



Considerations in forming a non-profit organization in New York State

**Brian Henehan, Senior Extension Associate
and
Judith Barry, Extension Associate**

Department of Applied Economics and Management, Cornell University

Scope of this article

This article is intended as a general tool which may be used by individuals, groups of related persons or groups of unrelated persons who seek to structure legal relationships amongst themselves and other for developing non-profit business frameworks. While the information contained in this article is not intended as legal advice, it does contain general information of New York and federal law which is important to the decision making process concerning the formation of a non-profit organization. Readers should consult with their own legal or financial advisors to insure the organizational choices they make best fit their individual or group needs. Questions about the process of forming a non-profit organization in New York State should be addressed with an attorney familiar with non-profit law and the office of the Attorney General.

Introduction

The New York Ag Innovation Center (NYAIC) provides assistance to agricultural producers to help them add value to their produce through offering a range of services including Business Structure Planning (<http://agviability.cornell.edu>).

The Business Structure Planning component of NYAIC continues to work with New York Producers that are exploring their organizational choices to accomplish a range of goals including: group marketing or purchasing, group product promotion, creating a more formal organization to coordinate and/or manage farmers' markets as well as other activities. Choices can include either the formation of a for-profit organization or a non-profit organization. This paper aims to provide information to decision makers about non-profit development. A resource developed to assist decision makers with for-profit organizational development is "Doing Business in New York State – Structures and Strategies" by Anderson, Henehan and Sullivan (2004). The paper can be found at: <http://aem.cornell.edu/outreach/extensionpdf/eb0407.pdf>

Forming a Non-Profit

The purpose of this fact sheet is to provide guidance to groups associated with New York State agriculture that may be considering forming a non-profit organization. You will find the information divided into 4 sections:

1. Questions to consider before developing a non-profit structure
2. Developing a Non-Profit Structure
3. Potential Advantages and Disadvantages of a Non-Profit Structure
4. Resources

1. Questions to consider before developing a non-profit structure

Answers to the following questions will enable your group to assess the reason for change and establish the function of the new entity you need to consider forming.

The reason for change:

- What is the current or hoped for legal structure of the organization?
- Why do you need to consider a new structure?
- What are the components of the current structure or situation that need to be addressed?
- What options/alternatives have you already considered?
- What are the long-term goals of the group, with regard vision, viability (particularly with respect to the economics of the organization) and expansion?

Functional Issues:

A general rule of thumb that can be useful in organizational development is “Form Follows Function”. Being able to understand what function the organization will be able to perform, enables the group to establish if a non-profit organization is suitable for the organization.

- What is the mission and vision of the organization? Does the organization qualify for a non-profit organizational structure under the Federal Tax Code?
- Financial planning and funding of the organization: How much equity is required to structure and run this organization? Where are the assets and cash for the organization coming from? How is the equity to be raised? Will the organization require outside donations to the business? What are the goals and expectations of these donors for the funds that they supply the organization?
- Decision makers for the organization: Who are the decision-makers? How will the decisions be made in the future? Does the group have a committed body of people that can donate time and resources to assist with organizational decisions and management?
- Operational management of the organization: Who is overseeing the management of the organization? What are the requirements of your employees from this organization, with respect to management, salaries and benefits?
- Marketing requirements of the organization: How will the organization market itself? Are there any specific marketing needs of the people this organization

serves with respect to distribution, products, promotion and pricing? How will the organization meet these needs?

- Risk Management: Do you need a formal structure, for example to negotiate leases and limit personal liability?
- How will the organization be able to adapt to change? How will the organization tackle changes in current or future funders or donors? How will the organization withstand a change in operational staffing? How will the organization handle supplier or employee change?
- Accountability: How will the organization report to its funders? Are organizational operations accountable to anyone other than funders? How will the operations ensure reporting and accountability is met?

When considering functional issues, some of the reasons for considering a non-profit structure for the organization might include:

- To minimize tax liability. (If however you are operating on a cost basis and generating no profit, you have little or no tax exposure).
- To you qualify for tax deductible gifts, grants or donations. Is it more beneficial economically, to qualify for this type of revenue than through other sources?
- To formalize organizational structures and limit liability

Why form a non-profit versus a for profit organization?

Factors that may influence the group's decision to select either a non-profit or a for-profit organizational structure can be found in Table 1 below.

Table 1: Factors in the Choice of Non-Profit and For-Profit Structures

Factor	Non-Profit Structure	For-Profit Structure
Personal Liability	Limited liability protection for directors, officers and members.	Shareholders generally do not have personal liability protection.
Ease and Expense of Forming	Expenses can include incorporation costs, filing fees, and filing documents to qualify as a non-profit in New York State. Additional filing with the Internal Revenue Service and State Taxation department is also necessary for tax exempt status.	Expenses can include incorporation costs, filing fees, and filing documents to qualify to do business in New York State
Duration of the Organizational structure	Unless the certificate of incorporation specifies an expiration date, the organization will have perpetual existence.	Unless the certificate of incorporation specifies an expiration date, the organization will have perpetual existence.
Governance or Management	Management is by a Board of Trustees (appointed or elected). May provide opportunity for community involvement, particularly through volunteer opportunities.	Management is by individual owners or Board of Directors elected by stockholders or members.
Tax Considerations	Under Federal Tax Code, a non-profit organization is eligible for certain Federal and State tax exemptions.	May be subject to State franchise tax. Typically liable for state and federal income taxes.
Property Interest and earnings distribution	No ownership shares or ability to distribute earnings. Any surplus must be retained in the organization.	Shareholders may receive dividends or participate in the economic growth of enterprise
Financial Considerations	Certain non-profit organizations receive discounted business rates. For example 501 (c) (3) organizations receive lower postal rates on some bulk mailings. Some businesses offer reduced rates for services to non-profit organizations. May qualify to receive grants or awards targeted towards non-profits. Funding or donations can be competitive and may be unreliable to sustain organization.	A variety of funding, debt, or equity sources may be used to finance and support the organization. Adequate revenues must be generated to attract investors or members to support the organization. May qualify to receive grants or awards targeted towards businesses.
Dissolution	Any remaining assets must be donated to another non-profit organization.	Remaining proceeds are distributed to shareholders or members as specified in the Bylaws
Legislative Activities	Limitations on lobbying and legislative activities.	Can engage in a range of legislative activities
Other	Can provide a neutral territory for competitors to operate in and cooperate. May have a mixed reputation in the private sector.	May have a mixed reputation in the public sector and communities.

2. Developing a non-profit Structure

A number of steps need to be undertaken to develop a non-profit organization. The process has been outlined here in Table 2 (see below). For more information on procedures for forming a non-profit in NYS, filing certificates of incorporation and

seeking tax exempt status, please refer to the resources provided at the back of this fact sheet.

It is important to note that the development of a non-profit structure and a tax-exempt status involves approval of several application processes which may or may not allow the development of a non-profit organization. Initially, approval must be sought from Secretary of State (or the Attorney General) through filing a certificate of incorporation. In addition, if the organization requires tax-exempt status, a further application process must be submitted first with the Inland Revenue Service (IRS) and then with the State department of Taxation.

Table 2: Steps in Forming a Non-Profit Organization

Steps	Activities	People Involved
<i>Step 1</i> Determine the Need	Discuss the need for forming a new non-profit organization. Are there any other organizations that already exist that might meet your needs? If group decides to move ahead, select steering committee to further pursue and discuss.	Potential members or stakeholders in general Steering committee
<i>Step 2</i> Arrive at Vision and Mission Clarify functions to be performed	Identify the vision for the group. Where do you want to go? Determine the Mission and key goals for the proposed organization. Discuss and agree on functions to be performed by non-profit. Bring proposal back to whole group with recommendations.	Steering committee Facilitator Whole group reviews proposal to form non-profit
<i>Step 3</i> Develop Certificate of Incorporation and Bylaws	Identify documents needed to incorporate and spell out how the organization will operate and be governed	Steering committee Bylaws committee Attorney Other Advisors(if needed)
<i>Step 4</i> File with NYS Secretary of State (in some cases the filing will first need to be reviewed by the Attorney General)	Select name for organization, identify incorporators, mailing address, etc. File Certificate of Incorporation with the Secretary of New York State. Make sure that the purpose of the organization meets the qualifications for non-profit status.	Steering Committee Attorney Other Advisors(if needed)
<i>Step 5</i> Receive Approval from Secretary of State for Non-Profit Status	Seek approval of NYS Secretary of State of Non-Profit Status	Steering Committee Attorney Other Advisors(if needed)
<i>Step 6</i> File for Tax-exempt Status with the Internal Revenue Service and the State Department of Taxation and Finance	File and seek approval for tax-exempt status, if so desired	Attorney and/or Accountant familiar with non-profit exemptions
<i>Step 7</i> Start organizational process	Hold general meeting and elect directors (trustees) to govern organization	Members Those eligible to vote
<i>Step 8</i> Establish book keeping and reporting procedures	Establish record keeping system that will meet reporting requirements for non-profit organizations	Accountant

3. Potential Advantages and Disadvantages of a Non-Profit Structure:

As with all business structure options there are potential advantages and disadvantages in the Non-profit structure.

Potential advantages of a Non-Profit Structure

- Under Federal Tax Code, a non-profit organization is eligible for certain Federal and State tax exemptions.
- The non-profit structure can provide opportunity for community involvement, particularly through volunteer opportunities.
- Non-profit organizations receive limited liability protection (for directors, officers and members), as would be the case in certain for-profit organizational structures.
- Certain non-profit organizations receive lower business rates than for-profit organizations. Some businesses offer reduced rates for services to non-profit organizations.
- A non-profit can provide a neutral territory for competitors to cooperate in.

Potential disadvantages of a Non-Profit Structure

- The organization is restricted from making a profit.
- Funding or donations can be competitive and unreliable to keep an organization financially viable.
- There is increased paperwork with setting up and operating a non-profit organization. The establishment of a non-profit organization is dependent on a successful application process (the mission of the operation must be appropriate for non-profit status). The corporation must keep correct paperwork to maintain and honor their additional reporting requirements for non-profit and tax-exempt status.
- A tax-exempt corporation cannot pay out dividends to members. There are no earnings to distribute. Any surplus must be held in the organization.
- A tax-exempt must distribute any assets that remain to other non-profit organizations, upon dissolution.
- A non-profit organization may be restricted with legislative activities (lobbying etc).

New York Agricultural Innovation Center, April 2006

4. Resources:

Understanding Non-profit or Not-for-Profit organizational structure

Frequently asked questions on Non Profits – Business Filings Incorporated
<http://www.bizfilings.com/learning/nonprofitfaq.asp>

Not-for-Profit Corporation – Bamboo Web Dictionary
http://www.bambooweb.com/articles/n/o/Non-Profit_Organization.html

What is a Nonprofit Corporation? - MyCorporation.com
<http://www.mycorporation.com/nonprofit.htm>

Basic Overview of Non-profit Organizations
http://www.managementhelp.org/org_thry/np_thry/np_intro.htm

Non-Profit Organizations – Cornell Law School
http://www.law.cornell.edu/wex/index.php/Non-profit_organizations#State_Judicial_Decisions

Forming a Not-for-Profit Corporation in NYS

Becoming a Non-Profit Organization: What do I need to know?
http://www.ocfs.state.ny.us/main/faith/4_2_need_to_know.asp

Information on forming a non-profit corporation in NYS (including drafting and filing a Certificate of Incorporation) can be found in the publication “Procedures for Forming and Changing Not-for-profit Corporations in New York” available from the New York State Department of Law Charities Bureau. The publication can be accessed from their website at:

http://www.oag.state.ny.us/business/not_for_profit.pdf

or from their office at State of New York Department of Law Charities Bureau, 120 Broadway, New York, NY 10271

The Non-profit organization may be required to register with the Attorney General. More information can be found on the Attorney General’s website:

http://www.oag.state.ny.us/charities/forms/forms_faq.html

Tax Information in NYS

If the organization wishes to seek tax exempt status for a non-profit, it must seek Federal Tax Exemption and State Tax Exemption

In New York State Federal information can be obtained from:
Internal Revenue Service Employee Plans and Exempt Organizations Division;
PO Box 1680, Brooklyn, NY 11220 Telephone: 718-488-2333
<http://www.irs.gov/charities/index.html>

New York Agricultural Innovation Center, April 2006

For New York State Tax exempt status, more information can be obtained from:
New York State Department of Taxation Exempt Organizations Unit,
Building #8 – Harriman Campus, Albany, NY 12227
Telephone: 518-457-2782
NYS Tax information and forms – NYS Department of Taxation and Finance:
<http://www.tax.state.ny.us/>

Additional Business Structure Resources

“Doing Business in New York State – Structures and Strategies” Bruce Anderson, Brian Henahan and Charles Sullivan (2004)
<http://aem.cornell.edu/outreach/extensionpdf/eb0407.pdf>

“Considering Cooperations : A Guide for New Cooperative Development” Brian Henahan and Bruce Anderson (2001)
<http://aem.cornell.edu/outreach/extensionpdf/eb0101.pdf>

New York Agricultural Innovation Center:
<http://agviability.cornell.edu>