**Nancy Fallon-Houle, P.C.**

5449 bending oaks place

downers grove, Illinois 60515-4456

## nfallon@nfhlaw.com Phone: 630-963-0439 x 22 [www.nfhlaw.com](http://www.nfhlaw.com)

June, 2011

Attached are the documents containing info for forming a business corporation.  These apply to a For-Profit corporation (regular business corporation), or to a taxable Not-For-Profit. These do not apply to a Tax Exempt Not-for-profit.

For-Profit (or Taxable NFP), or taxable business corporation, is what I highly recommend in most cases, because of the costs of compliance for a NFP and the risk to the Directors and Officers of NFP, balanced with the benefits of receiving charitable donations as its revenue source.

Some NFPs are more like trade associations (than like a church). Many trade associates are formed as for-profit business corporations (or as taxable (not tax exempt) Not-For-Profits), because they are funded by membership fees, rather than by donations. Churches, on the other hand, are formed as tax exempt NFPs because they are funded by donations. Back in days gone by, every swim club, golf club and trade association was formed as a tax exempt NFP. Today, the actual workings of these types of entities as businesses, coupled with the cost of forming and operating as a tax exempt NFP, have reduced the number of associations formed as tax exempt NFPs (and rightly so.). Most are either formed as taxable NFPs, or as for profit business entities.

***Consider the Source of Revenue and Whether the Entity Needs to be a Tax Exempt NFP in order to secure the Revenue Stream***

1.        The entity doesn’t ***need*** to be a tax exempt NFP unless its contributors & sponsors expect their contributions to be tax deductible as “***charitable donations***”. For industry related businesses contributing to the entity, their sponsorships and donations are likely already tax deductible on their business tax returns as ***“advertising expense”*** since the sponsorships can be deemed advertising.  Therefore, determine whether your sponsors and donors ***need*** you to be a NFP, or whether they care if you are or not.  Have your bigger sponsors ask their accountants anyway. And, their membership fees are already tax deductible as “dues/membership expense”.

2.         Will the entity receive any grants from government agencies that require that it be a tax exempt NFP? Could it receive a grant even if it were a for profit business entity?

3.         The entity doesn’t need to have “sales tax exempt status” with the Illinois Department of revenue. The sales tax costs it will save are minimal, since it is not generally in the business of buying and selling goods (and instead is a service business, since it is a basically a trade association). The small amounts saved in sales tax are not worth the legal and accounting fee costs to obtain tax exempt status, the reporting costs (accounting costs and legal) of filing for the 501(c) (3) and then the IL AG registration, and the federal and state 990 tax returns each year, plus the cost of maintaining tax exempt status.

4.         There is no tax exemption from payroll tax, so there is no value to the payroll to being tax exempt.

5.         If part of the revenue is membership fees, do the members care whether you are a NFP or a FP or tax exempt?  Their membership fees may be tax deductible as business association membership fees, and do not need to be tax exempt donations. Membership fees are just membership fees in the IRS’s view, and not donations.

***Reasons Why You Don’t Want to Be a Tax Exempt 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 to form a business corporation or $2,200 for taxable NFP, versus
	2. $2,200 + $5,000 for a tax exempt NFP (meaning $7,200 total to form a tax exempt NFP).  Reason: Tax Exempt NFP is required to obtain tax exempt status from the following governmental agencies, if the entity 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
	3. Being a NFP Tax exempt imposes more liability to the client company, and could impose liability to the directors, officers, lawyer and accountant, more so than a business corporation.
	4. The IRS (by filing the complex IRS Form 1023, which requires the inclusion of financial statements in the application),
	5. The Illinois Dept. of Revenue filing.
	6. The Illinois Attorney General filing in order to permit solicitation of donations.  (No solicitations can be made, including on website, unless the IL AG has granted tax exempt status.)
	7. In all states where donations are solicited, a not-for-profit registration filing is required, by state.

1. 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).

1. 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). In a regular for-profit business corporation, there is no such requirement to have the financials audited.

1. Financial statements on Form 990 become a matter of public record. So they need to be excruciatingly correct.
2. Financial statements can’t reflect any excessive expenses, and must reflect low-to-average salaries.
3. Operating as an NFP triggers fiduciary duties that may go beyond those of for-profits, to the officers and directors.
4. IRS scrutiny of operations and financials can be reviewed and audited at any time by the IRS.
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 on the horizon that insurance for board members is required.
7. New IRS reporting requirements coming and “SOX-Like” requirements.
8. NFP Boards are harder to fill even without that requirement.
9. Scrutiny of salaries paid to officers and employees….expectations are that salaries will be very low. No large salaries, no large bonuses.
10. Excess profits cannot be distributed to owners, must stay in the corporation
11. 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.  We do not do IRS 1023 applications pro bono. We charge our regular attorney rate of $350 per hour and legal assistant rate of $150 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.  $1,400 legal fee for Business Corporation. $2,000 legal fees for an NFP, plus estimated legal fees of $1,000 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.

\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*\*
Nancy Fallon-Houle
Corporate & Securities Lawyer
Nancy Fallon-Houle, P.C.
5449 Bending Oaks Place
Downers Grove, IL  60515-4456
nfallon@nfhlaw.com

[www.nfhlaw.com](http://www.nfhlaw.com)

630-963-0439 x 22 phone