mailings. While first-class postage rates for non-profits remain the same as those for the for-profit sector, second- and third-class rates are substantially less when non-profits mail to a large number of members or constituencies. For more information on eligibility, contact the U.S. Postal Service and ask for Publication 417, Non-profit Standard Mail Eligibility. If you anticipate producing a substantial amount of mailings this may be a major money saver, however with as much correspondence undertaken through email and social network sites, the effort and upfront cost for a discount mailing permit may not be worth the investment.

What professional help might you need?

Lawyer?

You can do much of the work yourself to incorporate (for example, completing Articles of

Incorporation). Applying for tax-exempt and/or tax-deductible status is more complicated, and your team would benefit from the advice of a lawyer who understands non-profit matters (for example, knows how to complete Form 1023). It is very important that your filing for tax-exempt and/or charitable status be very accurate about the purpose and program of the new organization. Otherwise, the new organization might not get special tax status at all, or it might get only tax-exempt status and not charitable status. To get references for a good lawyer, ask non-profits in your area, or call the local bar association. You might be able to find very low-cost legal fees from a Legal Aid chapter in your area, or from pro bono services of law firms in your area.

Accountant?

It is as likely that you will need an accountant as a lawyer. You can struggle through much of the legal filings and forms. However, if you do not have at least a basic understanding of bookkeeping and accounting, then you should get some help. Ideally, you can recruit a volunteer who has financial management skills, and even becomes your Board Treasurer. Call the local volunteer organization to see if they can recommend someone. Call several local corporations to see if they have a volunteer center to help their employees find useful volunteer positions in the community. Look through the Yellow Pages to find accountant organizations.

Alternatives to Starting a Non-Profit

While many people are tempted to incorporate first, there are a number of options for undertaking a new activity without starting a new organization. Because most people thinking about starting a non-profit have more passion for the purpose than the paperwork, it is wise to understand the ongoing reporting and record keeping requirements for non-profits. These obligations represent substantial time and financial requirements and can be an obstacle to success and an unwanted distraction for people wanting to spend their time directly involved in serving people, creating art, or promoting a cause.

Since many non-profits are formed with high hopes and a few dedicated people and never get off the ground, investing time on the front end to determine the level of interest and availability of funds can help you better understand whether a new organization is needed.

Here are five alternatives to starting a new organization:

- Join an existing effort — Study the list of non-profits already active in the same subject and geographic area and join their efforts as a volunteer, a board member or even as staff.
- Create a special program of an existing effort — Analyze the list of non-profits already active in the same area, identify the three most compatible with your ideas, and meet with them to explore creating a special project or initiative and negotiate your involvement. You may have ideas that they would welcome, including resources that may be available to finance the new undertaking. Your activity could be a sponsored project with a level of independence, but without the need for separate books, government reporting and boards and committees.
- Start a local chapter of a national or regional organization — Explore the list of national organizations in the subject area of your interest, and see if a local chapter is needed in your geographic area.

- Maintain an informal organization — This is a viable option for groups with annual revenues under \$25,000 with no employees. If your effort will be quite local and small, consider forming an unincorporated association or club -- have meetings and activities but skip the ongoing reporting requirements. Informal organizations can operate as a non-profit, however, donations to an informal organization are not tax-deductible. However, those that choose to remain informal may undertake risk to board members and founders by not incorporating the organization. By incorporating, the organization becomes a legal entity and can only be liable for the assets of the organization. An incident involving an unincorporated organization may put personal assets of board members, volunteers, or others, at risk.
- Find a fiscal sponsor for your organization — If you are considering creation of a group to finance activities or needs of others, plan to work on a limited-time project, or want to test a program idea first, exploring fiscal sponsorship. Fiscal sponsorship, sometimes referred to as fiscal agency, is a way to receive tax-deductible contributions by using the tax-exempt status of another organization as an umbrella.

Fiscal sponsors often provide more than the use of their tax-exempt status. They often co-locate, provide accounting and administrative services, and strategic planning guidance. The sponsored organization will pay a fee to the sponsor for their services, generally around 10 percent of the organization's revenues.

Fiscal sponsorship is a complex, individualized process. Organizations considering working with a sponsor should first identify several possible sponsors with missions in sync with that of the new organization. Work with each of these organizations to find the best fit in terms of missions, working style, and location. Will the sponsorship be structured to re-grant monies to the new organization? Will the sponsored organization purchase services from its sponsor? At what cost? How will both be assured against tax fraud? It is recommended that both parties consult with legal professionals to ensure their interests are being met in the sponsorship agreement.

Sources

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http://mncn.org/info/basic_start.htm - Alternatives to starting a new non-profit

Have questions or want some insight from S.A.R.C.H.? Visit <http://www.sarchonline.org> or contact Andronicus Brother April Rabanera.