“Now That You’re Incorporated”
Observance of Corporate Formalities and Other Post-Incorporation Matters

About This Form: Public Counsel’s Community Development Project has designed the attached form memorandum to serve as a sample of follow-up advice that a pro bono attorney may give to a nonprofit client after its incorporation.

The information contained in this form is provided as of October 2012 and is subject to change. Any volunteer attorney using this form should verify the accuracy of the information before providing it to a client. Nonprofit organizations using this form should understand that it is the obligation of the nonprofit corporation’s board to stay informed of any changes. Public Counsel will update this form periodically for changes in law and recommended practices. For the latest version, see www.publiccounsel.org/tools/assets/files/npincorp_memo.pdf.

Important Notes: This form is provided for information only and does not take into account particular facts and circumstances relevant to any specific nonprofit corporation. Depending on such factors as what legal steps and filings have already been completed by the nonprofit corporation, the specific provisions of the nonprofit corporation’s governing documents, and other facts relevant to the specific corporation, some language in this form may not apply to such corporation. In some cases, bracketed alternative language is provided. This form should not be used “as is” but should be modified after careful consideration of the corporation’s particular circumstances.

This form should not be construed as legal advice. Nonprofits reading this form should contact an attorney for legal advice about how the information in this form may apply to the corporation’s specific situation. Some corporations may need additional information not discussed in this form.

Public Counsel’s Community Development Project provides free legal assistance (including nonprofit incorporation) to qualifying nonprofit organizations that share our mission of serving low-income communities and addressing issues of poverty within Los Angeles County. If your organization needs legal assistance, or to provide comments on this form, visit www.publiccounsel.org/practice_areas/community_development or call (213) 385-2977, x. 200.
Re: Observance of Corporate Formalities and Other Post Incorporation Matters

Dear [Client Representative]:

Enclosed, please find the minute book of [Client Name] (the "Corporation"), which contains a certified copy of the articles of incorporation, the original bylaws, and [other incorporation documents, e.g., incorporator's action, initial meeting of directors]. I am also enclosing [copies of the exemption applications, the Corporation’s first statement by domestic nonprofit corporation and any documents not included in minute book]. The corporate secretary should retain all of these items in a safe place.

We appreciate the opportunity to have assisted you and the Corporation in its incorporation and application for recognition of exemption from federal income tax. We understand that our representation is now concluded. [OPTIONAL: except for the purpose of completing the California tax exemption process.]

Now that the Corporation has been formed, it will be faced with numerous legal requirements in order to maintain its corporate and tax-exempt status. The requirements outlined in this memorandum derive from the California Corporations Code, which imposes various rules for a nonprofit public benefit corporation under California corporate law, and the Internal Revenue Code and California Revenue and Taxation Code, which impose certain requirements in order to maintain tax-exempt status for both federal and state tax purposes.

If you have any questions, please feel free to contact me.

Sincerely,

[Attorney Name]

Enclosure
MEMORANDUM

TO: Directors and Officers of [Client Name]

FROM: [Attorney Name]

RE: Nonprofit Corporate Requirements

This memorandum outlines the most frequently encountered legal requirements facing nonprofit California corporations. The topics addressed are:

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The discussion of each topic is summary in nature and not exhaustive. Sections D.5, E.1 and E.2 of this memorandum include important information about filing requirements for all nonprofits. Failure to complete these filings on time may result in the revocation of the corporation’s tax exemption or its corporate status in California. It is very important that someone involved in the corporation’s management read this information and calendar important dates. I encourage you to contact counsel for further clarification or advice.
A. Observance of Corporate Formalities and Meetings of Directors

Incorporating as a nonprofit corporation provides the Corporation with certain advantages, such as certain protections from liability, a perpetual business existence, and eligibility for special treatment under the tax codes. However, the Corporation can only enjoy these advantages if it maintains what are called “corporate formalities.” Corporate formalities are the basic rules and procedures for governing and operating a corporation (the Corporation’s bylaws describe many of these formalities). To keep its corporate status, the Corporation will want to follow and, most importantly, keep records of all of these formal corporate activities.

Directors' meetings are perhaps one of the most important corporate formalities. Although there is no statutory requirement with respect to how frequently the board of directors should act, we suggest that the board of directors meet on a regular basis to deal with significant matters that have arisen during the quarter. [This section should be revised to reflect the Corporation’s bylaws]. In any case, your organization’s bylaws [mandate _______ meeting(s) of the board per year]. Generally, board action may be taken by a majority of the directors present at the meetings, provided that the meeting contains a quorum (fill in the definition of quorum from the Corporation’s bylaws here). Alternatively, board action may be taken by the unanimous written consent of the directors without a meeting.

Generally, matters appropriate for board action include the following:

1. Election of officers, which must include a chairperson or president (the Corporation may elect to have both), a secretary, a CFO or treasurer (or both), and other officers as stated in bylaws or determined by the board (multiple offices may be held by the same person, except that neither the secretary nor CFO or treasurer may serve concurrently as president or chairperson);

2. Review of financial arrangements, including review of investments, opening and closing of corporate accounts, designation and change of corporate officers authorized as signatories, review of cash flow needs and review of financial statements;

3. Approval of material contracts and leases;

4. Policy decisions with respect to the expenditures of funds and the making of grants and ratification of those grants made;

5. Amendment of the articles of incorporation;

6. Amendment, repeal or adoption of bylaws;

7. Electing directors, filling vacancies on the board, and removing directors in some instances;

8. Appointing any board committees;

9. Employing and monitoring activities of the executive director/CEO, if any;
10. Adopting budgets;

11. Appointing auditors;

12. Complying with governmental reporting requirements;

13. Bringing or defending legal actions;

14. Approving indemnification of corporate directors, officers and other agents;

15. Approving corporate borrowing or loans;

16. Approving the mortgage or other hypothecation of corporate property to secure payment or performance of contracts or obligations;

17. Approving the sale, lease, conveyance, exchange, transfer, or other disposition of corporate assets;

18. Approving mergers, reorganizations and dissolutions; and

19. Any other matters not delegated to an officer of the Corporation.

The secretary of the Corporation should prepare minutes or a written consent form evidencing any board actions. [Note that if the Corporation has members, they also have voting rights with respect to some of the above transactions, and this letter should be revised accordingly. See California Corporations Code §§ 5310-5354.]

The Corporation’s board (or a board committee) must also review and approve the compensation (including benefits) of the Chief Executive Officer/President and Chief Financial Officer/Treasurer, to verify that it is just and reasonable. Such review must be performed at the time of hiring, and whenever the compensation is modified or the employment term is extended. See California Government Code § 12586(g).

Also, any nonprofit corporation with annual gross revenues of more than $2 million (not including amounts received from governmental agencies if the government requires the corporation to account for the money received) must have an audit committee of the board of directors, and must obtain an audit of the corporation’s financial statements that is approved by that committee. If the Corporation has $2 million or more of gross revenues in any one year, you should consult an attorney about the audit committee requirements.

B. Directors’ Duty of Care

The board of directors is generally responsible for managing the corporation. Although the board may delegate some of the management functions and corporate powers to others, the acts of such delegates must always be under the board’s ultimate control and direction. Directors must, therefore, use due care in so delegating their authority.
Directors are considered fiduciaries of nonprofit organizations. Therefore, as a general proposition, a director must perform his or her duties in good faith, in a manner he or she believes to be in the best interest of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances. Each director has an obligation to ensure that the Corporation acts in accordance with its corporate purposes (as expressed in the Corporation's articles of incorporation and bylaws) and with all applicable laws.

In performing the duties of a director, the director is entitled to rely on information, opinions, reports or other statements (including financial statements and data) prepared by officers or employees of the corporation, legal counsel, independent accountants, or other persons, so long as the director has a reasonable belief in the presenter's reliability, competence, and/or expertise and acts in good faith. The director may be obligated to conduct a reasonable inquiry into the information to be relied upon when the need for such inquiry is indicated by the circumstances. Of course, a director may not rely on any information received when he or she has knowledge of facts that would cause such reliance to be unwarranted.

Members of the board should also be aware that special duties are required with regard to assets held by the corporation for investment. The board must avoid speculation, consider the probable income of the investment, as well as the probable safety of the corporation's capital, and comply with any agreement pursuant to which assets are contributed to the corporation.

C. Directors’ Duty of Loyalty

Directors are obligated to act in the best interests of the corporation and all of its members, including the members of any minority factions, and to administer their corporate powers for the common benefit. Several issues come up repeatedly in the operation of nonprofit corporations, and should be kept in mind as directors exercise their duties.

1) Interested Directors

No more than 49% of the directors of the Corporation may be “interested persons,” i.e., persons (or their close relatives) currently being compensated for services rendered to the Corporation during the past year, excluding reasonable compensation paid to them for serving as directors. Any compensation, regardless of the amount, will make a director an "interested person" for this purpose. Under the interested person rule, fewer than half the directors can be made up of officers, employees, consultants, or their close relatives, and more than half must be "outside" directors who do not receive any compensation from the Corporation other than for serving as a director.

2) Corporate Opportunity

If a director becomes aware of an opportunity or transaction that would be of interest or benefit to the Corporation, the director generally must disclose such opportunity to the Corporation and permit it to take advantage of the opportunity, if it so desires. If such an opportunity is presented, and the Corporation declines to act, the director may then pursue the transaction for his or her own advantage.

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2 See Cal. Corp. Code § 5240 for requirements relating to assets held for investment.
3) **Self Dealing**

"Self-dealing" transactions are those in which the Corporation is a party and in which one or more of its directors has a "material financial interest." A director with a material financial interest in the transaction is termed an "interested director." Transactions in which a director has a material financial interest are not prohibited completely, but are permitted only if the Corporation is acting in its own interest and for its own benefit, and the transaction is approved by one of the following methods:

1. Approval by the California Attorney General (please note that this is generally the only method by which a loan to or a guarantee of an obligation of a director or officer can be approved), or by a court in an action in which the Attorney General is a party. In most cases, this alternative will not likely be useful.

2. Approval by the board of directors (or, in certain limited circumstances, a committee of the board) of the transaction, which approval must be obtained before any part of the transaction is consummated. In addition, the transaction must be fair and reasonable to the Corporation at the time it is entered into. The board's authorization or approval of the transaction must be in good faith, made by directors with knowledge of the material facts concerning the transaction and the directors' interest in the transaction, and approved by a vote of a majority of the directors then in office without counting the vote of an interested director or directors.

If the transaction is approved by the board of directors without Attorney General approval, then either (i) before approving the transaction, the board must reasonably investigate and consider alternative arrangements and in good faith determine that the corporation could not obtain a more advantageous arrangement with reasonable effort under the circumstances, or (ii) the transaction terms must be such that in fact, the Corporation could not have obtained a more advantageous arrangement with reasonable effort under the circumstances.

D. **Tax Matters**

1) **Employer Identification Number**

The Corporation has applied for and received a federal employer identification number ("EIN") that will be used on its federal tax returns and certain other documents. For your reference, that number is [EIN number].

2) **Maintaining Federal Tax-Exempt Status and Public Charity Status**

   a) **Limit On Activities That Do Not Further Charitable Purpose**

In order to maintain tax-exempt status, an organization must continue to meet each of the requirements that qualified it for federal tax exemption in the first place. In particular, an organization must be operated primarily for the charitable purposes set forth in its organizational documents. Non-charitable activities are permitted only if they are insubstantial (for example, in terms of time and money expended) in relation to charitable activities. In evaluating an organization’s primary purpose, the IRS will consider the particular manner in which activities are conducted, including whether they are conducted in a
commercial manner, their scope, and the amount of profit generated by them. Any change in the
activities or purposes of the Corporation must be monitored to ensure that it continues to comply with the
purposes set forth in the articles of incorporation and bylaws. In addition, any changes to the articles of
incorporation or bylaws must not permit the Corporation to engage in activities that are not in furtherance
of exempt purposes, except as an insubstantial part of the Corporation’s activities.

b) Limit On Private Benefit and Inurement

The net earnings of an exempt organization may not benefit organizational “insiders,” and the
organization’s activities may not confer a direct or indirect benefit on any private persons.

c) Limit On Lobbying and Prohibition On Political Activity

Also, a substantial part of the organization’s activities cannot consist of carrying on propaganda or
attempting to influence legislation. Finally, the organization may not participate or intervene in any
campaign for or against a candidate running for office.

An organization that fails to meet the above requirements on an ongoing basis will lose its exemption
from federal income tax. (Note: to the extent that exemption from other taxes, such as the California
franchise tax (discussed below), depends on meeting the requirements for federal exemption, losing
federal tax-exemption also may cause the loss of such other exemptions.)

d) Public Charity Status

As a reminder, the Corporation has applied for tax exemption as a public charity. Organizations
designated as public charities will usually be described under either Internal Revenue Code
§ 170(b)(1)(A)(vi) or § 509(a)(2).

Alternative 1: [If, upon reviewing the Corporation’s application for tax exemption, the IRS determines
that the Corporation can reasonably be expected to be publicly supported, the IRS will automatically
classify the Corporation as a public charity for its first five years of existence. The IRS determination
letter will indicate whether § 170(b)(1)(A)(vi) or § 509(a)(2) applies to the Corporation.]

Alternative 2: [The IRS has determined that the Corporation can reasonably be expected to be publicly
supported and has automatically classified the Corporation as a public charity under § [fill in section
stated on determination letter: 170(b)(1(A)(vi) or 509(a)(2)] for its first five years.]

Donors will be entitled to rely on the determination letter in making donations to the Corporation unless
the IRS changes the Corporation’s status and publishes a notice of the change. The Corporation must
inform the IRS of any change in its sources of support, purpose, character or method of operation, and
any amendments to its articles of incorporation or bylaws.

e) Public Support Test to Maintain Public Charity Status and Recordkeeping

Beginning with its sixth taxable year, the Corporation must establish that it is a public charity by showing
that it meets the public support test under § 170(b)(1)(A) or § 509(a)(2) on Schedule A to Form 990/990-
EZ.
To qualify as a public charity under § 170(b)(1)(A)(vi), the Corporation must either receive at least 33 1/3% of its support from governmental units or contributions made directly or indirectly by the general public or, in the alternative, it must receive at least 10% of its support from these sources and demonstrate “facts and circumstances” sufficient to support its classification as a publicly supported organization, such as a program geared towards continuous solicitation of funds.

To qualify as a public charity under § 509(a)(2), the Corporation must receive more than 33 1/3% of its support from governmental units or contributions made directly or indirectly by the general public, including gross receipts from exempt purpose activities such as charitable sales of merchandise, and must receive NOT more than 33 1/3% of its support from the sum of its gross investment income and its net (after tax) unrelated business income (see below). The Corporation should consult with an attorney or accountant for more detailed information on these tests.

The Corporation will lose its public charity status if it cannot pass the public support test for two consecutive years. To avoid unexpectedly losing its public charity classification, the Corporation should keep track of its public support information (i.e., records of who donated funds and how much was donated) throughout the year instead of waiting until the end of the tax year when it is preparing Schedule A to Form 990/990-EZ. Also, the Corporation should calculate whether it is meeting the public support test during its first five years of existence to address and correct any public support issues before the sixth year.

f) Consequences of Failure to Maintain Public Charity Status

If the Corporation cannot meet the public support test for two consecutive years, it will be reclassified as a private foundation as of the start of the second consecutive year. Private foundations are also tax-exempt, but are subject to additional rules and excise taxes.

3) Unrelated Business Income Tax

A nonprofit organization otherwise exempt from federal income tax is taxed on net income realized from a regularly conducted trade or business that is unrelated to the organization’s exempt purpose (this is referred to as “unrelated business taxable income,” or “UBTI”). (Note: such a business must be “insubstantial” or the organization will lose tax-exempt status altogether, as described above.) Generally, a trade or business is an activity that involves selling goods or services to produce income. The fact that profits from such activity are essential to the organization’s ability to carry out its exempt purpose does not turn an “unrelated” business into a “related” one. Instead, the business must be connected to the exempt purpose by more than the mere production of funds in order to avoid the tax on net income.

Even if there is an unrelated trade or business, its net income is only taxed if the business is regularly carried on. In determining whether a trade or business is regularly carried on, the frequency and continuity of the business are compared with the frequency and continuity of a similar business conducted by a non-exempt organization. Generally, an activity is not regular if it is carried on only one or two weeks per year. Infrequent conduct such as an annual fundraising event is not regular. Because the determination of whether a trade or business is unrelated or regularly carried on depends on the particular facts of each situation, I encourage you to consult counsel for further advice on the specific activities of the Corporation.
Dividends, interest, annuities, royalties, and capital gains are excluded from UBTI in most circumstances because they are not generated from a trade or business. Because of these exclusions, consideration should be given to structuring transactions to produce one of these types of income where feasible. For example, publication and sale of a book by an exempt organization may result in income taxed as UBTI, but a royalty received as a result of a transfer of publication rights to a commercial publisher may not.

4) **Other Taxes**

   a) **Federal Private Foundation Excise Tax**

As discussed in Section D.2(d) above, the Corporation has applied for tax exemption as a publicly supported charity. If the Corporation does not receive a determination letter from the IRS stating that it is not a private foundation, or if it is classified as a publicly supported charity and fails the public support test for two consecutive years, then the Corporation will be treated as a private foundation. Private foundations are required to pay federal excise tax in estimated quarterly installments, and are subject to other taxes and restrictions that are beyond the scope of this memorandum. If the organization is a private foundation, you should consult your accountant in the near future regarding applicable excise taxes.

   b) **California Franchise Tax**

The California franchise tax is the equivalent of an income tax assessed on the net income of corporations doing business in California. Certain nonprofit organizations are exempt from the California franchise tax.

**Alternative 1:** [However, such exemption is not automatic. In order to qualify, the Corporation must file form FTB 3500 and receive a “determination letter” from the California Franchise Tax Board. Form FTB 3500, is available at www.ftb.ca.gov/forms/misc/3500.pdf. The instructions can be found at www.ftb.ca.gov/forms/misc/3500bk.pdf.]

**Alternative 1A:** [However, such exemption is not automatic. In order to qualify, the Corporation must file form FTB 3500A with a copy of its federal determination letter and receive a letter acknowledging receipt and specifying the effective date of its exemption under California law. Form FTB 3500A, along with instructions, is available at www.ftb.ca.gov/forms/misc/3500a.pdf.]

**Alternative 2:** [The Corporation has applied for tax exempt status from the California Franchise Tax Board by filing form FTB 3500, and if the exemption is granted, the Corporation will receive a “determination letter” from the Franchise Tax Board.]

**Alternative 2A:** [The Corporation has applied for tax exempt status from the California Franchise Tax Board by filing form FTB 3500A with a copy of its federal determination letter. The Corporation will receive a letter acknowledging receipt and specifying the effective date of its exemption under California law from the Franchise Tax Board.]
If the Corporation conducts activities outside of California, it should consult an attorney to determine whether it needs to apply for tax exempt status in those other jurisdictions.

c) **Sales and Use Taxes**

Even though the Corporation is tax-exempt, it is still generally subject to state and local sales and use taxes if it engages in the sale of tangible personal property. Refer to the California State Board of Equalization website (www.boe.ca.gov/sutax/sutprograms.htm) for more information about whether your organization’s activities might subject it to such tax, or whether the activities may be exempted.

d) **Local Business License Taxes**

Some cities, including Los Angeles, impose business license taxes on all businesses conducted within the city. Tax-exempt organizations generally are exempt from such taxes, but certain actions may be required in order to qualify for exemption. For example, in the City of Los Angeles, the organization must file a business license tax exemption application documenting that it is tax-exempt. For more information about the City of Los Angeles business tax exemption, visit the City of Los Angeles Office of Finance website http://finance.lacity.org/content/NonProfitCharitableOrganizationExemptions.htm.

e) **Property Tax**

If the Corporation owns property in California, it is not automatically exempted from paying property taxes by virtue of its federal or state tax-exempt status. All property in California is taxable unless exempt under the laws of the United States or the California Constitution. Under California law, the Legislature may exempt property from taxation if the property is used exclusively for religious, hospital, scientific, or charitable purposes and is owned or held in trust by corporations or other entities (1) that are organized and operating for those purposes, (2) that are nonprofit, and (3) whose net earnings do not inure to the benefit of any private shareholder or individual.

If you believe the Corporation qualifies for the so-called “welfare” exemption described above, you must obtain an Organizational Clearance Certificate for the Corporation from the California State Board of Equalization by filing Form BOE-277 (www.boe.ca.gov/proptaxes/pdf/boe277.pdf) with the Assessment Policy Standards Division of the State Board of Equalization. After the Corporation obtains this certificate, the Corporation must apply every year for an exemption from payment of property tax for a particular parcel of property. The claim for exemption should be filed each year on or before February 15 with the county assessor in the county in which the property is located. Form BOE-267 is the relevant form and should be available on the county assessor’s website (for Los Angeles County, that website address is: http://assessor.lacounty.gov/extranet/list/forms.aspx.)

f) **Employment Taxes**

Most nonprofit tax-exempt 501(c)(3) corporations with employees must generally withhold federal income taxes and social security (FICA) taxes from wages paid to employees. For more information, the Corporation should refer to IRS Circular E (Publication 15) Employer’s Tax Guide (www.irs.gov/pub/irs-
Because of the extensive record-keeping and reporting requirements involved, we urge you to discuss these requirements with your financial advisor or accountant.

Additionally, refer to Publication DE 44 (www.edd.ca.gov/pdf_pubCtr/de44.pdf), California Employer’s Guide, which addresses the various California employer withholding and taxpaying obligations.

5) **Tax Returns**

Both federal and California tax returns must be filed each year, generally on or before the fifteenth day of the fifth month following the close of the Corporation’s taxable year.

The following descriptions are intended to provide general information only; it is important that you consult your accountant regarding additional requirements that may be applicable to your particular organization, including, if applicable, special requirements for private foundations.

a) **Federal**

The basic annual return form is IRS Form 990/990-EZ, “Return of Organization Exempt from Income Tax.” Certain organizations are exempt from this filing requirement, including churches and, for tax year 2012, organizations (other than private foundations) with annual gross receipts that are normally $50,000 or less. However, organizations that are exempted under this threshold – annual gross receipts of $50,000 or less – must file IRS Form 990-N, an annual electronic notice form known as the “e-Postcard.”³ This form can be filed at [http://epostcard.form990.org](http://epostcard.form990.org).

Additionally, IRS Form 990-T, “Exempt Organization Business Income Tax Return,” must be filed by an organization that earns more than $1,000 in gross income deriving from an unrelated trade or business for the taxable year. Federal forms are available at [www.irs.gov/formspubs/index.html](http://www.irs.gov/formspubs/index.html). Failure to file a return or an e-Postcard, as required, with the IRS for three consecutive years will lead to automatic revocation of federal (and likely state) tax exempt status.

b) **California State**

California’s basic annual return form is FTB Form 199, “Exempt Organization Annual Information Return.” Note that churches and religious orders are not required to file Form 199. Beginning with the 2012 tax year, organizations with annual gross receipts that are normally $50,000 or less must file FTB Form 199-N (the “California e-Postcard”), which is an electronic notice similar to IRS Form 990-N.⁴ This form can be filed at [www.ftb.ca.gov/online/199N_epostcard](http://www.ftb.ca.gov/online/199N_epostcard).

In addition, if the Corporation has gross taxable income derived from an unrelated trade or business in excess of $1,000 for the taxable year, it must file FTB Form 109, “Exempt Organization Business Income

³ For more information on Form 990-N, please see [www.irs.gov/charities/article/0,,id=169250,00.html](http://www.irs.gov/charities/article/0,,id=169250,00.html).

⁴ For more information on Form 199-N, please see [www.ftb.ca.gov/businesses/Exempt_organizations/Filing_Requirements_Form_199N.shtml](http://www.ftb.ca.gov/businesses/Exempt_organizations/Filing_Requirements_Form_199N.shtml).
Tax Return.” California state forms may be obtained from www.ftb.ca.gov/forms/search/index.aspx. Failure to file a return or a California e-Postcard, as required, with the FTB for three consecutive years will lead to automatic revocation of state tax exempt status.

E. Other Post-Incorporation Matters and Filing Requirements

In addition to observing the requisite corporate formalities, the Corporation is subject to numerous other legal requirements. Although it is not intended to be exhaustive, the following list summarizes legal requirements that a new California nonprofit corporation should be aware of. Certain requirements are highly formal and technical, and many must be satisfied within a specified time period. Failure to comply with these legal requirements may subject the Corporation to fines or other penalties.

1) Statement of Domestic Nonprofit Corporation – Biennial Filing Required

The Corporation must, within 90 days after the filing of the original articles of incorporation and biennially thereafter in the month of the anniversary of the incorporation date, file a Statement of Information (Form SI-100) with the Secretary of State, providing: (1) the names and complete business or residence address of its CEO, secretary and CFO, and (2) the street address of its principal office. The statement also must designate a natural person or corporation as agent for the service of process. Whenever any of the information changes, the Corporation must file a current statement with the Secretary of State. This form is available at www.sos.ca.gov/business/corp/pdf/so/corp_so100.pdf. Alternatively, the Corporation may file the form online at https://businessfilings.sos.ca.gov.

2) Filing With the Registry of Charitable Trusts – Registration and Annual Filing Required

The Corporation must register with the Registry of Charitable Trusts of the California Attorney General’s office within 30 days of the organization’s initial receipt of assets. The Corporation should register before engaging in charitable solicitations in California. The registration form (Form CT-1) is available on the Attorney General’s website at http://ag.ca.gov/charities/forms/charitable/ct1-form.pdf. The Corporation also must file annually Form RRF-1, a disclosure reporting form available on the Attorney General’s website, with the Registry of Charitable Trusts. This report must be filed within four months and fifteen days after the end of the Corporation’s fiscal year unless the Corporation has received an extension of time to file its federal income tax return, in which case the Form RRF-1 (together with copies of any extension from the IRS) should be filed at the same time as the federal tax return. The report provides accountability to the public and to the Attorney General in its role as legal representative of the public interest. Form RRF-1 and instructions can be found on the Attorney General’s website at http://oag.ca.gov/charities/forms. Failure to file in a timely fashion could result in revocation of the Corporation’s state tax exemption for the year in question and substantial penalties.

In addition to registering and filing Form RRF-1, the Corporation may be required to file an Annual Financial Solicitation Report (Form CT-694) if all three of the following provisions apply: (1) the Corporation collected more than $1,000,000 in charitable contributions from donors in California in the
previous year, (2) such contributions represented more than 50% of the Corporation’s annual income in the same year, and (3) the Corporation’s non-program expenses (including salaries, overhead, fundraising expenses and travel expenses) exceeded 25% of the Corporation’s gross revenue for that year. Form CT-694 is available at http://ag.ca.gov/charities/forms/charitable/ct694.pdf.

3) Business Licenses

The Corporation may be required to obtain a business license or an exemption from the license requirement from the city in which it intends to operate. In the City of Los Angeles, tax-exempt organizations must obtain a business license (called a “Tax Registration Certificate”) from the Office of Finance (http://finance.lacity.org/index.htm). Please see Section D.4(d) for information about applying for the Los Angeles business tax exemption. Information about business license and other permit requirements in California can be found at www.calgold.ca.gov.

4) Local Solicitation Ordinances – Filing Required Before Fundraising Campaign or Event

In connection with fundraising activities, the Corporation may also be required to register with various counties, cities and states around the country under those jurisdictions’ statutes and ordinances regulating solicitation. For instance, solicitation registration is required by the City of Los Angeles. At least 15 business days before the start of any fundraising campaign or special event in Los Angeles, the Corporation must complete and file a “Notice of Intention” (www.lapdonline.org/police_commission/pdf_view/6195) with the Los Angeles Police Commission’s Charitable Services Section. After investigation, the Corporation will be issued an Information Card containing important facts to be considered by a prospective donor. The Corporation should not begin soliciting contributions until it has been issued an Information Card, and must give or display a copy of the Card to all persons solicited by the Corporation, including recipients of fundraising mailing appeals. The original Card must also be exhibited conspicuously at the site of special events. Finally, a report showing receipts, expenditures, and distributions of net proceeds of any fundraising campaign or special event must be signed by two officers of the Corporation and filed within 30 days of the termination of the campaign or special event (www.lapdonline.org/home/pdf_view/6196).

In addition to the above reporting requirements, the Corporation must maintain an accounting system in accordance with established accounting principles, and be prepared to give each donor a signed receipt for contributions. For a full listing of charitable solicitation guidelines in the City of Los Angeles, contact the Police Commission’s Charitable Services Section at (213) 996-1260 or visit www.lapdonline.org/police_commission/content_basic_view/9147. A partial list of city and county offices with information on local solicitation ordinances can be found at www.ceb.com/info/NonprofitsAppendixC.asp.
5) Other Fundraising Laws

a) The Nonprofit Integrity Act of 2004

Pursuant to the Nonprofit Integrity Act, the Corporation must conduct all fundraising activities without coercion and must not engage in any misrepresentation regarding the purpose or beneficiary of any fundraising solicitation. The Corporation must also approve every written contract entered into in connection with a fundraising activity conducted on its behalf. The act also governs contracts between charities and commercial fundraisers. If the Corporation intends to hire a commercial fundraiser to conduct a fundraising event or solicitation, you should review the provisions of California Government Code §§ 12599 et seq. (http://oag.ca.gov/sites/all/files/pdfs/charities/publications/nonprofit_integrity_act_nov04.pdf) and consult an attorney with any questions. You can find a detailed summary and frequently asked questions about these laws, including a list of specific actions that are prohibited in connection with fundraising, on the Attorney General’s website at http://oag.ca.gov/charities.

b) Federal Substantiation Requirements for Charitable Contributions

If the Corporation expects to receive charitable contributions, federal substantiation requirements must be met. Charitable organizations are required to provide a “written disclosure” or receipt to any donor who contributes $75 or more in cash and receives goods or services in exchange. However, in order to properly claim a deduction for a cash contribution of any amount, a donor is required to have a bank record (including a cancelled check or a bank or credit card statement) or obtain a receipt (called a “contemporaneous written acknowledgement”) from the charitable organization. Also, for a single cash contribution of $250 or more and for any contribution of property, the donor is required to obtain an acknowledgement from the charitable organization. Thus, it is best practice to provide a receipt for all contributions and to keep accurate records of all donations. IRS Publication 1771 (www.irs.gov/pub/irs-pdf/p1771.pdf) and IRS Publication 526 (www.irs.gov/pub/irs-pdf/p526.pdf) set forth the specific details with respect to substantiation of deductible contributions, including the type of information that should and should not be included in these receipts.

c) Raffles and Bingo

California law permits a charity that has been tax-exempt in California for at least one year to hold raffles if at least 90% of the gross receipts of the raffles are used for beneficial or charitable purposes. Note that separate registration and reporting with the Attorney General’s office is required on Forms CT-NRP-1 and CT-NRP-2, respectively. For additional information and the required forms, see http://oag.ca.gov/charities/raffles.

Bingo is generally permitted in California so long as the proceeds thereof are used only for charitable purposes and no profits, wages or salaries are paid from any bingo game. However, the Corporation may be required to register with various counties and cities under those jurisdictions’ statutes and ordinances regulating bingo. For instance, a bingo license is required by the City of Los Angeles. At least 60 days before conducting a game of bingo in Los Angeles, the Corporation must complete and file an “Application for Bingo License” (www.lapdonline.org/police_commission/pdf_view/6198) with the Los Angeles Police Commission.
Angeles Police Commission’s Charitable Services Section, Bingo Gaming Enforcement Unit. After investigation, the Corporation will be issued a license valid for one year.

For a full listing of City of Los Angeles bingo rules and regulations, including fees, visit www.lapdonline.org/police_commission/content_basic_view/9147. Refer to California Penal Code § 326.5 for more information on bingo, and § 320.5 for more information about raffles.

d) Other States

Each state has its own rules and regulations regarding charitable registration. Before conducting any fundraising activities in other states or online, the Corporation should consult with an attorney to determine whether it needs to register in another jurisdiction. For information about the Unified Registration Statement, a charitable registration statement accepted by most states, visit www.multistatefiling.org/index.html.

6) Insurance

Nonprofit organizations require at least a minimal level of insurance to protect against business risks to which all organizations are, to some extent, vulnerable. You should take the time to assess whether your organization may have exposure in any one of seven broad areas: property, directors and officers, crime, automobile, liability, employment practices or workers compensation. Almost all organizations will require commercial general liability insurance, which covers negligent acts performed by the organization or its employees. Directors and officers insurance may also be important if the organization wishes to attract qualified volunteer board members. While California law protects volunteer directors and officers of certain types of nonprofit corporations from liability for actions within the scope of their duties that are taken in good faith in a manner believed to be in the best interest of the corporation, some of these protections are only available to organizations that have purchased a specified amount of liability insurance. California nonprofit organizations may acquire insurance through the Nonprofits’ Insurance Alliance of California (www.niac.org), a nonprofit liability insurance pool established exclusively for nonprofit organizations in California. For a more detailed guide to insurance issues, see the manual entitled “Legal Issues for Small Businesses and Nonprofit Agencies” published jointly by Southern California Edison and Public Counsel (www.publiccounsel.org/tools/publications/files/edison.pdf).

7) Recordkeeping and Reports

a) Recordkeeping

The Corporation is required by law to keep up-to-date originals or copies of (1) books and records of account; (2) minutes of the meetings of its members (if any), board and committees of the board; (3) a record of its members (if any) giving their names and addresses and the class of membership held by each; and (4) business records relating to the amount, cost, and value of all property that the Corporation owns, claims, possesses and/or controls. In addition, the Corporation must keep the following documents at its principal office and available for inspection:

1. Articles of Incorporation and all amendments thereto.
2. Corporate bylaws and all amendments thereto.

3. Copies of the Corporation’s tax exemption applications (any state forms including California form FTB 3500/3500A and federal Form 1023) and determination letters.

4. Information returns on Form 990 filed with the IRS (three most recent years only).

As described above, the Corporation should keep records of all of its revenues and expenses for tax reporting purposes, and to prove its public charity status to the IRS.

b) Annual Report

A California nonprofit public benefit corporation that receives at least $25,000 or more in gross revenues in any fiscal year must send an annual report to each director and member (if any) within 120 days after the close of the Corporation’s fiscal year. In addition to information regarding loans, indemnifications and self-dealing transactions referenced in the next paragraph, the annual report should contain a statement of assets and liabilities and revenues and expenses in appropriate detail.5

If the Corporation does not produce the annual report, it must still furnish to the board and members (if any) a statement on the following types of loans, indemnifications and self-dealing transactions:

1. A brief description of the amount and circumstances of any loans, financial guarantees, advances, or indemnifications totaling more than $10,000 made the previous year to any officer or director of the Corporation (Cal. Corp. Code § 6322).6

2. A brief description of the amount and circumstances of any transaction in which the Corporation was a party and a member of the board or an officer of the Corporation had a direct or indirect financial interest, involving more than $50,000. (Cal. Corp. Code § 6322)

c) Required Federal and State Filings on Amendment of Articles or Bylaws

To amend the articles of incorporation, a certificate of amendment must be filed with the Secretary of State. Generally, the Corporation sends three copies of the certificate to the Secretary of State. Once accepted, the Secretary of State forwards one copy to the Attorney General and notifies the Franchise Tax Board of the amendment. The Corporation must then submit a copy of the amended articles with its California information return (Form 199) for the year in which the amendment became effective. Similarly, if the Corporation’s bylaws are amended, the Corporation must report the amendment to the

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5 Refer to Cal. Corp. Code § 6321 for specifics. The annual report may be sent less often than annually if member meetings are held less often than annually – the annual report need be made only with the frequency with which regular membership meetings are required, unless otherwise stated in the articles or bylaws.

6 Note that, as a general rule, California nonprofit public benefit corporations may not lend money or property to, or guarantee the obligations of, their directors or officers, unless an exception applies or Attorney General approval is obtained. (Cal. Corp. Code § 5236).
Franchise Tax Board by filing the amendment with the applicable tax returns for the year in which the amendment became effective.

The Corporation must also notify the IRS of an amendment to its articles of incorporation or bylaws for the year in which the amendment became effective. If the Corporation files a Form 990 or 990-EZ, the amendment must be described on Schedule O. If the Corporation is not required to file annual returns, it must report the amendment to the IRS Exempt Organizations Determinations Office. For more information about reporting changes to the articles and bylaws to the IRS, please refer to the instructions to the Form 990 or 990-EZ.

In addition, the Corporation must report new, significant program services or significant changes in how it conducts program services on its annual state and federal returns.

8) Health and Safety Hazardous Materials Fee

Health and Safety Code § 25205.6 imposes a fee on corporations operating in California relating to hazardous materials. There is no general exception for nonprofit corporations. If the Corporation has 50 or more employees, this fee likely applies. The fee must be paid by the last day of February and late payments are subject to a penalty of 10% plus interest. More information is available on the State Board of Equalization website at www.boe.ca.gov and on BOE Publication 90 (www.boe.ca.gov/pdf/pub90.pdf).

9) Accounting and Financial Information

As may be evident from the information described above, nonprofit organizations are subject to various tax, accounting and financial reporting requirements. We suggest that you consult with an accountant knowledgeable about nonprofit corporations to help establish appropriate accounting and reporting procedures.

F. Conclusion

This memorandum outlines many of the legal requirements and challenges the Corporation will face in order to maintain its corporate and tax-exempt status. The memorandum is summary in nature and designed to give those responsible for the operation of the Corporation a general idea of the issues that may arise, but it is not intended to substitute for on-going consultation with counsel. We encourage you to contact counsel for further clarification or advice, or if you have any questions, please feel free to contact me at [Attorney contact information].