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**Setting Up a Nonprofit  
State Law and Organizational Issues &  
Considerations**

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## Formation Documents

As the core building block of any nonprofit organization, it is important to have this first step solid to create a firm foundation on which to build everything on from bylaws to policies to operations.

1. Formation documents are the primary building blocks for any nonprofit.
  - a. The Certificate of Formation (or Certificate or Articles of Incorporation depending on your jurisdiction) is akin to the organizational birth certificate – a document declaring that the new legal entity was “born.” This is a public record with basic information about the nonprofit that can be viewed by anyone with time and interest.
  - b. The bylaws are akin to the “rules” of the organization – an internal document that articulates general procedures regarding management and operations and rarely is filed with the state.
2. Formation documents must meet both state requirements and federal tax exemption requirements.
3. State Requirements for Formations Documents:
  - a. In Texas, the Texas Business Organizations Code (TBOC) governs the formation of a nonprofit corporation and sets for the provisions required or permitted to be contained in the Certificate of Formation.
    - i. For all legal entities, the COF must have provisions outlining:
      1. Name;
      2. Type of entity being formed;
      3. Purposes for which the entity is being formed;
      4. Period of duration, if not formed to exist perpetually;
      5. Registered agent and address;
      6. Mailing address of entity;
      7. Name and address of each organizer.
    - ii. For nonprofit corporations, the COF also must have provisions outlining:
      1. A statement that the nonprofit is to have no members
      2. A statement that management of nonprofit’s affairs is vested in the nonprofit’s members;
      3. A statement that management of nonprofit’s affairs is vested in the nonprofit’s members;
      4. Number of directors constituting the initial board of directors and the names and addresses of those directors OR a statement that the management of the nonprofit is vested solely in the nonprofit’s members; and
      5. A statement that the nonprofit is to be authorized on its winding up to distribute the nonprofit’s assets in a manner other than as provided by the TBOC.

4. Texas Secretary of State promulgated Form 202 which is a standardized form for the Certificate of Formation drafted to meet minimal statutory filing requirements under the relevant TBOC provisions. It's a plug and play form with step-by-step instructions easily creating a nonprofit organization and may be filed through SOS Direct. It is often used by nonprofit organizations who feel the need to "DIY" the organization to save on professional fees.
5. Form 202 may meet Texas requirements for a nonprofit organization, but it is faulty for compliance with federal tax exemption requirements. While it is possible for it to occur with varying types of nonprofit entities, below are the specific failures for entities desiring to be exempt under IRC Section 501(c)(3):
  - a. Purpose Article, Article 5 in Form 202, is generally completed with what an entity desires to accomplish, but this may not be broad enough or contain the correct language to meet exemption requirements.
    - i. The provision must limit the purposes of such organization to one or more exempt purposes and cannot expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not to further one or more exempt purposes. [Treas. Reg. Sec. 1.501(c)(3)-1(b)].
    - ii. The purpose may be so narrowly defined that the organization becomes restricted in what it may do.
  - b. The document requires the other necessary provisions to be included in the Supplemental Provisions further meeting the organizational and operational tests of Section 501(c)(3) but most organizations utilizing the form do not realize the need for these additional provisions including:
    - i. Dissolution clause requiring all IRC Section 501(c)(3) organizations distribute assets to other 501(c)(3) organizations upon dissolution (the IRS has ruled this must be in the certificate of formation and not in the bylaws to meet the organizational test) [Treas. Reg. Sec. 1.501(c)(3)-1(b)(4)].
    - ii. Provision prohibiting certain political activities must be included to meet the "exclusively for one or more exempt purposes" test. [Treas. Reg. Sec. 1.501(c)(3)-1(b)(3)].
    - iii. Provisions prohibiting private inurement must be included to meet the "exclusively for one or more exempt purposes" test. [Treas. Reg. Sec. 1.501(c)(3)-1(c)(2)]. (While this is specifically referencing 501(c)(3) organizations, several other types of nonprofit organizations also must prohibit inurement to qualify for exemption.)
  - c. The above failures result in a nonprofit entity that does not qualify for federal tax exemption. The certificate of formation must be amended before filing for tax exemption. In the worst-case scenario, the exemption could be denied at the original formation date and be delayed until the date the corrections were made. All federal exempt entities have certain requirements to be addressed in the

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