



THE NONPROFIT  
ASSOCIATION OF  
OREGON

*Connect. Improve. Advance.*

## NAO Nonprofit Start-up Packet 2020

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# PROS AND CONS OF FORMING A NONPROFIT ORGANIZATION

Nonprofit organizations can be used for any type of entity, but are specifically intended to support activities or benefit the following:

- Charity
- The Environment
- Humanitarian Aid
- Education
- Animal Protection
- The Arts
- Wildlife Conservation
- Social Issues
- Health care
- Medical aid
- Religion
- Research
- Science
- Sports
- Any other admirable or public purpose

The term “nonprofit organization” does not simply refer to an organization that cannot generate a profit; it means that an organization can only earn a profit at the entity level and the profit may not be passed on to the organization’s board of directors, officers, or members. The profit reorganization must be used for a charitable or public purpose. A nonprofit entity may legally and ethically run a trade or business that generates a profit, or hold investments; however, the profit must be used exclusively for attaining the organization’s goals. A nonprofit entity is generally exempt from taxation, with certain exceptions.

[Common 501\(c\)\(3\) Rules and Regulations](#) (BoardEffect)

## Advantages & Benefits

Tax exemption is one of the principal benefits for nonprofit organizations. Tax exemption enables the organization to operate without federal (and perhaps state) income tax. This benefit often enhances the organization's ability to accumulate income and assets and can, therefore, lead the organization to be more productive over the long-term.

A second primary benefit to a tax-exempt entity is that charitable contributions to a 501(c)(3) organization are tax deductible. If an organization has obtained IRC Section 501(c)(3) tax-exempt status, an individual or company's charitable contributions to this entity are tax-deductible. Organizations must apply to the Internal Revenue Service for such status as not all nonprofit organizations qualify for tax exemption. Qualification as a nonprofit organization is defined by state law, while qualification for tax exemption is largely determined by federal tax law.

**Tax exemption does not apply to employment or payroll taxes.** Conditions such as the tax-exempt purpose, complying with limitations on spending, and an internal safeguard for a charity must be met for the IRS to issue an authorization letter of tax-exempt status. Failure to maintain operations in compliance with the law may result in an organization losing its tax-exempt status.

There are benefits of organizing a nonprofit organization as a corporation. Limitation on personal liability is a significant benefit in organizations of the corporate form. If the corporation is found liable for damages, the liability is generally confined to the corporation. The directors and officers of the organization are generally not held liable for the wrongdoing of the corporation, whereas unincorporated associations do not have this protection available. However, organizations that are incorporated are required to file organizational documents and annual reports with the state. These documents are a matter of public record.

## Disadvantages

The cost of setting up and running a nonprofit organization is one of its principal disadvantages. Because a nonprofit is a legal entity, the use of an attorney or accountant is recommended as the rules and regulations are complex. While tax exemption is one of the advantages of qualified nonprofits, the fee of incorporation and application for exemption is a disadvantage. These costs are not the same for every entity. With the corporate form of nonprofit organizations, filing with the state is required. The cost of annual reporting requirements is also a disadvantage.

In creating nonprofits, personal control is limited. In some cases the organization's directors are the only people allowed to elect officers and to determine corporate policies. Nonprofits are subject to federal and state laws and regulations, and must follow its own articles of incorporation and bylaws, which again limit personal control over the nonprofit entity.

As a nonprofit organization is dedicated to charity or the public, its finances are also open to inspection by the public. The public may be able to obtain copies of the nonprofit organization's expense and salary reports as well as state and federal filings.

Certain detailed documents including financial records, articles of incorporation, bylaws and annual reports, as required by the state in which it is incorporated, must be prepared in a specific manner and filed by certain deadlines.

[Pros and Cons of Becoming a Nonprofit Organization \(GrantSpace\)](#)

## Problem Areas

There are many ongoing problems faced by nonprofit organizations. Congress and the IRS perceive a great deal of fraud in the area of charitable giving and have a great deal of concern about taxpayers avoiding their legal obligations. As a result, the Pension Act of 2006 details the significant changes in the laws that deals with charitable organizations. These recent tax law changes are broadly ranged into several categories:

- Greatly increased information-sharing between the IRS and state governments on exempt organizations.
- Greatly increased regulation and scrutiny of donor-advised funds.
- Greatly increased regulation and scrutiny of supporting organizations.
- Increased and more detailed reporting requirements in charitable information returns, including Form 990, with reporting requirements extended to more charitable organizations.
- Increased penalties for self-dealing, excess benefit transactions, fraud and abuse.
- Increased reporting and scrutiny of in-kind and cash donations, with greater requirements for appraisals and receipts.

Another problem area is the increasing cost associated with Capacity Building. Capacity Building is best described as actions that enhance a nonprofit's ability to work towards its mission. Since most nonprofit organizations rely on outside funding (grants, government funds, and direct donations), changes in these funds may influence reliability and predictability with which the organization can hire and retain staff, create programs and maintain facilities.

# Steps to Becoming a Nonprofit Corporation in Oregon

Being a nonprofit corporation is not the same as being tax exempt. The nonprofit corporation designation is a matter of state law, while being tax exempt is a matter of federal law. Although it is not required, if you are planning on conducting business in Oregon, you will need to become an Oregon State Nonprofit Corporation before filing for Federal Tax Exemption.

The Steps to becoming both an Oregon State recognized Nonprofit and Federal Tax Exempt Nonprofit are outlined at the Oregon Department of Justice website, Charitable Activities Division.

## Starting a Charity in Oregon

<https://www.doj.state.or.us/charitable-activities/starting-or-closing-a-charity/starting-a-charity-in-oregon/>

## Filing Notes

### Filing your Articles of Incorporation

- Filing the Articles of Incorporation will reserve your organization's name. No other form is necessary unless you plan to use an assumed business name such as an acronym. If you want to know whether the name you want is available, visit the Secretary of State's website and click on *Business Search*.
- Articles of Incorporation may be filed by an attorney or any person involved in the organization that is incorporating.
- Most nonprofit corporations in Oregon must have a minimum of three board members.

### Applying for your Employer Identification Number (EIN)

Your EIN number, also called Federal Tax Identification Number, is used to identify a business entity. The form to obtain an EIN number is called the **Form SS-4**.

### Developing your Bylaws

Nonprofit corporations are required to have bylaws, a document that lays out the roles of board members, and outlines procedures governing your organization. There are no pre-printed bylaws or forms to fill out, but sample bylaws for Oregon for both membership and non-membership corporations can be found in the Oregon Nonprofit Corporation Handbook, available at local libraries and available for purchase through NAO.

**Oregon Nonprofit Corporation Handbook:** <https://nonprofitoregon.org/publications>.

**Oregon Handbook Chapters** (download): <https://nonprofitpublications.net/digital-products-2>

- You don't need to file your bylaws along with the Articles of Incorporation, but you do need to file them with the application for tax-exempt status and when you register with the Oregon Department of Justice.
- Once you have incorporated your nonprofit corporation, you are subject to Chapter 65 of the Oregon Statutes: <http://www.oregonlaws.org/ors/chapter/65>.
- Refer to [Changes to the Nonprofit Corporation Act](#); an ORS 65 amendment as of 1/1/2020.

## **Filing for 501(c)(3) Tax-Exempt Status**

As a nonprofit corporation, you are not tax exempt unless and until you take the additional step of applying for tax-exempt status with the Internal Revenue Service.

You may apply to the IRS for tax-exempt status once you have filed your Articles of Incorporation the Oregon Secretary of State and obtained your Employer Identification Number (EIN).

*NOTE: Not all tax-exempt organizations are exempt under Section 501(c)(3) of the Internal Revenue Code. To find out whether a 501(c)(3) exemption is the most appropriate for you, talk to an attorney or CPA.*

## **Attorney Guidance**

If you want to be certain about a proper course of action for your organization, please consult with a licensed attorney. Below is a link to NAO's online Directory with legal service providers.

[http://directory.nonprofitoregon.org/search\\_results?q=Attorneys%2FLegal+Services+&location\\_value=](http://directory.nonprofitoregon.org/search_results?q=Attorneys%2FLegal+Services+&location_value=)

# Fiscal Sponsorship

Fiscal Sponsorship is an agreement through which a project or organization without tax-exempt status – but which could qualify for exemption - partners with an existing tax-exempt organization in order to receive donations and grants. Any nonprofit that the IRS recognizes as exempt under section 501(c)(3) can be a fiscal sponsor. If you are already working closely with a 501(c)(3) organization, you may want to consider asking them to be your organization's fiscal sponsor. It is important for sponsoree organizations to find a fiscal sponsor that have a similar mission or area of interest, as the fiscally sponsored program is technically a “program” of the fiscal sponsor.

With the complexity and detail in structuring an agreement, it is important to understand that charitable contributions for the project are accounted for in the financial books of the 501(c)3 organization, and the organization serving as a fiscal sponsor is doing so under the rules and regulations of the IRS. Funds earmarked for the project must be properly controlled and overseen by the fiscal sponsor: they must have the capacity to properly steward the funds, have mission alignment, and a willingness to maintain good communication with the project.

The Internal Revenue Service (IRS) has been more closely scrutinizing these types of arrangements in recent years, so being thoughtful in how you form your fiscal sponsorship is important. It should also be noted that the fiscal sponsor will usually take an administrative fee (typically between 7% and 15% of the sponsored organization's funds) to cover the costs of administering the sponsored organization's financial reporting and banking fees.

One of the best resources available for quickly understanding fiscal sponsorship is Gregory Colvin's book: [Fiscal Sponsorship, 6 Ways to Do It Right](#). This excerpt showing [Fiscal Sponsorship Models](#) is helpful to understand the relationship of the parties. You can also refer to the wealth of information from [National Network of Fiscal Sponsors](#).

The two most commonly implemented forms of fiscal sponsorship are described by the [Best Practices for Fiscal Sponsorship](#).

## Additional Fiscal Sponsorship Resources

[Guide to Fiscal Sponsorship](#) (GrantSpace)

[Fiscal Sponsorship for Nonprofits](#) (National Council of Nonprofits)

[Sample Fiscal Sponsorship Agreement](#)

## The following resources may help you find a fiscal sponsor:

- [Cascade Pacific Fiscal Sponsorship Services](#) – Provides fiscal sponsorship services in Oregon.
- [The Fiscal Sponsors Directory](#) - A searchable directory of potential fiscal sponsors as well as other helpful information.

For additional questions, we recommend that you consult a licensed nonprofit attorney for guidance in this matter and to review your fiscal sponsorship agreement. Here is a link to NAO's online Directory with [legal service providers](#).