

# Starting a 501(c)(3) Nonprofit:

## *Benefits, Limitations & Legal Requirements*

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# D.C. Bar Pro Bono Center – About Us

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- We are a legal services organization based in Washington D.C.
- Nonprofit Legal Assistance Program: We match DC-based nonprofit organizations with pro bono legal counsel; host free in-person legal clinics to assist with common issues; and provide free education/training on real-world legal topics facing nonprofits
- We maintain a nonprofit legal library with webinars and print resources: [www.probono.center/nonprofits](http://www.probono.center/nonprofits)

# Background: Nonprofits and the Nonprofit Sector

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- There are over 1.5 million registered nonprofits in the U.S.; the focus of today's webinar will be on 501(c)(3) public charities
  - Public charities account for approximately 2/3 of all registered nonprofits, and represent the quintessential nonprofit organization – operated exclusively for charitable/educational purposes
    - There are over 30 other types of tax-exempt nonprofit organizations (including private foundations, chambers of commerce, fraternal organizations, and civic leagues) - special rules apply, and are not the focus of today's session
  - 501(c)(3)s are afforded unique benefits and advantages, but they also come with significant operational demands & restrictions

# Benefits and Advantages of Operating a 501(c)(3) Nonprofit

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1. **Mission First**: 501(c)(3)s are legally required to pursue their tax-exempt mission – no legal imperative to generate revenue or satisfy shareholders; staff & board members are generally passionate, driven, and mission-aligned
2. **Tax Exempt**: 501(c)(3)s are generally exempt from paying income, sales, use, franchise, property, and other state, federal, and local taxes
3. **Donations Deductible**: Donations to 501(c)(3) orgs are also tax deductible for donors, creating a unique financial incentive to donate; this is a unique feature of (c)(3) organizations

# Benefits and Advantages of Operating a 501(c)(3) Nonprofit (cont.)

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4. **Dedicated Funding Sources**: In addition to tax-deductible donations from individuals, 501(c)(3)s are exclusively eligible for certain government grants, government contracts, grants from private foundations, grants from other public charities, and corporate sponsorships, co-ventures, and partnerships
5. **The 501(c)(3) Brand**: Donors, and the public at large, recognize and trust the 501(c)(3) brand; they expect transparency and accountability from 501(c)(3) entities because of state, federal, and private party oversight

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# Before You Start – Six Key Considerations for Nonprofit Founders

# 1. Avoiding Duplication: Needs Assessment & Environmental Scan

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- Nonprofits compete for funding, personnel, resources, board members, and clients/constituents – duplication is bad for your startup, and for the sector as a whole
  - Consider working within an existing nonprofit organization instead
- Perform a needs assessment – research, identify and describe the community you plan on serving & the specific needs or issues you plan on addressing
- Perform an environmental scan to understand the existing nonprofit landscape
  - Tools: candid.org (formerly Guidestar) – Catalog of Philanthropy – Google searches – issue area-specific resources/directories – talk to existing/allied organization
  - “Completing vs. competing” – if similar organizations exist, can you distinguish yourself/serve an underserved niche?

## 2. Business Planning

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- Nonprofits are businesses – start-ups should create a detailed business plan to attract funders, partners, board members, and to help with their 501(c)(3) application
- A business plan will require you to articulate a financially sustainable model for your organization and to identify initial/prospective sources of funding; even all-volunteer organizations will have expenses and financial needs
- Components of a nonprofit business plan often include:
  1. Mission statement
  2. Description of specific programs
  3. Survey of existing nonprofit landscape/market research
  4. Leadership/personnel needs & assets
  5. Financial model, projections, & potential sources of funding
  6. Short and long-term growth plan
- NORD has many business planning resources (sample bylaws, sample conflict of interest policies, how to build a mission statement primer, etc.) under its RareLaunch program
  - Email [rarelaunch@rarediseases.org](mailto:rarelaunch@rarediseases.org) to obtain copies of templates and resources



## 2. Business Planning (cont.)

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- Business planning resources:
  - [SCORE](#)
  - [US SBA Business Plan Tool](#)
  - [DCRA Small Business Resource Center](#) (DC)
  - [Washington DC Small Business Center](#) (DC)
  - [Anacostia Economic Development Center](#) (DC)
  - Sample/template nonprofit business plans (available online)
  
- Note – these Resources will generally focus on for-profit entities; nonprofit-specific business planning resources are not as readily available, but can be adapted from for-profit models

# 3. Board Oversight/Shared Control

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- The Board of Directors collectively determines the priorities and strategic direction of the organization, and is ultimately responsible for fiscal oversight – not the founder or the ED/CEO
- Board recruitment, retention, and management is an art – possibility of conflicts, factions, and dysfunction
  - On the other hand, good directors can perform vital functions and bring in critical expertise (e.g. financial, legal, programmatic, fundraising) and resources
- Founder(s) often choose the initial board members and can exercise a significant amount of control – founder may also serve as initial staff (e.g. first Executive Director) and make key management decisions
  - Nevertheless, founders do not have 100% control and can be outvoted or removed, especially as the board/organization grows
- Only start a nonprofit if you are comfortable with the concept of shared control & the demands of board management
- If you don't have board experience, recruit initial board members who do; avail yourself of educational resources: <https://www.lawhelp.org/dc/resource/serving-on-the-board-of-directors>

## 4. Limits on Political Activity

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- 501(c)(3)s are subject to limits/restrictions on their political activities: they can engage in an *unlimited amount* of issue advocacy, but only a *limited amount* of lobbying and *absolutely no* political intervention
  - Advocacy = speaking up on public policy issues and/or on behalf of constituents; raising awareness and/or educating the public and policymakers on topics of concern; calling for changes at the administrative (e.g. FDA) level
  - Lobbying = supporting or opposing specific legislation (e.g. in Congress; state/local bills), either directly or by creating grassroots campaigns targeting the legislation
  - Political intervention = intervening in, or participating in, any political campaign on behalf of or in opposition to any candidate for public office
- If you would like to engage in political intervention or a substantial amount of lobbying, 501(c)(3) is not the best entity choice for you
  - 501(c)(4)s, 501(c)(6)s, and PACs are alternative options

# 5. Initial Start-up Requirements and Costs

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Incorporating and registering a 501(c)(3) is a multi-step process that requires a significant investment in time and money. Steps include:

- A. Recruiting incorporators and initial board members – should have at least 3
- B. Create a state-level nonprofit corporation by filing Articles of Incorporation with a state corporate registration agency
  - Agency may be the Secretary of State or other regulatory agency; see SBA website for information: <https://www.sba.gov/business-guide/launch-your-business/register-your-business>
  - Articles must contain IRS-required language in order to register the corporation as a 501(c)(3) – refer to template articles/“Starting a Nonprofit” guide for more information
  - Decide whether you will be a formal membership organization or a non-membership organization; non-membership organizations are more common and are easier to operate – they can still have “members”, but don’t play a formal governance role

# 5. Initial Start-up Requirements and Costs

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- C. Draft bylaws – bylaws spell out the internal operating rules of the organization
  - Should address: election and tenure of directors; rules regarding board meetings (e.g. notice requirements, quorum, voting thresholds); appointment of officers (e.g. CEO, treasurer, etc.); creation of board committees; etc.
  - NORD's RareLaunch program has templates
- D. Draft a Conflicts of Interest policy and other governance policies (e.g. whistleblower; record retention)
  - A COI policy is an instruction manual for how your organization navigates potential conflicts involving organizational decisions which impact the organization's directors, officers, and key employees in their individual capacities
  - NORD's RareLaunch program has templates
- E. Hold an inaugural board meeting to confirm directors, adopt the Bylaws and governance policies, elect officers, and conduct other start-up formalities

# 5. Initial Start-up Requirements and Costs

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- F. Federal recognition – file IRS Form 1023 to “upgrade” organization from state-registered nonprofit to federally-registered 501(c)(3). 2 filing options:
- Form 1023-EZ: File if your organization’s projected annual gross receipts will not exceed \$50,000 in any of the next three years, and if its assets do not exceed \$250,000
    - Three-page form that asks for basic information on your organization and activities - filing fee is \$275
  - Form 1023: For organizations who do not qualify for 1023-EZ
    - 26-page, multi-part form that asks for detailed information on your organization and activities; requires detailed financial history information and/or financial projections for the next 3 years - filing fee is \$600
  - On both forms, filer must affirmatively opt into being classified as a “public charity” – default assumption is that 501(c)(3) organizations are “private foundations”, which enjoy less favorable tax status and have more financial restrictions
  - Processing time for 1023 applications vary significantly – between 4 weeks to 6 months

# 5. Initial Start-up Requirements and Costs

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- G. Apply for state tax exemptions and charity licenses
  - Requirements vary by state, but new 501(c)(3)s will generally have to apply for a number of licenses and exemption certificates from their state of incorporation
  - For example, DC nonprofits with over \$50,000 in gross receipts need to obtain a Basic Business License (filing fee: \$412.50) and apply for state tax exemptions from the Office of Tax and Revenue

## 6. Ongoing Governance & Administrative Requirements

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- After incorporation and 501(c)(3) registration, nonprofits are subject to ongoing filing & administrative requirements imposed by both the IRS and state agencies
- Nonprofit founders should be prepared to take on these administrative requirements, or to recruit additional personnel who can manage these aspects of the organization, especially as the org grows and matures
- Major requirements include:
  - IRS and state-level filing requirements: Form 990 reports; corporate registration maintenance; charitable solicitation registration
  - Ongoing board engagement & oversight: The Board of Directors should be engaged, meet regularly, and exercise its legally-mandated oversight functions
  - Fundraising & financial compliance: Acknowledging charitable donations; avoiding conflicts of interest; keeping and auditing financial records
  - Day-to-day business operations: Employment law compliance; risk management & insurance; etc.



# Questions?

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Nonprofit Resources: [www.lawhelp.org/dc/ced](http://www.lawhelp.org/dc/ced)

“Starting a Nonprofit” resource collection:  
<https://www.lawhelp.org/dc/resource/starting-a-nonprofit>

“Starting a Nonprofit in D.C.” guide (with links to template documents):  
<http://www.lawhelp.org/dc/resource/starting-a-nonprofit-booklet/download/36E476B0-6336-45CE-8D9E-6F0B5E8CA905.pdf>