

501(c)(3) - To Be or Not to Be?

*For most fledgling organizations, the process of forming a nonprofit corporation is fraught with confusion. To help demystify these complicated procedures, attorney **Anthony Mancuso** has written a step-by-step guide that lays out the basic principles of nonprofit incorporation, How to Form a Nonprofit Corporation. In the following Q&A, Mancuso addresses some of the most common concerns of groups that may be planning to apply for tax-exempt charitable status.*

How to Form a Nonprofit Corporation (\$39.95), which includes incorporation forms on diskette, may be ordered from Nolo Press, 950 Parker Street, Berkeley, CA 94710; phone (800) 992-6656; fax (510) 548-5902. Mancuso's California Nonprofit Corporation Handbook (\$29.95), which supplements the federal guidelines with California-specific information, is also available from Nolo Press.

Q: We're a small association devoted to the historic preservation of our own downtown neighborhood. We give occasional tours of local sites and sometimes appear before the city council to make the case for preserving the neighborhood. The dues that we collect from our members basically cover our expenses. Do we need to incorporate?

A: Not necessarily. As long as your association doesn't generate a surplus (makes no taxable profit from its activities), isn't trying to attract tax-deductible contributions from donors, doesn't intend to apply for public or private grant money, and doesn't require the limited protection from legal liability that incorporation may afford, there's no compelling need to become a tax-exempt nonprofit corporation. If you do eventually decide to seek outside funding, or if your advocacy efforts have the potential to provoke legal quarrels (with, say, hostile developers), you should revisit the issue.

Q: Are there any disadvantages to incorporating?

A: Primarily the cost and the paperwork burdens. If you do decide to incorporate, you'll be responsible for preparing legal incorporation documents, you'll have to file annual tax returns, and you'll have to perform the other record-keeping and reporting chores associated with ongoing corporate activities (such as double-entry accounting and payroll tax withholding and reporting). Filing fees for the articles of incorporation, tax

exemption application fees, and other miscellaneous fees will probably run a few hundred dollars. If you hire an attorney to prepare those forms, expect to pay at least another \$1,000 -- and possibly much more.

Q: Is there any meaningful distinction between a nonprofit organization that has "members" and one that doesn't? Does it really matter if we're a "membership" organization?

A: For nonprofit corporations in most states, the term "member" has a special, limited legal definition quite different from its common-usage meaning. Specifically, a legal member is someone who (according to the organization's articles of incorporation or bylaws) has the formal right to vote for the election of directors, and who also has a formal say in the sale of corporate assets and the merger or dissolution of the corporation. Your bylaws may still refer to other people as "members" -- and those people may even enjoy special privileges, such as positions on advisory committees or discount rates for services. No matter what you call those people, however, they will not be considered legal members of your corporation unless they have the formal rights enumerated above.

Q: Last month, the young daughter of someone in our office was diagnosed with lymphoma. Our health insurance plan won't cover all the expenses that the family will incur, so friends and colleagues have offered to help defray their costs with monetary gifts. We'd like to set up a fund for this purpose. Can we create a 501(c)(3) organization in her name? Should we?

A: An organization that has been established to benefit a particular individual is not charitable under 501(c)(3). One solution is to simply set up a bank account for the child, although it's important for donors to understand that their contributions would not be tax-deductible under that scenario. Also, the child would be subject to income tax on individual gifts in excess of \$10,000. Another possibility is to work with an "umbrella" organization, such as a church or community foundation.

Q: We're a group dedicated to reforming the legal system by promoting arbitration and mediation. We've been told that as a tax-exempt 501 (c) (3) nonprofit, we would be prohibited from acting to influence legislation "except to an insubstantial degree." Is there any way to know ahead of time whether the IRS will consider our lobbying efforts to be "insubstantial"?

A: Not really. In determining whether a group's legislative activities are substantial in scope, the IRS looks at the amount of time, money or effort expended on legislative lobbying in relation to the organization's other activities. There are two characteristics that will almost certainly render your organization ineligible for tax-exempt charitable status: (1) its main objective or objectives -- not incidental or secondary objectives -- can be attained only by legislation or defeat of proposed legislation; and (2) it advocates or campaigns for the attainment of such objectives rather than engaging in nonpartisan analysis, study, or research which is made available to the public. That's why you should be careful in writing your articles of incorporation and bylaws. Try not to express your exempt purpose in such a way that it seems to be attainable only through political action. Instead of describing your exempt purpose as "reforming the legal system," it would be safer to describe it as "educating the public on the efficacy of non-judicial dispute resolution mechanisms."

Q: Are there any legal requirements for choosing a corporate name?

A: Yes, but there are even more important non-legal considerations. The name of your organization will convey a sense of who you are and what you do to. It's what identifies you to the people in your community, to grantmakers, to other nonprofits, and to everyone else with whom you do business. (Besides, you'll have to print new stationery and brochures every time you change it.) So pick a name that you'll be happy with for a long time. In most states, the name of your nonprofit corporation must be approved by the secretary of state when you file your articles of incorporation. If your name is confusingly similar to that of another organization, it will be rejected. Finding an appropriate, available name for your organization takes time and patience. Ask others both inside and outside the organization for feedback. And remember that your proposed name may not be available, so it's a good idea to come up with some alternative names in case your first choice is already taken.

What's in a Name?

When a group decides to incorporate as a 501(c)(3) organization, one of its principal responsibilities is to choose a name. Some names may be too vague to give a clear idea of what the organization does. Some may be too specific to encompass all that the group does. And some may simply be misleading.

Just how important is a name? In 1989, six child welfare agencies in the San Antonio area participated in an interesting experiment. They revised the names they used in the brochure for the Combined Federal Campaign fundraising drive. Most altered their names to give a clearer idea of their mission, and several worked the words "child," "children," or "abuse" into their new names. (For example, "Family Focus" became "Advocates for Child Abuse Prevention.") The effort paid off: all but one increased their donations substantially, and several doubled, tripled, and even quadrupled the level of contributions.

*Of course, enticing potential donors is only one consideration that an agency should take into account when selecting a name. In this excerpt from *How to form a Nonprofit Corporation*, Anthony Mancuso outlines some of the others.*

Use Common Nonprofit Terms

There are a number of words that broadly suggest 501 (c) (3) nonprofit purposes or activities. Choosing one of these names can simplify the task of finding the right name for your organization and can help alert others to the nonprofit nature of your corporate activities. Here are just a few.

- Academy
- Aid
- Appreciation
- Assistance
- Benefit
- Betterment
- Care
- Charitable
- Coalition
- Community
- Conservation
- Consortium
- Council
- Cultural
- Educational
- Friends
- Help
- Humane
- Learning
- Literary
- Mission
- Organization
- Philanthropic
- Program
- Project
- Protection
- Public
- Refuge
- Relief
- Research
- Service
- Shelter
- Social
- Society
- Voluntary
- Welfare

Words to Avoid

When selecting a corporate name, avoid -- or use with caution -- the types of words described and listed below. (Of course there are exceptions, and if one of them relates to your particular nonprofit purposes or activities, it may make sense to use the word in your name.) Avoid words that, taken together, signify a profit-making business or venture:

- Booksellers Corporation
- Commercial Products Inc.
- Jeff Baxter & Company
- Entrepreneurial Services Corp.

Avoid words that describe or are related to special types of nonprofit organizations [those that are tax-exempt under provisions of the Internal Revenue Code other than Section 501(c)(3)]:

- Business League
- Chamber of Commerce
- Civic League
- Hobby, Recreational or Social Club
- Labor or Agricultural Organization
- Political Action Organization
- Trade Group

Avoid words or abbreviations commonly associated with nationally known nonprofit causes, organizations, or trademarks. You can bet that the well-known group has taken steps to protect its name as a trademark or service mark. Here is a small sampling of some well-known nonprofit names and abbreviations:

- AAA
- American Red Cross
- American Ballet Theater or ABT
- National Public Radio or NPR
- Public Broadcasting System or PBS

Avoid words using special symbols or punctuation that may confuse the secretary of state's computer name-search software:

!@4%A&*O+?<>

Pick a Descriptive Name

It's often a good idea to pick a name that clearly reflects your purposes or activities (Downtown Ballet Theater, Inc.; Good Health Society, Ltd.; Endangered Fish Protection League, Inc.). This allows potential members, donors, beneficiaries and others to locate and identify you easily. More fanciful names (The Wave Project, Inc., and Serendipity Unlimited) are generally less advisable because it may take a while for people to figure out what they stand for. On the other hand, their uniqueness may provide better identification over the long haul.

Example: *Although the name Northern California Feline Shelter, Inc. will alert people at the start to the charitable purposes of the nonprofit group, Cats' Cradle, Inc. may stay with people longer once they are familiar with the activities of the organization.*

Limit your name geographically or regionally, if necessary, to avoid name conflicts or confusion. If you use general or descriptive terms in your name, you may need to further qualify it to avoid conflicts or public confusion.

Example: *Your proposed name is The Philharmonic Society, Inc. Your secretary of state rejects this name as too close to a number of philharmonic orchestras on file. You re-file using the proposed name, The Philharmonic Society of Bar Harbor, and your name is accepted.*

Another Example: *Suppose you are incorporating the AIDS Support Group, Inc. Even if this name does not conflict with the name of another corporation on file in your state, it's a good idea to limit or qualify the name to avoid confusion by the public with other groups in other parts of the country that share the same purposes or goals. This could be done by changing the name to the AIDS Support Group of Middleville.*

Choose a new name rather than limiting your proposed name with a local (or other) identifier if there is still the likelihood of public confusion between your name and the name of another group.

Example: *Your proposed nonprofit name is The Park School, Inc. Suppose another corporation (specializing in a nationwide network of apprentice training colleges) is already listed with the name Park Training Schools. In that case, your secretary of state may reject your name as too similar. You may be able to limit your name and make it acceptable (The Park Street School of Westmont, Inc.) but there are two reasons why you might not want to:*

1. Members of the public who have heard of the Park Training Schools may believe that your school is simply a Westmont affiliate of the national training program; and
2. You may be infringing the trademark rights of the national group. (They may have registered the name as a state or federal trademark.)