

**HOW TO SET UP A CORPORATION IN ANTICIPATION OF AND PRIOR TO
FILING FOR IRC §501(c)(3) TAX-EXEMPT STATUS¹**

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- I. A. The new corporation² must be established under the New York Not-For-Profit Corporation Law (N-PCL): N-PCP § 402 lists the requirements that must be contained in the Certificate of Incorporation.³

"§ 402. Certificate of incorporation; contents

(a) A certificate, entitled "**Certificate of Incorporation of
. . (name of corporation)⁴, under section 402 of the Not-for-Profit Corporation Law,**" shall be signed by each incorporator with his name and address included in such certificate and delivered to the department of state. It shall set forth:

¹ IRC §501(c)(3) recognizes the following organizations as being eligible for tax-exempt status: corporations, community chest, funds (including charitable trusts) or foundations. An individual or partnership is ineligible. Must file Form 1023 application within 15 months of the date in which corporation was formed. Publication 557 (Tax Exempt Status for Your Organization) at p.17.

² N-PCL §501 states that a not-for-profit corporation shall not have stock certificates. However, it may issue non-transferable membership cards. *Id.* If the Certificate of Incorporation requires that its members make "capital contributions", the corporation may issue a non-transferable capital certificate (except Type A corporations whose certificates may be transferable to other members with consent of corporation) N-PCL §502. Capital contributions are to be repaid or redeemed upon dissolution. *Id.* Redemption of a member's capital certificate must be in accordance with the price stated in the certificate of incorporation (not to exceed the capital amount contributed), the period, terms and conditions and always, at corporation's option. *Id.* Redemption can be prior to dissolution, again at the corporation's option, if the certificate holder ceases to be a member. *Id.* at §516.

³ For existing not-for-profit/non-tax exempt corporations that wish to amend their certificates of incorporation to obtain IRC 501(c)(3) tax exemption, a Certificate of Amendment must be filed with the N.Y. Department of State. N-PCL §§801-804. Attorney General and judicial approval must be obtained prior to filing with the Department of State. N-PCL §804. For court approval, there is no fee; contact Special Term (Suffolk 631.852.2410/Nassau 516.571.3252). For Attorney General approval, contact the Charities Bureau (212.416.8000).

⁴ See N-PCL §301 for do's and don'ts of corporate names.

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(1) The name of the corporation.⁵

(2) That the corporation is a corporation as defined in subparagraph (a)(5) of section 102 (Definitions); the purpose or purposes for which it is formed⁶ and the type of corporation it shall be under section 201 (Purposes); and in the case of a Type C corporation, the lawful public or quasi-public objective which each business purpose will achieve.

(3) The county within the state in which the office of the corporation is to be located. It may also set forth the post office address of an office without the state, at which, pursuant to section 621 (Books and records; right of inspection; prima facie evidence), the books and records of account of the corporation shall be kept.

(4) In the case of a Type A, Type B, or Type C corporation, the names and addresses of the initial directors.⁷ In the case of a Type D corporation, the names and addresses of the initial directors, if any, may but need not be set forth.⁸

(5) The duration of the corporation if other than perpetual.

(6) A designation of the secretary of state as agent of the corporation upon whom process against it may be served and the post office address within or without this state to which the

⁵ Check name availability with N.Y. Secretary of State web site: http://appsex5.dos.state.ny.us/corp_public/enter_search.

⁶ The powers set forth in N-PCL §202 are not to become the “purposes” of the corporation, since these powers are stated to be “in furtherance of its corporate purposes”. Therefore, it is not necessary to spell out these powers in the certificate of incorporation. Only set forth additional powers in certificate of incorporation, such as power to solicit contributions (before you can solicit grants and contributions, corporation must first register with Charities Bureau at Office of Attorney General; this will require that corporation has already been granted 501(c)(3) status by IRS (Article 7-A of the Executive Law and EPTL §8-1.4)(See also Regulations adopted by Attorney General at 13 N.Y.C.R.R. 90-105)).

⁷ N-PCL §401 “One or more natural persons at least eighteen years of age may act as incorporators of a corporation to be formed under this chapter.”

⁸ N-PCL §201(b) describes Types A-D corporations as follows: Type A is a corporation “formed for any non-business purpose” such as “civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, animal husbandry, and for a professional, commercial, industrial, trade or service association”. Type B corporations are the most popular and are those that are formed for “charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals.” Type B corporations fit in more with the organizational test required by the IRS (see Part I(B), *infra*). Type C corporations are a catch-all—“formed for any lawful business purpose to achieve a lawful public or quasi-public objective. Type D corporations are more unusual. Type D corporations are formed only when “authorized by any other corporate law of this state for any business or non-business, or pecuniary or non-pecuniary, purpose or purposes . . .” N-PCL §201(b). Unless otherwise specified, the corporation will be considered a Type B Not-For-Profit corporation. N-PCL§113(a).

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secretary of state shall mail a copy of any process against it served upon him.

(7) If the corporation is to have a registered agent, his name and address within this state and a statement that the registered agent is to be the agent of the corporation upon whom process against it may be served.

(8) The statements, if any, with respect to special not-for-profit corporations required under article 14 (Special not-for-profit corporations).⁹

(b) If the certificate is for the incorporation of an existing unincorporated association or group it shall have annexed thereto an affidavit of the subscribers of such certificate stating that they constitute a majority of the members of a committee duly authorized to incorporate such association or group.

(c) The certificate of incorporation may set forth any provision, not inconsistent with this chapter or any other statute of the state, which provision is (1) for the regulation of the internal affairs of the corporation, including types or classes of membership and the distribution of assets on dissolution or final liquidation, or (2) required by any governmental body or officer or other person or body as a condition for giving the consent or approval required for the filing of such certificate of incorporation.”

N-PCL §402 (emphasis added).

The corporate “purpose”, as required by N-PCL §402(a)(2), is also known as the “Mission Statement”. Bottom line, this is what your corporation’s charitable purpose is all about. Great care and attention must be taken in drafting this statement. It will be used, not only in Certificate of Incorporation, N-PCL §402(a)(2), but also in the By-Laws as well as in the 1023 Application. See also IRS requirements in subsection I(B), *infra*. You must show that your corporation is organized and operated for purposes beneficial to the public interest such as, relief of the poor; advancement of religion/religious organizations, education or science; erection or maintenance of public buildings; lessening the burdens of government; elimination of prejudice and discrimination; defense of civil rights; combating community deterioration and juvenile delinquency; amateur athletic organizations, literary organizations and prevention of cruelty to children or animals.¹⁰

⁹ This deals with Fire Corporations.

¹⁰ These examples are not meant to be exclusive.

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B. IRS Requirements to Include in Certificate of Incorporation.

Beware that the IRS requires certain language to be included in the Certificate of Incorporation (Articles of Organization) to meet, what the IRS refers to as the “organizational test”.¹¹

a. Meeting the IRS “organizational test”

- i. Certificate of Incorporation must state that its purposes are limited to those set forth in IRC §501(c)(3).
- ii. In addition to the language required by N-PCL (see section 1(A), *supra*, the IRS requires that the Certificate of Incorporation also state the following:
 1. the “corporation is organized exclusively for charitable, religious, educational, and scientific purposes, including, for such purposes, the making of distributions” to other 501(c)(3) organizations. See IRS Publication 557 (Tax-Exempt Status for Your Organization) at page 19, for examples of what is acceptable and what is not.¹²
 2. the names and addresses of the initial trustees must be included;
 3. No self-dealing language¹³; and
 4. Dissolution provisions to insure that the assets are distributed in accordance with IRC §501(c)(3) or distributed to the federal, state or local government or are used for a public purpose. Generally, state court approval of the distribution will be required.
 5. “No substantial part of the activities of the corporation shall be the carrying on of propaganda, or otherwise attempting to influence legislation, and the corporation shall not participate in, or intervene in

¹¹ As an attorney/accountant dealing with the IRS, do not forget to have your client give you power of attorney. See IRS Form 2848 (Power of Attorney and Declaration of Representative) which can be downloaded from IRS web site www.irs.gov. (see footnote 11, *infra*).

¹² IRS web site is www.irs.gov. Once you are in the IRS web site, click on the field labeled, “charities”. Once inside “charities”, you can download IRS Publication 557 as well as the 1023 application that you will need when you apply to the IRS for 501(c)(3) status and the Form 2848 Power of Attorney.

¹³ Because the corporation cannot issue stock, no dividends are allowed. N-PCL §515. Although corporation is not allowed “to pay dividends or distribute any part of its income or profit to its members, directors, or officers”, reasonable compensation for actual services rendered is allowed. N-PCL §515.

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(including the publishing or distribution of statements) any political campaign on behalf of or in opposition to any candidate for public office.” IRS Publication 557 (Tax Exempt Status for Your Organization) Draft A at p. 20.

6. IRS spells out the language that it would like to see in IRS Publication 557 (Tax Exempt Status for Your Organization) Draft A at pp. 19-20.

b. Public Charity vs. Private Foundation:

- i. **Public Charities Defined:** IRC §509(a)(1)-(4) defines a public charity. 509(a)(1) includes organizations such as churches, educational organizations, hospitals and medical research organizations, endowment funds for city and state colleges/universities, a government unit and a publicly supported organization (See IRS Form 557 (Tax-Exempt Status for Your Organization) at p.30).¹⁴

1. **IRS Test for Public Charities:** Must pass either the one-third support test or the facts and circumstances test to qualify as publicly supported. IRS Form 557 (Tax-Exempt Status for Your Organization) at p.31.

- a. **One-Third Support Test:** Entity receives 1/3 of its support from government or from contributions made by the general public, or a combination of both. *Id.*

- b. **Facts and Circumstances Test:** Organization may still qualify as publicly supported, even if it failed the one-third support test, if receives a substantial part of its support from the government or from direct or indirect contributions from the general public or a combination of both. However, to pass, the

¹⁴ IRC §509(a)(2) organizations are similar to 509(a)(1) organizations, with the exception that the 509(a)(2) organizations have income which is derived from activities related to their exempt function. IRS Form 557 (Tax-Exempt Status for Your Organization) at p.37. Such income is factored into the one-third support test for the 509(a)(2) organization. *Id.* 509(a)(3) organizations carry out the function/purpose of one or more organizations exempt under 509(a)(1) and (2). *Id.* at p.40. 509(a)(4) organizations are those that test products for public safety. *Id.* at p.44.

organization must meet the **ten-percent-of-support** requirement and the **attraction of public support** taking into account **five different factors**. *Id.*

c. **Ten-Percent-Of-Support**

Requirement: At least 10 percent of its support must come from government or from contributions from the general public or a combination of both. *Id.*

i. **Attraction of Public Support:**

Must be organized and operated to attract new and addition public or government support on a continuous basis. This required will be met if the organization maintains a continuous and bona fide program for solicitation of funds from the general public or it carries on activities designed to attract support from government. *Id.*

ii. **Five Public Support Factors**¹⁵:

1. **Percentage of financial support.**
2. **Sources of Support** (support comes from public, not from a limited number of interested donors).
3. **Representative governing body:** Public officials, community leaders, civic leaders and others representing a broad cross-section of the community or persons with special

¹⁵ Not necessary to satisfy all five factors. Weight of each factor depends on nature and purpose of organization and length of time in existence.

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knowledge or expertise in the field that the organization operates.¹⁶

4. Availability of Public Facilities.
5. Whether solicitation of dues paying members designed to enroll broad section of community or field of special interest vs. limited interest group; whether dues set at rate to make membership available to broad cross section of interested public vs. restricted membership to limited number; and whether activities of organization will be likely to appeal to persons having some broad common interest or purpose. *Id.* at pp.31-32.

ii. **Private Foundations: Additional Language to include in Certificate of Incorporation:** A private foundation is any other organization not exempted by IRC §§509(a)(1)-(4). See Section I(B)(b), *supra*. If the corporation is a private foundation as opposed to a public charity¹⁷, the certificate of incorporation must include the following additional language:

1. “The corporation will distribute its income for each tax year at a time and in a manner as not to become subject to the tax on undistributed income imposed by section 4942 of the Internal Revenue Code, or the corresponding section of any future federal tax code.

¹⁶ In a membership organization, the IRS looks to see if the by-laws allow the membership at large to elect an individual onto the board.

¹⁷ Every organization that qualifies for IRC 501(c)(3) tax exemption status is a private foundation unless it falls into a category reserved for public charities referred to in IRC §509(a)(1)-(4). Caveat: Unless you timely notify IRS at time you file Form 1023 application that your organization wants to be considered as a public charity, it will be presumed to be a private foundation. That your organization wishes to be treated as a public charity should be stated in Part III of the Form 1023 application.

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2. The corporation will not engage in any act of self-dealing as defined in section 4941(d) of the Internal Revenue Code, or the corresponding section of any future federal tax code.
3. The corporation will not retain any excess business holdings as defined in section 4943(c) of the Internal Revenue Code, or the corresponding section of any future federal tax code.
4. The corporation will not make any investments in a manner as to subject it to tax under section 4944 of the Internal Revenue Code, or the corresponding section of any future federal tax code.
5. The corporation will not make any taxable expenditures as defined in section 4945(d) of the Internal Revenue Code, or the corresponding section of any future federal tax code.”¹⁸ See also N-PCL §406.

C. State Agency Approval. Agency approval is required to be attached/endorsed on the Certificate of Incorporation if the Not-For-Profit Corporation has any one of the following as part of its Mission/purpose:

- a. Formation of trade/business association--consent from NYS Attorney General, N-PCL §404(a);
- b. Care of children (including day care development programs), care of the aged, care of victims of domestic violence, shelter or home for unmarried mothers or providing health-related facilities—consent NYS Department of Social Services, N-PCL §404(b);
- c. Establishment of a hospital or health service or medical/dental expense indemnity plan—consent required from both the NY Insurance Department and the Health Department, N-PCL §404(c);
- d. Anything to do with education—consent required from NYS Education Department, N-PCL §404(d).¹⁹
- e. If Judicial approval and consent from the Attorney General is required (ie. Mergers of Not-For-Profit Corporations under Article 9 of the N-PCL or amendments to the certificate of incorporation under Article 8 of the N-PCP), contact the NYS Attorney General’s Office²⁰ and the Supreme Court, Special Term

¹⁸ IRS Publication 557 (Tax-Exempt Status for Your Organization) Draft A at p.27.

¹⁹ NY N-PCL §404 provides a listing of the various types of purposes that require agency approval prior to filing the Certificate of Incorporation with the NY Department of State. Also, IRS will require that educational organizations, including private schools, include a racially nondiscriminatory policy as to its students and applicants in its certificate of incorporation or by-laws. Such policy must be included in all its brochures and catalogs dealing with admission and in its written advertising to prospective students. See page 22 in of **IRS Publication 557**.

²⁰ NY Attorney General Web site <http://www.oag.state.ny.us/charities/charities.html>.

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in the County where the corporation is located. Special Term in Suffolk County is 631.852.2410 and Special Term in Nassau County is 516.571.3252. Please note that there is no fee required for judicial approval.

- II. **Employer Identification Number (EIN):** Once the Department of State approves the Not-For-Profit corporation and issues a Filing Receipt, obtain an EIN number from the IRS. The form can be obtained, on-line, from the IRS at its web site: <http://www.irs.gov/formspubs/>. Once there, type in the form number “SS-4”, then click on and follow instructions.

- III. **Corporate By-Laws:** Once the corporation has been formed, you will need to meet with the incorporators at the organization meeting, N-PCL §405, or, if not adopted by the incorporators, the board of directors at its first meeting to adopt by-laws. N-PCL §602 The by-laws should contain the following:
 - a. **Membership:**²¹ Either the by-laws or the certificate of incorporation, or both, can specify if there is more than one class of membership, or, if a Type B corporation, if there are no members. N-PCL §601.
 - i. **Members’ Rights/Powers:** The by-laws may set forth members rights or powers. N-PCL §602(f).
 - 1. **Voting Rights:** Either the by-laws or the certificate of incorporation, or both, can specify if members of a particular class are entitled to vote. N-PCL §612. If set forth in the by-laws or the certificate of incorporation, or both, a particular class of members may be required to vote as a class in connection with certain matters so specified. N-PCL §616.
 - a. **Limitations on Right to Vote:** Either the by-laws or the certificate of incorporation, or both, may deny members of any class the right to vote or limit or define the matters that such members are entitled to vote upon. N-PCL §612.
 - b. **Elections:** Either the by-laws or the certificate of incorporation, or both, may provide for directors to be elected or appointed. N-PCL §703. If elected, the by-laws should fix the date for such elections

²¹ Members, like corporate shareholders, are not “personally liable for the debts, liabilities or obligations of the corporation.” N-PCL §527. Members are only liable for “any unpaid portion of the initiation fees, membership dues or assessments”. *Id.*

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- or specify that they be held at the annual meeting. N-PCL §604 (see *also* N-PCL §§605 (meetings in general).
- c. **Quorum:** Either the by-laws or the certificate of incorporation, or both, may provide for a greater or lesser quorum number. N-PCL §608. See *also* N-PCL §615²² (greater quorum and vote by a class of members). See *also* N-PCL §709 (quorum requirements for directors at board meetings).
 - d. **Proxies:** Every member entitled to vote may vote by proxy, unless proxies are prohibited by either the by-laws or the certificate of incorporation, or both. N-PCL §609.
 - e. **Inspectors:** By-laws may provide for inspectors to be present at meetings to verify voting eligibility, count votes and determine the result, resolve disputes about voting eligibility. N-PCL §610.
 - f. **Record Date for Voting Eligibility:** By-laws may provide, or if silent, the board may fix, the record date (not more than 50 nor less than 10 days prior to meeting) for members to be eligible to vote. N-PCL §611.
 - g. **Vote of Members:** Directors elected by a plurality and any other action, a majority vote, except as otherwise required by either the by-laws or the certificate of incorporation, or both. N-PCL §613. Cumulative voting for directors is allowed only if the by-laws or the certificate of incorporation, or both, so provides. N-PCL §617.
- ii. **Fees and Dues:** Either the by-laws or the certificate of incorporation, or both, can specify if there are initiation fees, dues and assessments and may impose reasonable fines or other penalties upon its members for violation of its rules. N-PCL §507.
 - iii. **Redemption/Distribution:** Either the by-laws or the certificate of incorporation, or both, can specify if the

²² Requires 2/3 vote of all members to amend certificate of incorporation and/or by-laws to include a provision setting forth a greater quorum/vote requirement for a class of members. N-PCL §615.

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corporation will redeem capital certificates and/or may specify if a member or class of member has distributive rights in its assets upon dissolution. See N-PCL §§507(d) and 516.

- iv. **Officers’ Rights/Powers:** The by-laws may set forth officers rights or powers. N-PCL §602(f).²³
- v. **Directors’ Rights/Powers:** The by-laws may set forth directors rights or powers. N-PCL §602(f).²⁴ The by-laws or the certificate of incorporation, or both, may prescribe qualifications to be eligible to sit as a director as well as the total number of directors, not less than three in number. N-PCL §§701 and 702.²⁵ If authorized by by-laws or certificate of incorporation, or both, directors may be present and participate at meetings via teleconference.
 1. **Annual Report of Directors:** Board must present its report at the annual meeting setting forth the assets/liabilities and trust funds of the organization as of the end of a 12 month fiscal period, the organizations expenses and disbursements and number of members as of the date of the report. N-PCL§519.
 2. **Compensation:** Included in by-laws or certificate of incorporation, or both. If not, board has the intrinsic power to set salaries of officers and compensation for directors. N-PCL §715. Certificate of incorporation may provide restrictions, including the power to void transactions between a director and the corporation. *Id.*

²³ Board of Directors elects and/or appoints officers in accordance with provisions in by-laws. N-PCL §713. Same person cannot hold office of president and secretary. *Id.* Certificate of incorporation or by-laws, or both, may have some or all officers elected by membership and not by the board. *Id.*

²⁴ “The number of directors constituting the entire board shall be not less than three. Subject to such limitation, such number may be fixed by the by-laws” N-PCL §702.

²⁵ Unless otherwise stated in by-laws or certificate of incorporation, or both, directors must be at least 18 years of age, except for educational organizations in which one director may be at least 16 years of age. N-PCL §701.