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**Forming a Not for Profit**

**Compliance Factors and Formation Cost Factors for forming a NFP**

Attached are the documents which contain info for forming a business corporation.  These apply to a For-Profit corporation (regular business corporation), or to a taxable Not-For-Profit, rather than to a Tax Exempt Not-for-profit. For Profit or Taxable NFP:

1. Forming as a tax exempt NFP is much more expensive than forming as a business corporation or as a taxable NFP:
	1. $1,950 for business corp or $2,050 for taxable NFP, versus
	2. $7,050 for a NFP. ($2,050 + $5,000 for a tax exempt NFP (meaning $7K total to form a tax exempt NFP).

Reason Tax Exempt costs more than a business corporation: Tax Exempt NFP is required to obtain tax exempt status from the following governmental agencies, if the Company intends to solicit donations as tax exempt charitable contributions. (Solicitations include website, brochures, ads, etc.)

The application process is complicated, time-consuming, and therefore costly, and imposes more liability to the client company, and could impose liability to the officers, and to the lawyer and the accountant, more so than a business corporation. Therefore signification Legal Fees and Accounting Fees are required to do everything correctly at the formation and in the ongoing operations:

a.      The IRS (by filing the complex IRS Form 1023, which requires the inclusion of financial statements in the application),

b.      The Illinois Dept. of Revenue filing,

c.      The Illinois Attorney General filing in order to permit solicitation of donations.  (No solicitations can be made, including on the Company website, unless the IL AG has granted tax exempt status)

2.               Ongoing Tax reporting requirements (to IRS and IL Dept. of Rev on Form 990), and Donations Reporting requirements to the IL AG (on IL AG990), and the underlying accounting work, are significant, complex, and therefore more costly than a regular corporation.  Operating as an NFP is considerable more expensive than operating as a FP, since special federal and state tax returns are required, that only some accountants know how to do (and they charge extra for the expertise)

3.                If the total charitable donations (not including membership fees), reach over a certain level (one trigger at $40,000 and another at $100,000), then the financials must be AUDITED, costing another at least $5,000 per year (could be as high as $10,000 per year for auditing fees).

4.        Financial statements on Form 990 become a matter of public record. So they need to be excruciatingly correct and they can’t reflect any excessive expenses, and must reflect low-to-average salaries

5. Operating as an NFP triggers fiduciary duties that may go beyond those of FPs, to the officers and directors.

5.                 Operation as an NFP triggers “conflicts of interest” restrictions that are greater than those of for profits. IRS requires specific conflict of interest policies to be included in the application. (See attached “ABC’s of Non-profits” seminar).

6.                  New IRS requirement possible that insurance for board members required.

7.                  New IRS reporting requirements coming and “SOX-Like” requirements.

1. NFP Boards are harder to fill even without that requirement.
2. Scrutiny of salaries paid to officers and employees….expectations are that salaries will be very low. No large salaries, no large bonuses.
3. Excess profits cannot be distributed to owners, must stay in the corp
4. When company becomes successful and is sold, the founders cannot keep the profits; instead the profits must be donated to another tax exempt not-for profit.

In summary, applying for tax exempt status is a complicated and time-consuming process, for the business, the attorney, and the accountant, requiring a time and cash commitment from the founders of the NFP or the NFP itself.   Tax exempt status applications are rarely ever done as pro bono work by attorneys and accountants, because of the significant complexity, legal liability, and the significant time sync factor. Therefore, if a client is expecting that "Not-For-Profit" means an inexpensive, or a free, alternative to a "For Profit", those expectations are not realistic.

For tax-exempt application on IRS Form 1023, we charge our regular attorney rate of $300 per hour and legal assistant rate of $100 per hour.

The legal and accounting fees to form and operate a tax exempt NFP will be substantially more than those of a FP.  In addition, the fiduciary duty of the founders of a tax exempt not-for-profit, and a regular not-for-profit, and the legal liability to the founders, accountants and attorneys is no less than the duties and liabilities of a FP, and in fact are probably greater than those duties and liabilities to a FP.

Attachments are:

1.      Accountants, Tax Preparers and Bookkeepers referred by NFH. (List of excellent business accountants who work with startups and early stage companies. Not all work with NFPs.)

2.      Name Search and Selection Checklist. Name Selection issue is huge, requiring thought and focus.

3.      Illinois Incorporation Checklist (applies to any corporation, NFP of FP)

4.      LLC vs. Corp – Legal Issues and Some Brief Tax Issues (Comparison doesn’t apply here because you wouldn’t form it as an LLC, but

5.      Owners, Board Members, Officers: Legal Duties and Business Duties

6.      Piercing the Corporate Veil Memo

7.      Legal Fees for forming a regular corporation and items included in the $1,400 flat fee. ($2,000 for a NFP).

8.      Filing Fees, expenses and Legal Fee chart for forming an Illinois corporation.  $1,500 legal fee for Business Corporation. $1,500 legal fees for an NFP, plus estimated legal fees of $750 for preparing special bylaws for not-for-profits, plus estimated legal fees of $5,000 to apply for tax exempt status with the IRS and with IL Attorney General.

9.      Items and Facts Needed for Incorporation

10. ABC’s of Nonprofits, Seminar notes, including some very significant regulations coming.

11. Reports to be filed and steps to take after Forming a NFP.

12. Decision Factors list for client considering forming a NFP.

13. Details about the “Purpose clause”, and allowable purposes; powers, directors, restrictions and other issues that need to go into a NFP application.

So the Company pays legal fees of $1,500 and filing fees and costs of $550; costing a total of $2,050 in legal and filing fees. Then add on top of that, the $5,000 legal fee and $500 filing fee cost or applying for tax exempt status of the not for profit. I would do the NFP application work charging by the hour at $300 per hour.

Questions please email or call.

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