

Entity Formation Guide

Introduction

This document is intended as a guide to the life cycle of a Wisconsin nonprofit organization. It will provide a broad overview of the before, during, and after steps and requirements regarding forming and maintaining a nonprofit corporation.

Ten questions organizations should be able to describe in detail are:¹

1. What will be the nonprofit's charitable purpose(s)?
2. What will be its core activities?
3. Who are its intended beneficiaries?
4. Are there existing nonprofits with a similar mission, and, if so, has the organization discussed its ideas with them?
5. Can an existing nonprofit further the mission more effectively and efficiently?
6. Can the organization attract sufficient resources to start and operate a new nonprofit?
7. Has the organization drafted a business plan (including a three-year projected budget)?
8. Is the organization familiar with what it takes to start and run a nonprofit in compliance with the law and best practices?
9. Has the organization considered alternatives to forming a new nonprofit, such as fiscal sponsorship?
10. Whose help will the organization need to form the nonprofit and get it running?

Other things to consider:

11. Researching: identifying supporters, beneficiaries, environment, and competitors and allies.
12. Seeking advice from: existing nonprofits, attorneys, accountants, etc.
13. Does the organization have or intend to have any intellectual property that should be copyright or trademark protected?

Options for Types of Nonprofits That Can Be Formed

Unincorporated Association – Chapter 184 of WI statutes

- An unincorporated association is a separate legal entity created—without any legal formalities—by a group of individuals. This option is common for neighborhood associations or small one-time event groups.
 - Informal, small organizations with limited exposure to liability and fewer fundraising needs.
 - Advantages:
 - No required formalities for formation and few required for operation
 - Disadvantages:
 - Somewhat less liability protection than with corporations
 - No framework of rules to assist in organizing operations
 - Entity is not tax-exempt and cannot accept tax deductible contributions

¹ Emily Chan & Gene Takagi, *Alternatives to Forming a Charitable Nonprofit: A Start-Up May Not Be in Your Client's Best Interests*, Business Law Today 15 (vol.18 no.6 2009).

Nonstock Corporations – Chapter 181 of WI Statutes

- A nonstock corporation is a corporation that does not issue capital stock. Typically, this type of corporation is a nonprofit because it aims to provide a service and is not motivated by financial gain. However, it is still a corporation and is subject to state and federal requirements.
 - Best structure – default option for nonprofits with day-to-day activities
 - Advantages:
 - Entity can be tax-exempt and accept tax deductible contributions
 - Preferred structure for recipients of foundation grants
 - Clear statutory rules to guide activities and operations
 - Disadvantages:
 - Complex formational and operational requirements
 - Including record keeping and governance requirements

Fiscal Sponsorship

- A fiscal sponsorship is a term used to describe the relationship between an individual or group of individuals who have initiated a charitable project and an existing tax-exempt organization (“the sponsor”) that has agreed to support the project.² The most common type of a fiscal sponsorship is when the project is housed within the sponsor’s building, conducted by the sponsor’s employees, and the project has no separate legal existence.³
 - What is this?
 - A fiscal sponsorship is a contractual relationship between an organization and an existing nonprofit.
 - Make sure that the contract allows either party to terminate upon a specified amount of notice to the other party
 - The existing nonprofit collects funds for the organization and manages them in a separate bank account.
 - Who should be the fiscal sponsor?
 - Generally best to team up with a larger, already established 501(c)(3) corporation.
 - The organization must adhere to the existing nonprofit’s tax-exempt purposes and the existing nonprofit must have a mission that encompasses the organization’s planned activities.
 - What is the benefit?
 - The organization essentially becomes a program under an existing nonprofit and receives its ability to accept tax-deductible contributions through this relationship.
 - The organization avoids filing tax returns because the existing nonprofit completes those forms for the organization.
 - What type of organization does this work for?
 - Typically, this is the best structure for new nonprofits that are still deciding what they would like to do and where their supporting funds will come from.
 - Also, for nonprofits who would rather focus on their direct charitable activities instead of focusing on maintaining an independent nonprofit.

² *Id.* at 17.

³ *Id.*

Entity Formation Process for Tax-Exempt Nonstock Corporation

To be tax-exempt under Section 501(c)(3), an organization must be both (1) organized and (2) operated exclusively for an exempt purpose.

Step 1: Draft Articles of Incorporation

- M-LINC has model articles of incorporation and model conflict of interest policy it can provide.
- Alternate Source: http://www.wdfi.org/_resources/indexed/site/corporations/form102_f.pdf
 - NOTE: The Department of Financial Institutions provides a model articles of incorporation, however, it should be used with caution because it does not contain information required by the IRS for a 501(c)(3) corporation.

Requirements for Articles of Incorporation in Wisconsin (Chapter 181.0202)

1. A corporate name must be selected.
 - The name must include one of the following:
 - Corporation, Corp., Incorporated, Inc., Company, Co., Ltd., or Limited.
 - The name must be distinct from other Wisconsin corporations.
 - Confirm name availability with the Wisconsin Department of Financial Institutions.
 - Consider trademark and website availability as well.
2. A statement of the corporation's tax-exempt purposes is **required**.
 - This means that the articles **MUST** include a statement of the corporation's purpose.
 - The purpose should be drafted broadly so that it encompasses all current, future, and potential activities of the corporation.
 - The purpose **MUST** fall within the limits of an IRC section 501(c)(3) organization.
 - E.g., charitable, educational, religious, educational, etc.
 - An organization will not receive a tax exemption if the mission does not fall under the IRS guidelines.
3. A statement of the nonstock corporation's powers.
4. State whether the corporation will have members.
 - Members are not required
 - Generally, not recommended
5. State that the corporation will be managed by a board of directors.
 - A director's fiduciary responsibility to care may conflict with an individual's self-interest. The organization may want to implement a conflict of interest policy to address these conflicting interests. M-LINC has an example of a conflict of interest policy from the IRS that can be provided.
 - A Wisconsin nonprofit must have at least **three** directors.
 - Also provide the names and addresses of the persons constituting the initial board of directors.
6. A Dissolution and Liquidation article is **required**.
7. State that the articles may be amended according to Wisconsin law.

8. Provide the mailing address of the initial principal office of the corporation.
 - Typically, most nonprofit corporations have the following officers: president, vice-president, secretary, and treasurer.
 - Provide the street address of the corporation's initial registered office and the name of its initial registered agent at that office. The board of directors elect the positions to carry out the day-to-day business of the nonprofit.
 - One person may be both a director and an officer. This is typical in small nonprofit corporations.
9. Provide the name and address of each incorporator.
10. State if the corporation is authorized to make distributions (see Wisconsin Statute 181.1302(4)).

Step 2: File Articles of Incorporation with the Wisconsin Department of Financial Institutions

- Submit the original and one exact copy.
 - Make sure the person who files the articles is a statutorily allowed person (most likely an officer, director, or incorporator).
 - Organizations should make a third copy to keep for their own records.
- Makes checks payable to the "Department of Financial Institutions."
- Send completed articles of incorporation plus one copy along with check to:

Department of Financial Institutions
 Division of Corporate & Consumer Services
 P.O. Box 7846
 Madison, WI 53707-7846

- Physical Address for Express Mail:

Department of Financial Institutions
 Division of Corporate & Consumer Services
 345 Washington Ave.– 3rd Fl.
 Madison, WI 53703

- Fee Schedule for the WDFI: <http://www.wdfi.org/corporations/fees/us.asp>
 - Current cost for articles of Incorporation for Nonprofit: \$35.00
 - Once the organization sends the articles, most transactions are acted on within five working days following their receipt.
 - The organization may request expedited service for an additional \$25 fee.
 - Mark the request conspicuously "FOR EXPEDITED SERVICE."
 - The organization may call the department to confirm that a document has been received, but acceptance cannot be determined until it has been examined.
 - Phone number: (608) 261-7577.

Step 3: Draft Bylaws

- Bylaws are the body of internal rules and procedures adopted by the nonprofit's board of directors, and, if applicable, its members.
 - M-LINC has model bylaws it can provide.
 - Common bylaws rules & procedures:
 - Conflict of interest policy.
 - IRS Form 990 advises each nonprofit to have one.
 - Sample in Appendix A of IRS Instructions to form 1023, available at <http://www.irs.gov/pub/irs-pdf/i1023.pdf>.
 - Elections of directors & officers.
 - Powers of its members, if any (generally M-LINC **does not** recommend having members).
 - IMPORTANT: Bylaws are **NOT** filed with the state of Wisconsin
 - NOTE: WI statute chapter 181 does impose certain requirements for nonprofit corporations that should be included in the organization's bylaws, such as having a minimum of three directors. (Wis. Stat. §181.0803).
 - Refer to Chapter 181 for further default rules: <http://www.legis.state.wi.us/statutes/Stat0181.pdf>
 - Make sure bylaws are not inconsistent with and do not overlap the articles of incorporation
 - If a provision in bylaws is inconsistent with the articles, the articles control.
 - **REMEMBER** bylaws should be kept basic; more specific elements of the nonprofit can be implemented as policy decisions that are approved by the board.

Step 4: Hold an Initial Meeting of the Board of Directors

- This meeting is held **AFTER** the articles of incorporation have been filed with Wisconsin's Department of Financial Institutions.
- Meeting should cover:
 - Adoption of bylaws;
 - Ratification of the actions of the incorporator;
 - Elections of officers;
 - Authorization of an officer to open bank accounts on behalf of the nonprofit;
 - Authorization of the necessary state and federal filings. (See step #5).
 - Any policies that are to be included in the nonprofit from its inception.
- Any action permitted at the initial meeting of the board of directors may be taken without a meeting if each director signs a document detailing the actions so taken.

Step 5: Obtain Employer Identification Number

- File IRS Form SS-4 to obtain an employer identification number (“EIN”).
 - Entities must obtain a nine-digit EIN to use for tax filing and reporting purposes. See page 2 of the form to determine what lines the organization needs to complete
 - Link to Form: <http://www.irs.gov/pub/irs-pdf/fss4.pdf>
 - Link to Instructions: <http://www.irs.gov/pub/irs-pdf/iss4.pdf>
 - If the principal business, office, or agency is in one of the 50 states or in the District of Columbia, fax the application to:
 - Attn: EIN Operation
 - Cincinnati, OH 45999
 - Fax-TIN: 859-669-5760
 - NOTE: There is no fee to obtain an EIN

Step 6: File IRS Form 1023-EZ to Obtain Tax-Exempt Status

- If the IRS determines that an organization is tax-exempt after it files Form 1023 or Form 1023-EZ, the organization is exempt from **federal income tax** due on **any income that furthers the organization’s exempt purpose**.
- File IRS Form 1023-EZ or Form 1023 to obtain tax-exempt status.
 - Link to Forms: <http://www.irs.gov/pub/irs-pdf/f1023.pdf> and <https://www.irs.gov/uac/About-Form-1023EZ>.
 - Link to Instructions: <http://www.irs.gov/pub/irs-pdf/i1023.pdf> and <https://www.irs.gov/pub/irs-pdf/i1023ez.pdf>.
- The cost to file IRS Form 1023-EZ is **\$275.00**.
 - The fee may be submitted through www.pay.gov when filing the 1023-EZ application.
 - The fee can be directly paid through a bank account or by credit/debit card.
- Note: Form 1023 can be difficult for organizations to complete, especially newly formed organizations. Often the responses will be the “best guess” of what will be expected.
 - For example, Part IV on page 2 asks for a narrative of past, present, and future activities of the organization.
 - Most new organizations will have to create a narrative that constitutes a “best guess” of its planned activities that will encompass its charitable purposes.
 - M-LINC suggests that this narrative be anywhere from 1 ½ to 2 pages in length.
 - Similarly, Part IX, the financial data, can present an obstacle for new organizations.
 - Again, a “best guess” of the revenues and expenses of the organization is expected.
 - This data is often discussed in a complete business plan.
 - Furthermore, some questions ask whether the nonprofit will engage in certain activities. M-LINC suggests that newly formed organizations provide an answer that coincides with their planned activities for the next 2 years.
- IMPORTANT:
 - Although the organization is not required to file a Form 1023 to operate as a nonprofit in the state, if the organization intends on taking in donations, many people will not donate without being able to deduct that amount from their taxes. In order for donors to deduct, the nonprofit must have 501(c)(3) status.

Step 7: Wisconsin State Forms

- In addition, a tax-exempt organization is exempt from state income tax in many states without any further application from the state. **In Wisconsin, a tax-exempt organization must register and file annual reports with the state.**
- File Wisconsin Form S-103 to obtain exemption from Wisconsin sales tax for purchases by the organization.
 - There is no fee and the form only needs to be filed once
 - Link to Form & Instructions: <http://www.revenue.wi.gov/forms/sales/s-103.pdf>
 - Complete the form and mail it to:

Wisconsin Department of Financial Institutions
Division of Corporate and Consumer Services
P.O. Box 7879
Madison, WI 53707-7879

- File Wisconsin Form 296 to register to solicit funds in Wisconsin (or Wisconsin Form 1954 if the organization is exempt from the registration requirement).
 - Also, the nonprofit must register in any other state it plans to solicit funds.
 - Link to WI Form: <https://www.wdfi.org/CharitableOrganizations/forms/dfi-dccs-296.pdf>
 - Read Sections B and C before completing the form.
 - Application Fees:
 - \$15 filing fee to file this form. Annually, the charity must renew its registration. The form to renew is found online and there is a \$54 renewal fee. All charities expire August 1st of every year.
 - Complete this form and mail it to:

Department of Financial Institutions
Division of Banking
P.O. Box 7879
Madison, WI 53707-7879

- Other forms may need to be filed depending on the organization.
 - Link to other Forms: http://drl.wi.gov/prof_docs_list.asp?profid=85&locid=0

Ongoing Requirements for a Wisconsin Tax-Exempt Nonstock Corporation

A tax-exempt organization must still pay the following taxes:

- Unrelated Business Income. Federal and state income tax on any income it earns that does not further its exempt.
 - Unrelated Business Income Tax rules require a tax-exempt organization to pay income tax when the organization regularly carries on a trade or business that is not substantially related to the organization’s exempt purposes.
 - Income from rents of real property are excluded in computing unrelated business taxable income. However, rents from personal property are not excluded (see IRS Publication 598 Chapter 4, exclusions on page 10).
 - Example: A nonprofit has federal tax exemption for providing books for underprivileged youth in Milwaukee. This organization then decides to sell t-shirts that say “Reading is Neat!” The income from the sales of the t-shirts would be subject to unrelated business income tax since the tax-exempt purpose of this organization is to provide books and not sell t-shirts.
- Payroll taxes. Organization is tax on any amounts paid to employees of the organization.
- Property taxes. A tax-exempt organization can receive a property tax exemption, but it must separately qualify for and apply for a property tax exemption in each jurisdiction that the organization operates in.
- State sales and use taxes.
 - Example: a 501(c)(3) youth sports league that sells concessions at games. The 501(c)(3) organization is liable for collection and payment of Wisconsin sales tax on the concessions that it sells.
 - A tax-exempt organization must apply to be exempt from sales tax for purchases. This involves sending the DOR a copy of the organization’s determination letter.

File IRS Form 990 Annually/File IRS Form 990-T and Wisconsin Form 4-T—Annually if Taxable Income

- NOTE: Form 990 is a public document and is often reviewed by potential donors and journalists.
 - Form 990 – for the largest organizations classified as public charities
 - Form 990-PF – for organizations classified as private foundations
 - Form 990-EZ – for mid-sized organizations classified as public charities
 - Form 990-N – for the smallest organizations classified as public charities
- SOURCE: <http://www.irs.gov/charities/article/0,,id=184445,00.html>

<i>2010 Tax Year and later (Filed in 2011 and later)</i>	<i>Form to File</i>
Gross receipts normally ≤\$50,000	990-N
Gross receipts > \$50,000 and < \$200,000, and Total assets < \$500,000	990-EZ or 990
Gross receipts ≥ \$200,000, or Total assets ≥ \$500,000	990

- File a Wisconsin Annual Financial Report
- All Wisconsin nonprofits must file an annual report with the Wisconsin Department of Financial Institutions—Division of Corporate and Consumer Services.
 - There are three different forms. The nonprofit must select **one** that fits the organization.
- The report will be mailed by the state to the organization’s registered agent.
- Form 1952--Supplement to Financial Report

- This form is a shorter, more commonly used version of the annual report form and must be accompanied by the organization's IRS 990, 990EZ, or 990-P.
- Form 1943--An affidavit in lieu of the annual financial report
 - This Affidavit in Lieu of Annual Financial Report form should be used by organizations that qualify for an exemption from the annual report filing requirement. Organizations that are or may be exempt include:
 - Organizations that received \$25,000 or less in contributions during their most recent completed fiscal year.
 - Organizations that operate solely in the county in which their principal office is located and that received less than \$50,000 in contributions during their most recent completed recent completed fiscal year.
- Form 308--Charitable Organization Annual Report
 - A charitable organization must submit this form if it does not qualify for Form 1943 or Form 1952.
- The Annual Financial Report must be submitted within 12 months after the organization's fiscal year-end. Forms are available at: <https://www.wdfi.org/CharitableOrganizations/forms.htm>
 - Note: There are additional financial review requirements for organizations receiving contributions of over \$300,000 and \$500,000.
- The forms can be mailed to:
 - Department of Financial Institutions--Division of Corporate and Consumer Services
 - PO Box 7879
 - Madison, Wisconsin 53707-7879

Annual Re-registration to Solicit Funds in Wisconsin (and other states where funds are solicited)

- See WI Form 296 – Must be completed by August 1st of each year.
 - The fee to register to solicit in WI is \$15 (as of October 2012).
- Link to WI Form: <https://www.wdfi.org/CharitableOrganizations/forms/dfi-dccs-296.pdf>
- Keep Minutes at All Board of Directors Meetings
- The nonprofit must maintain complete and accurate books and records. Such books and records must contain information necessary to prepare the nonprofit's tax returns and other annual reports.

Disclosure Obligations

- The nonprofit will be subject to various federal disclosure obligations.
- For example:
 - The nonprofit must make its (1) annual IRS filing (IRS Form 990) for the last three years, and (2) its application for tax-exempt status (IRS Form 1023) available for public inspection without charge at its principal office during regular business hours. The nonprofit must provide a copy of such documents without charge (other than reasonable fees for reproduction and postage costs) to any individual who makes a document request.
- Other obligations can be found at: <http://www.irs.gov/pub/irs-drop/n-07-45.pdf>
 - Link to required public disclosures: <http://www.irs.gov/charities/article/0,,id=135008,00.html>

Substantiation of Gifts

- Upon receipt of any gift with a value of \$250 or more, the nonprofit must provide the donor with a receipt indicating (1) the property received (if not cash), (2) the date it was received, and (3)

whether the donor received any goods or services in return (not including certain *de minimus* gifts—which generally means gifts under \$75).

- For example, if someone donates \$300 and receives a bumper sticker in return, it is not necessary to report the bumper sticker as something they received in return for their donation.
- If a donor makes a gift of more than \$75 and receives goods or services in return, the nonprofit must prepare a receipt indicating the property donated and the fair market value (not cost) of the goods or services received.
- In addition, due to more stringent documentation requirements recently imposed on charitable tax deduction claims, some donors may ask for statements to substantiate smaller donations. Many nonprofits prepare statements for **all** donors regardless of the value of the item or amount donated to assist their donors in claiming a charitable income tax deduction. This, of course, can be quite time consuming.
- See IRS Publication 1771 for more information: <http://www.irs.gov/pub/irs-pdf/p1771.pdf>

Other Ongoing Requirements

- If the nonprofit has employees it must: (1) file employment tax returns, (2) withhold taxes, (3) pay FICA tax, (4) pay state and federal unemployment taxes, and (5) obtain worker's compensation insurance.
- If the nonprofit sells taxable items, it may need to obtain a Wisconsin seller's permit and collect sales tax. The nonprofit must file sales tax returns if sales tax is due. Occasional exemptions apply.
 - Application for WI seller's permit: <http://www.dor.state.wi.us/forms/sales/btr-101.pdf>
 - More information: <http://www.dor.state.wi.us/faqs/pcs/seller.html#s2>

**This is not intended to be an exhaustive listing of entity formation steps and/or ongoing requirements for organizations meeting with the Marquette Legal Initiative for Nonprofit Corporations. This document does not constitute legal advice and organizations seeking legal advice on the information contained herein should contact M-LINC (www.marquettelegalclinic.org/m-linc).*