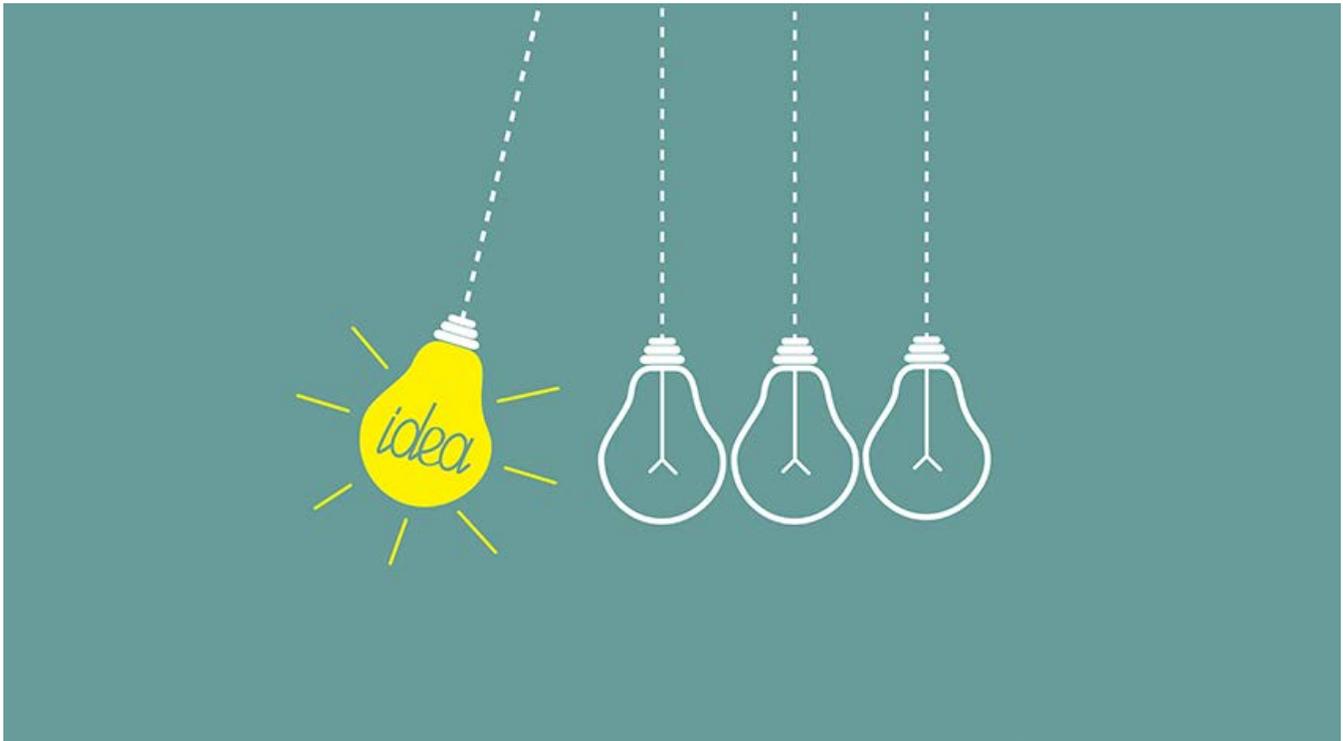


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Forming a Nonprofit Tax-Exempt Corporation in Texas



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About Texas CBAR

Texas Community Building with Attorney Resources (Texas CBAR) is a special project of Texas RioGrande Legal Aid, the nation's third-largest provider of free legal services to low-income persons. Texas CBAR provides free non-litigation legal assistance to nonprofits and small businesses through its collaboration with law firms and volunteer attorneys, bettering the lives of thousands of low-income families and communities throughout the state. For more information about Texas CBAR, or to apply for our services, please visit our website, www.texasbar.org.

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Forming a Tax-Exempt, Nonprofit Corporation in Texas

The purpose of this guide is to help you decide whether to form a tax-exempt, nonprofit corporation. It will also explain the basic steps required to form a Texas nonprofit corporation and to secure tax-exempt status for the nonprofit corporation from the state of Texas and the federal government.

This guide provides general guidance on how to form a tax-exempt Texas nonprofit corporation in Texas. It does not provide specific legal advice.

Will the organization serve an unmet need?

The threshold question in forming a tax-exempt, nonprofit corporation is whether the corporation will serve an unmet need in the community. The answer to this question directly affects the organization's financial sustainability, as donors and foundations that support nonprofits are unlikely to provide funding to a "new" organization unless they see a need for the organization's programs. Some factors to consider when answering this question are the following:

- ◆ What is the primary purpose to be served by the new nonprofit?
- ◆ What community or group does the nonprofit intend to serve?
- ◆ Does this community or group have a need?
- ◆ What are the competing organizations that are already providing the same or similar services to this community or group?
- ◆ Is there a strong commitment from the organizers and participants of the organization to build the nonprofit?
- ◆ Is there an adequate source of funds to support the nonprofit?

What is a nonprofit corporation?

Under Texas law, a nonprofit corporation is simply a corporation in which no part of its income is distributable to a member, director or officer of the corporation. A nonprofit corporation may be organized in Texas for any lawful purpose unless expressly prohibited by the Texas Business Organizations Code ("Tex.Bus.Org.Code"). A nonprofit corporation may also apply for state and federal tax-exemption.

A for-profit corporation has shareholders who own the corporation. No person, on the other hand, owns the nonprofit corporation or has an interest in its property. A nonprofit corporation may have members (which should not to be confused with "members" as the term is used to refer to the owners of a limited liability company). Management of the nonprofit corporation may be vested in its members or in a Board of Directors.

What are the benefits and limitations of a tax-exempt, nonprofit corporation?

A primary benefit of forming a nonprofit corporation is protection from personal liability for the corporation's members and directors (unless the member or director acts in bad faith, without ordinary care, and in a manner not reasonably believed to be in the best interest of the nonprofit). Tex.Bus.Org.Code [§22.221](#). Another benefit

of nonprofit incorporation is access to additional funding sources, such as government or community development loans and grants, which often are reserved for nonprofit organizations.

The Internal Revenue Service (“IRS”) recognizes 28 types of tax-exempt nonprofit organizations under Section 501(c)(3) of the Internal Revenue Code (“IRC”). While all 501(c) organizations are exempt from federal income taxes, only 501(c)(3) contributions are tax-deductible to the donor. Other types of Section 501(c) organizations, such as 501(c)(4) civic leagues or 501(c)(7) sports organizations, are beyond of the scope of this publication.

To qualify for federal tax-exemption under Section 501(c)(3), a nonprofit must be organized and operated exclusively for one or more of the following purposes: religious, charitable, scientific, testing for public safety, literary, educational, or the prevention of cruelty to children or animals. It cannot be organized for the purpose of financial profit for its members or directors, although they can be paid a reasonable compensation for their work. Section 501(c)(3) nonprofit organizations are absolutely precluded from engaging in partisan political campaign activities. Certain lobbying activities are permissible but regulated.¹

What constitutes charitable, educational, or literary purposes?

Charitable Purposes — Charitable purposes under the Internal Revenue Code are broadly defined as services that are beneficial to the public interest and may encompass some of the other specifically enumerated 501(c)(3) purposes (such as religious or educational). The organization must serve an open class of people and not limit its activities to specific individuals. For example, a charitable organization established to provide food to the homeless in the community would be a charitable organization, but an organization established to provide food to a designated set of low-income families would not be. The beneficiary class needs to be open and unspecified, but does not have to be large. An organization established to feed the hungry in a certain two-block area would qualify as a charitable organization. Examples of charitable purposes include relief of the poor, distressed, or underprivileged; advancement of education or science; erection or maintenance of public buildings or monuments; lessening the burdens of government; elimination of prejudice and discrimination; promotion and development of the arts; and defense of human and civil rights secured by law.

Educational Purposes — Educational purposes under the IRC include instruction of the public on subjects useful to individuals for the benefit of the community and for self-development. The Internal Revenue Service (“IRS”) generally will find that a curriculum is educational if, when presenting particular viewpoints, it provides a sufficiently full and fair exposition of pertinent facts to permit an individual or the public to form an independent opinion or conclusion. However, mere presentation of unsupported opinion is not considered educational. Some examples of educational purposes include: publishing public interest educational materials that do not conflict with the requirements above; conducting public discussion groups, forums, panels, lectures, or workshops; offering a remote learning course; operating a museum, zoo, planetarium, symphony orchestra, or other performance groups; serving an educational institution, such as a college bookstore, alumni association, or athletic organization; and publishing educational newsletters, pamphlets, books, or other material.

¹For information on permissible advocacy activities for nonprofits, including [Texas-specific](#) resources, visit [Bolder Advocacy](#), a special initiative of the [Alliance for Justice](#), or the National Council of Nonprofits resource pages on [Everyday Advocacy Resources](#).

Literary Purposes — Usually, nonprofit organizations fall under educational purposes when they involve publishing written materials. An organization that wants to publish materials geared to benefit the public interest may also qualify for tax-exempt status as long as it does not target commercial markets and sells the publications at a modest price. Some examples include publishing material on environmental preservation, highway safety, or drug and alcohol abuse.

What is a community development organization?

An important category of charitable purposes is community development, such as job training, small business assistance, or affordable housing development. Although there is no established legal definition for a “community development organization”, it is characterized by its community-based leadership and its work primarily in the development of housing and job creation. There are essentially four independent bases for Federal tax-exemption for a nonprofit community development organization:

- ◆ relieving the poor and distressed,
- ◆ combating community deterioration,
- ◆ eliminating discrimination, and
- ◆ lessening the burdens of government.

Relieving the Poor and Distressed — The difficulty with this basis for exemption is determining whether an individual or family is “poor and distressed.” The IRS defines “poor and distressed” as the inability to afford the “necessities of life” without undue hardship. When the IRS grants federal tax-exempt status to a community development organization for its work to relieve the poor and distressed, it looks at the organization’s anticipated impact on families’ lack of adequate housing, chronic unemployment or underemployment, and whether the work will be performed in a geographic area identified as economically disadvantaged by a government agency.

Combating Community Deterioration and Eliminating Discrimination — Under this basis for exemption, a community development organization can seek a federal tax exemption based on social welfare activities without having to show that the population it serves is “poor and distressed.” Examples include organizations that erect or rebuild housing in a deteriorated area, sponsor efforts to promote racial integration, stabilize the neighborhood, and provide social services to area residents.

Lessening the Burdens of Government — To qualify under this basis for exemption, an organization must meet a two-part test: (1) the government must consider the activities the organization will perform to be the government’s responsibility, and (2) the activities must actually “lessen” the burden of the government. The best way to establish an activity as a government burden or duty is to find a law or a government rule or policy that applies to the particular activity (such as a local housing or economic development plan or policy). Other relevant factors to establish a government’s burden include a governmental unit’s prior involvement in an activity on a regular basis for a significant length of time; the funding of an organization’s activities by the government; or an activity which is one that could be performed directly by a governmental unit.

The second part of the two-part test is whether the organization’s activities will actually “lessen” the government’s burden when considering all of the circumstances as a whole. Basically, the organization’s activities must fairly directly address the burden. It helps if the organization has a good relationship with the government or the organization’s activities allow the government to improve its functions without additional government expenditures. Providing affordable housing for low-income families is historically a governmental function (for example, the federal Department of Housing and Urban Development, or the Farmers’ Home Administration Program). Encouraging job creation and growth of small business is also a goal of government, so nonprofit economic development corporations have a strong claim that they lessen the government’s burden.

What are some alternatives to incorporation?

Unincorporated Association – An unincorporated association lacks the strict organizational, reporting, and registration requirements imposed on nonprofit corporations. There are no formal requirements to form the association. This structure is best suited for a small organization that does not intend to receive outside funds.

Fiscal Sponsorship – A fiscal sponsorship occurs when an existing organization or program that is not yet tax-exempt partners with an established tax-exempt nonprofit organization. The activity or program is carried out under the control and tax-exempt status of the existing organization (the “fiscal sponsor”). This allows grants and contributions to be raised through the fiscal sponsor, which already has fiscal, accounting, personnel, and management systems in place. There are no incorporation costs, and the sponsor assumes the risk of liability. The downside of fiscal sponsorship is that the fiscal sponsor has ultimate authority over all decisions and the IRS considers the activity to be a program of the fiscal sponsor, rather than a separate organization or entity).

What are the steps to form a nonprofit corporation in Texas?

Step 1: Check Availability of Name

(Optional: Reserve Name with Secretary of State)

The Secretary of State will allow an entity seeking incorporation to use a name that is “distinguishable” from a name already in use. Tex. Bus. Org. Code [§5.053](#).²

Some names require prior approval from specific entities. For example, a nonprofit must obtain prior approval from the Texas Higher Education Coordinating Board to use the following terms: college, university, seminary, school of medicine, medical school, health science center, school of law, law school, law center, and words of similar meaning. A nonprofit that wants to use the terms veteran, legion, foreign, Spanish, disabled, war or world war must obtain written approval from a Congressionally recognized Veteran’s organization. Tex. Bus. Org. Code [§5.062](#). Use of the terms olympic, olympiad, olympian, and olympus is precluded under state and federal law unless authorized by the U.S. Olympic Committee.

Check the name availability and legality of the organization’s proposed name by calling or emailing the Texas Secretary of State in Austin: (512) 463-5555; corpinfo@sos.state.tx.us. For more information on entity names, visit the Secretary of State’s information page on [Names of Entities](#).³

² Effective June 1, 2018, Sections 5.053, 5.012, and 5.153 of the Texas Business Organizations Code were amended to replace the term “deceptively similar” with “distinguishable name.”

Unlike a for-profit corporation, a Texas nonprofit corporation does not need to add an organizational designation such as “Inc.,” “Ltd.,” “Incorporated,” or “Company” to its name.

An organization may take an optional step if it does not plan to file its Certificate of Formation for a few months. If an organization wants to ensure that its proposed name is not “taken” before filing its Certificate of Formation, it can reserve the name with the Secretary of State for a period of 120 days. If the name is available, the organization can reserve it using the Secretary of State’s online tool, [SOSDirect](#), 24 hours a day, 7 days a week; or file [Form 501](#) (Name Reservation).⁴ Filing instructions are included on the first page of the Form 501.

A nonprofit organization may operate under an assumed name or dba (“doing business as”) by filing [Form 503](#)⁵ Assumed Name Certificate with the Texas Secretary of State. Tex. Bus. Org. Code [§5.051](#).

Step 2: Prepare Certificate of Formation

The Certificate of Formation, as the name implies, is the document filed with the Secretary of State to form the nonprofit corporation. The Certificate, which becomes a public document, defines what the corporation will do and who will be initially responsible for the management of the corporation. Secretary of State [Form 202](#)⁶ meets the minimum statutory filing requirements for a Certificate of Formation, but requires additional language if it is to be used as part of an IRS application for tax exempt status under Section 501(c)(3). If a Certificate of Formation does not include the necessary language, it will need to be amended and restated.

The following provisions need to be included in the Certificate:

Purposes Clause: The purposes clause should define the charitable purpose of the corporation. The nonprofit needs to make sure the purposes clause is not so narrow that it unduly limits the nonprofit’s activities, and not so broad that it prevents the nonprofit from obtaining 501(c)(3) exemption from the IRS. All that is required is: “The Corporation is a nonprofit corporation organized for exclusively charitable, scientific, religious, and educational purposes within the meaning of section 501(c)(3) of the IRC of 1986, as amended.”

IRS Language: To obtain tax-exempt status from the IRS under Section 501(c)(3) of the IRC, the Certificate of Formation also needs to include the following special clauses:

- ◆ *Dissolution Clause* – a statement that upon dissolution of the nonprofit, any remaining assets will be distributed to other organizations exempt under Section 501(c)(3).
- ◆ *Inurement Clause* – a statement that no part of the earnings of the nonprofit shall inure to the benefit of individual members, and
- ◆ *IRS Clause* - a general statement that the corporation may not take action that would be inconsistent with the requirements for tax-exemption under Section 501(c)(3).

³ www.sos.state.tx.us/corp/boc_presentation/VI_names.shtml

⁴ www.sos.state.tx.us/corp/forms/501_boc.pdf

⁵ www.sos.state.tx.us/corp/forms/503_boc.pdf

⁶ www.sos.state.tx.us/corp/forms/202_boc.pdf

Visit the Texas CBAR online library for a sample [Certificate of Formation](#) containing samples of these clauses.⁷

Initial Directors: The certificate must name the directors constituting the initial board. The initial board of directors will serve in this capacity until replaced as outlined in the bylaws and the Certificate of Formation. A Texas corporation must have a minimum of three directors. Tex.Bus.Org.Code [§22.204](#). The directors need not be residents of Texas.

Incorporator: The incorporator is the person who signs the Certificate of Formation and must be 18 years of age or older. The incorporator does not need to be one of the initial directors. The incorporator does not need to acknowledge the certificate before a notary. Once the Secretary of State approves the Certificate of Formation, the incorporator's work is completed.

Registered Agent and Address: The Certificate of Formation must provide the name and address of the corporation's registered agent and office. The registered office generally cannot be a post office box. The business address of the corporation does not need to be the registered office of the corporation although this is frequently the case. The registered agent is the person designated to receive or accept and forward to the corporation (or otherwise notify the corporation), of any The agent is often the incorporator or another officer or director of the corporation. The organization should appoint as registered agent a person who will remain affiliated with the corporation for at least a year. The person agreeing to serve as registered agent must sign a written consent to serve (Secretary of State [Form 401-A](#)), which must be kept with the corporate books and records. The signed consent form does not need to be filed with the Secretary of State. However, the corporation *must* notify the Secretary of State of any *change* in the registered agent or office by completing and filing [Form 401](#), Change of Registered Agent/Office.

Members: In forming a nonprofit corporation, you need to decide who will govern the corporation: voting members, the board of directors, or a combination of the two. If the corporation is not going to have members, the certificate needs to state so; otherwise, it is assumed that the nonprofit has members. Many nonprofit corporations choose the membership form when they seek increased formal accountability to a particular community or when there is another strong reason for having members, such as increased ability to attract funds from sources that require or encourage membership, or the need to demonstrate a base of support within a community or group of people. The increased administrative burdens of running a membership corporation, however, have led many corporations not to have members. If you are creating a nonprofit corporation with members, be sure to review the various statutory requirements relating to membership corporations, including provisions relating to voting rights and notices of meetings.

Step 3: File the Certificate with Secretary of State

Generally, the incorporator will need to submit the completed Certificate of Formation, with the appropriate clauses described in Step 2 above, in duplicate together with the appropriate filing fee. Online filing is available through the Secretary of state's online filing portal, [SOS Direct](#). Alternatively, it can be delivered to the Texas

⁷ www.trla.org/www_texasbar/wp-content/uploads/2016/08/Sample-Cert.-Formation-7.20.17.doc. To change or amend an existing Certificate of Formation, review the CBAR Sample Restatement Form at www.trla.org/www_texasbar/wp-content/uploads/2018/05/Sample-Amended-Restated-COF-Form-414-5.1.18.doc

Secretary of State's office by mail to Box 13697, Austin, Texas 78711-3697, by fax to (512) 463-5709, or hand-delivery to the James Earl Rudder Office Building, 1019 Brazos, Austin, Texas 78701. If faxing, the certificate must be accompanied by credit card information on [Form 807](#)⁸ (as described in the Form 202 instructions). For an expedited fee, an organization can get approval within approximately 72 hours. Even without the expedited fee, it generally takes no longer than a couple of weeks to receive a returned file stamped copy of the certificate. The incorporator will need to order a "certified copy" of the Certificate of Formation to submit with the federal tax-exemption paperwork. The certified copy may be ordered simultaneously with the filing of the Certificate of Formation for approximately \$1 per page.

The nonprofit corporation legally exists on the date stamped on the Certificate of Formation (or another future effective date, if one was specified on the Certificate of Formation).

Step 4: Prepare Bylaws

The initial board of directors should prepare and adopt bylaws for the corporation simultaneously with the preparation of the Certificate of Formation or soon thereafter. If using IRS Form 1023 (not 1023-EZ), you must submit a copy of the bylaws signed by a corporate officer, along with your application for federal tax-exemption.

The bylaws are the rules governing the internal structure and internal management of the corporation. The bylaws, along with the Certificate of Formation, are the "governing documents" of the organization. State law requires certain provisions to be part of the bylaws, but most provisions are optional. The law often provides that "unless the certificate or bylaws state otherwise, then..." What that means is that, when the certificate and bylaws (the governing documents) are silent, Texas law governs by default. However, when the bylaws are not silent, the bylaw provisions apply, provided they do not conflict with the certificate or state law.

Some of the most important issues in drafting the bylaws include:

Meetings: the frequency and place of meetings, the type of notice required, and whether directors may vote by written proxy.

Leadership: the titles and specific responsibilities of the officers, qualifications for directors, the number of directors, the length of terms for the directors and officers, and the method for electing and removing directors and officers. The corporation must have a president and a secretary.

Provisions for Membership (if the corporation has members): the qualifications for membership, method of selection, dues and fees, voting rights, and the frequency and place of membership meetings.

Quorum: the number of members or directors required for a quorum to conduct business, and the proportion of votes required to take action on a matter (pursuant to Texas law, an act of the board is an act of the majority of the directors present unless a greater number is required by the certificate or bylaws).

Controls: the signatures required for execution of legal documents, signatures required for checks, and other controls over financial transactions and transfers of corporate assets.

⁸ <https://webservices.sos.state.tx.us/forms/payment.pdf>

Committees: the types of committees, responsibilities of committees, and qualifications for serving on a committee.

Action without a meeting: a board can take action without a meeting if authorized in the bylaws and written consent to the action is signed by the number of directors/committee members necessary to take it. The written consent must state the specific action taken, the signature of member and date of consent, and “prompt” notice to directors/ committee members who did not provide written consent. Tex. Bus. Org. Code [§22.220](#).

Fiscal Year: the accounting period of the corporations (which need not be the calendar year).

Bylaw Amendments: the procedures for amending the bylaws.

Step 5: Meeting of Initial Directors to Adopt Bylaws and Transact Business

After the organization obtains its Certificate of Formation, it must hold an organizational meeting, called by the incorporator or a majority of the directors (or each of the actions that would have otherwise occurred at the organizational meeting may be agreed to by a unanimous written consent of the initial directors in lieu of a meeting). If a physical meeting will be held, the directors named in the Certificate of Formation must receive at least three days’ notice of the meeting, stating the time and place of the meeting. At the initial meeting, the following actions should be taken:

Adopt bylaws.

Elect officers. The corporation must elect a president and secretary. Any two offices may be held by the same person, except for the president and secretary. An officer may serve unlimited terms, unless the certificate or bylaws include term limits. The corporation can elect other officers’ positions as well, in accordance with the certificate or bylaws.

501(c)(3) application. If the nonprofit corporation will seek federal tax-exemption, the directors should vote to authorize the preparation and filing of the appropriate tax-exemption application.

At the initial meeting or subsequent board meetings, the following actions should also be taken:

- ◆ Appoint members of committees.
- ◆ Authorize purchase of corporate record books.
- ◆ Fix the location of the principal office.
- ◆ Select a bank or banks and authorize the opening of an account.
- ◆ Authorize check signers.
- ◆ Authorize payment or reimbursement of incorporation and filing expenses.
- ◆ Authorize the filing of state tax-exemption applications.
- ◆ Appoint a registered agent for service of process (if the agent named in the Certificate of Formation will not continue to serve in this capacity).⁹
- ◆ Select an insurance broker and authorize the purchase of general liability and property insurance, bonding, director’s and officer’s liability insurance, and employee fringe benefits such as medical insurance and

⁹ Make sure information concerning your registered agent is up-to-date. This is the person to whom important state notices will be sent. To change your registered agent, file [Form 408](#) with the Texas Secretary of State.

retirement plans.

- ◆ Select an accountant or auditor.
- ◆ Authorize obtaining a nonprofit mailing permit to use special bulk nonprofit rates.

Step 6: Apply for a Federal Employer Identification Number

In order to be tax-exempt, an organization must obtain a Federal Employer Identification Number (EIN). An EIN is a nine-digit number (for example, 12-3456789) assigned to certain individuals and entities for tax filing and reporting purposes. An organization must have an EIN regardless of whether it has employees. This number is used on all federal tax returns and receipts. The EIN (together with the file stamped copy or certified copy of the Certificate of Formation) is also essential when opening a bank account for the corporation.

Complete [IRS Form SS-4](#)¹⁰ and place the original completed form in the organization's minute book. Then, using the information from the completed IRS Form SS-4, use the IRS' [online interactive application](#)¹¹, which will assign the EIN instantly upon submission. Completing the IRS Form SS-4 before submitting the information through the interactive site ensures that you have a file copy of your Application for EIN.

Step 7: Prepare Federal Tax-Exemption Application

To obtain federal tax-exempt status as a Section 501(c)(3) charitable organization, a corporation generally needs to file an *Application for Recognition for Exemption Under Section 501(c)(3) of the IRC*. IRS Form 1023 or 1023-EZ should be filed within 27 months from the date the Certificate of Formation is filed with the Texas Secretary of State.

There are two types of Form 1023 Applications: the regular IRS Form 1023 and the streamlined IRS Form 1023-EZ. The version to file depends upon whether the organization meets a certain asset and gross receipt threshold.

IRS [Form 1023-EZ](#), *Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the IRC*, is for small charities. Organizations with assets of \$250,000 or less and annual gross receipts of \$50,000 or less are generally eligible to file Form 1023-EZ. Use the Eligibility Worksheet found in the 1023-EZ Instructions.

The 3-page 1023-EZ Streamlined Application must be completed online. The user fee for Form 1023-EZ is \$275, and must be paid through www.pay.gov when the application is filed. Unlike the regular Form 1023, Form 1023-EZ requires the organization to choose a National Taxonomy of Exempt Entities (NTEE) Code, a three character series of letters and numbers that best describes the organization and its purpose. Although the 1023-EZ must be submitted online, you can view a preview of the form [here](#).¹²

Form 1023-EZ was updated in January 2018 to require the applicant to include more information than the previous version. Part III of the 1023-EZ calls for a brief (250 characters or less) description of the organization's mission or most significant activities that further its exempt purpose. The organization must also certify answers to questions about annual gross receipts, total assets and public charity classification. A formerly exempt organization that was automatically revoked and applying for reinstatement must use the same NTEE Code in

¹⁰ www.irs.gov/forms-pubs/about-form-ss-4-application-for-employer-identification-number-ein

¹¹ www.irs.gov/businesses/small-businesses-self-employed/apply-for-an-employer-identification-number-ein-online

¹² www.pay.gov/public/form/preview/pdf/62759871

use at the time of revocation. If the organization seeking reinstatement uses another classification, it must file a full (regular) Form 1023.

The regular or standard [IRS Form 1023](#)¹³ Application for Exemption is required for organizations with more than \$50,000 in gross receipts. The Form includes detailed instructions for completion. The IRS also offers an [Interactive Form 1023 Application](#)¹⁴ to guide an organization through the application process. It must be signed by a principal officer, an authorized employee, or an attorney for the corporation. The user fee for Form 1023 is \$600, by check or money order payable to United States Treasury. Send the completed Form and attachments by certified mail, return receipt requested to: Internal Revenue Service, P.O. Box 12192, Covington, KY, 41012-0192. As set forth in the Instructions, the completed Form 1023 must include the following as part of the application:

- ◆ Certified copy of the Certificate of Formation;
- ◆ Copy of bylaws;
- ◆ Detailed pro forma¹⁵ financial statements, including revenue and expense statement for current and three preceding fiscal years; for new organizations, proposed budgets for the next two fiscal years including a list of anticipated financial support;
- ◆ Narrative description of past, present, and future planned activities with an emphasis on broad public benefit of the organization’s activities;
- ◆ Names and addresses of directors and officers and their annual compensation;
- ◆ Annual accounting period (fiscal year);
- ◆ Statement as to whether the organization is claiming status as a private foundation or public charity; and
- ◆ EIN.

The IRS has 270 days to rule on the application. Usually within 2-3 months, the IRS either requests additional information or approves the organization’s tax-exempt status by issuing a “determination letter” to the corporation formally approving the exemption. The approval process for smaller charities filing a 1023-EZ generally takes less time than the long-form 1023 Application. Regardless of which form the organization files, Federal law requires that the Determination Letter, 1023 Application and attachments, and correspondence to and from the IRS relating to the application must be made available for public inspection.

The IRS will presume that a corporation qualifying for a tax-exemption is a private foundation unless the corporation proves that it falls under the definition of a public charity. Generally, a nonprofit corporation will want to qualify as a public charity and not a private foundation. Operational, distribution, and reporting requirements for private foundations differ from those of public charities and are more restrictive and burdensome. To qualify as a public charity, a nonprofit corporation must generally receive funding from a broad base of private supporters. The IRS has very specific tests to determine public charity status. The [instructions to the IRS Form 1023](#) discuss this in more detail.

¹³ www.irs.gov/forms-pubs/about-form-1023

¹⁴ www.stayexempt.irs.gov/home/starting-out/interactive-form-1023-rerequisite-questions

¹⁵ “Pro forma” financial statements are meant to provide a general understanding finances, unlike a financial statement that complies with [Generally Accepted Accounting Principles](#) (GAAP), which is the accounting standard for an up-and-running nonprofit corporation.

The instructions to the Form 1023 also point to the additional IRS Forms that must be filed annually by the tax-exempt, nonprofit corporation, including any income the nonprofit generates that is unrelated to its exempt purposes (described as “unrelated business taxable income”).

Step 8: Apply for Sales, Franchise and Hotel Tax-Exemption from Texas Comptroller

Nonprofit corporations are subject to all state taxes that for-profit corporations are subject to, including sales/use, franchise and hotel occupancy tax, unless the nonprofit corporation obtains an exemption from

The Texas Comptroller of Public Accounts. The easiest method for obtaining state tax-exemption is by first obtaining federal tax-exemption. To apply for state exemption based on the federal exempt status, complete [Form AP-204](#).¹⁶ Include a copy of the exemption determination letter issued by the IRS, including any addenda. The organization name on the IRS letter must match the organization’s legal name as listed in the Certificate of Formation.

Step 9: Apply for Property Tax-Exemptions from the Local Tax Appraisal District

Organizations engaged primarily in charitable activities may be eligible for a local option property tax-exemption. The availability of the exemption is at the option of local taxing authorities. Before an organization can apply for the exemption, the Texas Comptroller’s office must verify that the nonprofit organization is a statewide charitable organization engaged primarily in charitable activities. Complete and submit along with a copy of the Comptroller determination to their local appraisal district.

What are the legal obligations of a tax-exempt nonprofit?

There are strict statutory obligations that nonprofits must follow under Texas law:

- ◆ The corporation may not make a loan to a director and any director who votes for the loan (and any officer who participates in making the loan) is jointly and severally liable to the corporation for the loan until repaid. Tex.Bus.Org.Code [§22.225](#).
- ◆ The corporation must maintain current and accurate financial records with complete entries of each financial transaction of the corporation. Tex.Bus.Org.Code [§22.352\(a\)](#).
- ◆ The corporation must prepare the following annual reports in accordance with the accounting standards of the American Institute of Certified Public Accountants: a statement of support, revenue and expenses, a statement of changes in fund balances, a statement of functional expenses and a balance sheet for each fund. Tex.Bus.Org.Code [§22.352\(b\)](#).
- ◆ The corporation must keep its records, books and annual reports at its registered or principal office for three years and make the records available to the public for inspection and copying. Tex.Bus.Org.Code [§22.353](#).
- ◆ The corporation must keep a current registered agent and their consent to serve on record.
- ◆ The corporation must submit IRS Form 990 every tax year.
- ◆ The corporation must submit Secretary of State [Form 802](#)–General Information (Periodic Report--Nonprofit Corporation) once every four years.
- ◆ If the corporation has members, it must hold an annual meeting of its members. Tex.Bus.Org.Code [§22.153](#). Notice of the meetings must be delivered between 10 and 60 days before the meeting, in person, by fax or email, or by mail. Tex.Bus.Org.Code [§22.156](#). The bylaws may provide that no notice is required (in which

¹⁶ www.window.state.tx.us/taxinfo/exempt/index.html.

- case, the bylaws should describe the time and place of the annual meeting). Tex.Bus.Org.Code [§22.157\(a\)](#).¹⁷
- ♦ If it has members, it must prepare an alphabetical list of the names of all of its voting members. Tex.Bus.Org.Code §22.158. Unless otherwise provided for in the Certificate of Formation or the bylaws, members holding 1/10th of the vote constitute a quorum and a majority of the quorum is an act of the members. Tex.Bus.Org.Code [§22.159](#).

Who monitors nonprofit organizations?

The Board of Directors is legally responsible for the activities of the organization, including guarding it against fraud and corruption. Private watchdog groups, such as the National Charities Information Bureau and the American Institute of Philanthropy, monitor the behavior of nonprofits in order to ensure that money is being spent appropriately and effectively. The state, through the Attorney General's office, is responsible for investigating fraud and abuse claims. The IRS monitors nonprofits by requiring annual reporting on IRS Form 990 as a condition of being tax-exempt and through its audit process. The IRS can also individually sanction officials who receive excess benefits or otherwise violate the federal tax laws applicable to nonprofit organizations. Individual donors and members can regulate the organization by withholding financial support as well. Increased media coverage has also held nonprofits accountable to their true purposes.

Should an organization use a lawyer to help gain tax-exempt status?

In almost every case, the answer is yes. A lawyer can help you by avoiding unnecessary mistakes, which might jeopardize your ability to incorporate or gain tax-exempt status. A lawyer will also advise you on certain corporate responsibilities, such as withholding and paying Social Security tax as well as any other wage withholding taxes for employees. Such taxes generally apply regardless of your tax-exempt status. If you do not have a lawyer and cannot afford to pay for one, you may be able to obtain free legal assistance through Texas CBAR or a similar organization in your area.

¹⁷If the corporation has more than 1,000 members, and if the bylaws so provide, the corporation may give notice by publication in a newspaper in the community. Tex.Bus.Org.Code [§22.157\(b\)](#).

The following resources provide management support services to nonprofit organizations.

— May 2018 —

AMARILLO

Amarillo Area Foundation Nonprofit Services Center
www.amarilloareafoundation.org

AUSTIN

Texas CBAR
4920 N. IH-35, Austin, TX 78751
(512) 374-2712
Email: texasobar@trla.org
www.texasobar.org

Texas Association of Nonprofit Organizations
www.tano.org

BEAUMONT

Southeast Texas Nonprofit Development Center
700 North Street, Suite D, Beaumont, TX 77701
(409) 832-6565
www.setxnonprofit.org

DALLAS

The Center for Nonprofit Management
2902 Floyd Street, Dallas, TX 75204
www.cnmconnect.org

HOUSTON

Nonprofit Connection
50 Waugh Drive, Houston, TX 77007
(713) 685-2300
www.unitedwayhouston.org/nonprofit-connection

JACKSONVILLE

A Circle of Ten
205 E. Commerce, #205, Jacksonville, TX 75766
(903) 541-0013
www.circleof10.org

LUBBOCK

Volunteer Center of Lubbock
1706 23rd Street, #101, Lubbock, TX 79411-1213
(806) 747-0551
www.volunteerlubbock.org

MIDLAND

Nonprofit Management Center of the Permian Basin
3500 North A Street, Suite 2300, Midland, TX 79701
Email: info@nmc-pb.org
<http://nmc-pb.org>

SAN ANTONIO

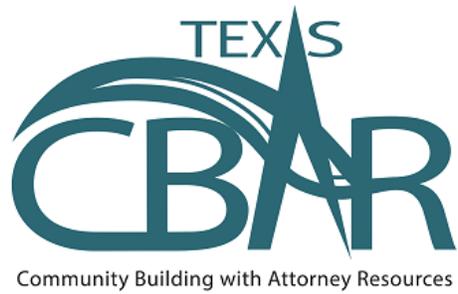
San Antonio Area Foundation Center for Nonprofit Support
303 Pearl Parkway, Suite 114 San Antonio, Texas 78215
(210) 225-2243
Email: info@saafdn.org
<http://www.saafdn.org>

TYLER

East Texas Center for Nonprofits
4000 Southpark Drive, Tyler, TX 75703
(903) 581-6376
<https://uwsmithcounty.org/east-texas-center-for-nonprofits-2/>

WICHITA FALLS

Nonprofit Center of Texoma
2301 Kell Blvd., Ste. 218, Wichita Falls, TX 76308
(940) 322-4961
<http://nonprofitcenterwf.org>



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