

S E P T E M B E R 2 0 0 2 E D I T I O N



A Publication by
Community Building with Attorney Resources

2201 Post Road, Suite 104 • Austin, Texas 78704 • www.texasbar.org

Published in collaboration with ACC Center for Community-Based & Nonprofit Organizations
www2.austinctc.edu/npo

Introduction

Our nonprofit legal toolkit was created for 501(c)(3) nonprofits in Texas to provide an overview of Texas and federal laws governing the day-to-day operations of nonprofit organizations. In addition, space is provided in the binder for nonprofits to keep their governing and other important legal documents. This toolkit should be helpful for both board members and executive directors.

As you will see, there are numerous different laws that govern the day-to-day operations of nonprofits, from federal tax law reporting requirements, to Texas workers' compensation laws. It is critical that both board members and executive directors become familiar with these laws and ensure that the nonprofit is in compliance with them. While this manual provides only a snapshot of some of the most relevant laws in areas where nonprofits commonly struggle, it should serve as a starting point in this direction.

By no means does this toolbook provide a comprehensive list of every law. The toolbook also does not include a discussion of the laws' applicability to every particular fact scenario. Moreover, laws governing nonprofits and interpretation of these laws by the courts are constantly changing. As a result, while every effort has been made to make these materials as accurate as possible, **these materials are not to be used as a substitute for the advice of an attorney. Persons reviewing this guide should not act upon the information without seeking professional legal counsel.**

This is our first edition of our nonprofit legal tool kit. We would appreciate your comments on issues that are unclear, suggested additions, and any other recommended changes. Please contact us with your feedback at txcbar@lact.org, or 512-447-7707, ext. 379.

We appreciate the support of the Center for Community-Based and Nonprofit Organizations at Austin Community College in helping to publish and distribute this toolkit. Additional resources of interest and use to nonprofit organizations can be found at the Center's web site at www2.austincc.edu/npo, in its quarterly web-based journal, Strategic Creativity (www.strategic-creativity.org), and via the Center's mostly free learning opportunities, which are posted on the web site. The Center's Director, Barry Silverberg, can be reached at (512) 223-7076 or bsilverberg@austincc.edu.

D'Ann Johnson
Legal Services Coordinator
Texas C-BAR
September 2002

Nonprofit Legal Toolkit

Table of Contents	Page
Section One: Overview of Legal Requirements	3
A. Legal Obligations of Texas Nonprofits	5
B. Legal Compliance Checklist	17
Section Two: Articles of Incorporation & Bylaws	23
A. Articles of Incorporation and Bylaws	25
B. Sample Form Articles of Amendment	27
C. Sample Form Restated Articles without Amendments	29
D. Sample Restated Articles with Amendments	31
E. Amending the Bylaws	33
F. Sample Bylaws for a Texas Nonprofit	35
Section Three: Minutes and Agendas	47
A. Overview	49
B. Sample Minutes	49
C. Sample Agenda	50
Section Four: Corporate Resolutions	51
A. Overview	53
B. Sample Corporate Resolutions	54
Section Five: Conflict of Interest and Procurement Policies	59
A. Conflicts of Interest	61
B. Sample Conflicts of Interest Policy	63
C. Sample Procurement Policy	66
Section Six: Federal Tax Matters	69
A. IRS 501(c)(3) Application and Exemption Letter	71
B. Public Disclosure Requirements	72
C. Donations	74
Section Seven: Reporting and Filing Requirements	77
A. IRS Reports	79
B. Texas Reports	81
Section Eight: Risk Management	85
Section Nine: Useful Resources on Nonprofit Management	93



SECTION: ONE

Overview of Legal Requirements

Overview of Legal Requirements for Texas Nonprofits

Nonprofits in Texas are subject to many laws and regulations. The main state law that nonprofits need to be familiar with is the Texas Non-Profit Corporation Act, which applies to all nonprofit corporations organized under Texas law. Other federal and state laws and local ordinances also apply to nonprofit organizations. The following is a summary of some of the most important legal obligations governing Texas nonprofits.

Corporate Governance Matters

- ◆ **Nonprofits must maintain a current registered office and registered agent for service of process.** The agent for service of process is the person who is supposed to be notified of a lawsuit or claim against the nonprofit. The agent is first designated in the nonprofit's original articles of incorporation filed with the Secretary of State. If a nonprofit fails to maintain a current registered office or agent, then anyone suing the organization may serve the Secretary of State instead. In that case, a judgment may be taken against the organization without its knowledge. If a nonprofit changes the agent's address or the registered agent, the nonprofit must notify the Secretary of State of the change by completing Form 401 or Form 408 and paying the applicable fees. See www.sos.state.tx.us for Form 401, Form 408, and all current requirements.
- ◆ **Nonprofits must have at least three members on the Board of Directors.** Vacancies should be filled in accordance with the articles of incorporation and the bylaws. If the articles and bylaws are both silent, the vacancies must be filled by a majority vote of the remaining directors.
- ◆ **The nonprofit must have at least two officers: a president and a secretary.** A nonprofit may have other officers. The president and the secretary cannot be the same person. The term of office cannot exceed **three** years. To exceed a term of a year, the articles of incorporation or bylaws must specify a term of up to three years. In the absence of a provision authorizing a specified term, the officers must be appointed or elected annually. Despite the state's limit on the length of a term, state law does not preclude officers from being reappointed for more than one term and, therefore, from serving more than three consecutive years. Churches are exempt from the above requirements.
- ◆ **Dividends and loans to directors are prohibited.** No part of the income of a nonprofit can be distributed to members, directors, or officers. However, if the directors provide services to the nonprofit, the directors may be paid a reasonable amount for the services. A nonprofit corporation is barred from making loans to its directors. Directors and officers

who approve a loan to a director are personally liable for the amount of the loan until it is repaid. Loans may be made to an employee if permitted by the bylaws and if the loan:

- is made to finance the employee's principal residence;
- does not exceed the employee's annual salary if made during the first year of employment; or
- does not exceed 50% of the employee's salary if made after the first year of employment.

- ◆ **Directors may not allow the distribution of assets if a nonprofit is insolvent or the distribution would make it insolvent, unless the nonprofit is paying a debt.** If directors violate this rule, they can be personally responsible for the value of the unpaid debts of the nonprofit. Directors may be protected if they acted in good faith and relied on the written opinion of an attorney for the nonprofit.

- ◆ **No proxy voting is allowed unless authorized.** A director may vote by proxy only if proxy voting is specifically authorized by the articles of incorporation or bylaws.

- ◆ **A board of directors cannot take actions without a meeting unless there is unanimous written and signed consent.** Consent sent by a director via telegram, fax, or similar transmission is regarded as a written consent. **Because the law requires a signature on the consent, the law is unclear as to whether consent sent by e-mail can count as proper consent.**

- **Written consent must contain:**

- the specific action taken;
- the date; and
- signatures of the directors.

- **Action with less than unanimous consent is allowed only if:**

- the articles of incorporation permit; and
- at least the same number of members, directors, or members of a committee agree to the action as necessary to take an action at a meeting.

- **Other requirements for less than unanimous consent include:**

- prompt notice must be given to all directors who did not consent in writing; and
- consent is not effective unless, within 60 days of the date of the earliest dated consent, the written consent is delivered to the corporation in person or by certified mail.

- **Telephone meetings are permissible if:**

- not restricted by the articles or bylaws; and

- all persons can hear each other concurrently.
- **Other remote electronic communication meetings are permissible if:**
 - not restricted by the articles or bylaws;
 - each member entitled to participate in the meeting consents; and
 - all persons can communicate concurrently with each other.
- ◆ **Contracts and transactions between the nonprofit and a director are prohibited under state law unless the following requirements are met:**
 - the material facts of the interest of the director are disclosed to the board, and the board in good faith and with ordinary care authorizes the transaction with majority vote of disinterested directors (even if this is less than a quorum);
 - the material facts of the interest of the director are disclosed to the board, and the contract or transaction is specifically approved in good faith and with ordinary care by vote of the disinterested directors; or
 - the transaction is fair to the corporation when it is authorized.

The IRS also prohibits insider transactions in which an insider benefits unreasonably. See Section Five for more information on conflicts of interest and a model conflicts of interest policy that provides additional protections for nonprofits in this area.

Books and Records

- ◆ **Nonprofits must keep correct and complete books and records.** All nonprofits must maintain the following information at the registered or principal office of the nonprofit in Texas:
 - names and addresses of members, if any, entitled to vote;
 - minutes of meetings of members, Board of Directors, and any committees having the authority of the Board of Directors; and
 - complete books and records of accounts.
- ◆ **Nonprofits that receive contributions from sources outside their membership in excess of \$10,000 during a fiscal year must maintain additional documents and make them available to the public.** These additional documents include:
 - **True and accurate financial records.** Records should have full and correct entries, including income and expenditures in accordance with generally accepted accounting principals. The records must be kept at the registered or principal office of the nonprofit in Texas for at least three years after the close of the fiscal year.

- **Nonprofits must prepare a report of financial activity of the nonprofit for the preceding year.** Nonprofits must prepare or approve an annual report that must include a statement of support, revenue and expenses, changes in fund balances, a statement of functional expenses, and balance sheets for all funds. The report must conform to accounting standards as promulgated by the American Institute of Certified Public Accountants.
- **Members of the public may copy these documents during normal business hours.** Nonprofits do not have to disclose the names of members or contributors. The nonprofit may charge for the reasonable expense of preparing a copy of a record or report. Failure to maintain financial records, prepare an annual report, or make the records available to the public is a Class B misdemeanor under state law. There are additional penalties under federal law. **Note:** IRS rules also require that the three most recent annual information returns (Form 990) be available for public inspection. For more information on public disclosure requirements, see Section Six.
- ◆ **Nonprofits with members must allow any member to examine and copy books and records.** A member must make a demand to examine the books and records in writing and state the purpose of the demand. The member or a member's agent, attorney, or accountant may examine the books at any reasonable time and for any proper purpose. The cost of copying is borne by the member. The Attorney General of Texas may also inspect all the books and records of the nonprofit.
- ◆ **Nonprofits with employees must keep extensive records in accordance with numerous employment laws.** Nonprofits are subject to different employment laws depending on the number of full- and part-time employees each nonprofit has. Record-keeping requirements vary under each law. A good rule of thumb is to keep all payroll information, including time cards, sick and other leave, overtime, and payment history for at least four years. Keep records of work-related injuries and illnesses for at least five years.
- ◆ **Nonprofits with more than four employees must keep records in accordance with the Texas Unemployment Compensation Act.** A nonprofit is also required under this law to keep job descriptions for paid employees. The records must be kept for four years.

Federal Tax Matters for 501(c)(3) Organizations

- ◆ **Nonprofits are subject to fundraising requirements.**
 - **Not all payments to charitable organizations are deductible.** In order for a

donation to be deductible, the amount of the deduction must not exceed the value of items or services given in return for the donation. If something is given in return for the donation, the deductible donation is the difference between the value of the donation and the value of the item received in return. See Section Six for more information on charitable contributions.

- **Provide donors with signed receipts for any contribution over \$250.** Donors giving more than \$250 in a single contribution need a written acknowledgment from a nonprofit to claim the donation on their individual income tax return. For more information, see Section Six.
- **Some types of income exposes the nonprofit to taxes and may cause the IRS to revoke the nonprofit's exemption.** Nonprofits are not taxed on donations or dividends and interest earned on investments. Nonprofits, however, may be taxed on what the IRS calls "unrelated business income," which is income from:
 - a trade or business,
 - regularly carried on, which,
 - is not substantially related to the nonprofit's exempt purpose.

The federal tax on unrelated business income is called Unrelated Business Income Tax ("UBIT"). UBIT may be generated from activities such as selling unrelated products to raise money, advertisements, and hyperlinks to businesses from a nonprofit's web site. For more information on UBIT, see IRS Publication 598, available at www.irs.gov.

- ◆ **Nonprofits are subject to restrictions on use of funds.**
 - **A nonprofit must use funds derived from tax-exempt donations to accomplish the charitable purposes stated in the nonprofit's articles and bylaws.**
 - **A nonprofit may not redirect the use of funds donated or raised for one purpose to a different purpose.** If a nonprofit wants to redirect such funds, it must obtain permission from the donors or file suit seeking permission in court and give notice to the Attorney General.
 - **Lobbying and political activity are restricted.** A 501(c)(3) nonprofit is prohibited from engaging in partisan political activity for or against a candidate. Do not endorse candidates. Lobbying is not completely prohibited, but a nonprofit cannot spend a substantial part of its activities on lobbying. The definition of "substantial part" is complex. Lobbying may include talking to a legislator or providing testimony on legislation. For more information, see "Worry Free Lobbying for Nonprofits," by the

Alliance for Justice, available at www.afj.org.

- **An employee or contractor may not receive a salary or payment that exceeds the value received by the nonprofit.** The IRS's "Excess Benefits Rule" restricts the use of funds to improperly benefit an individual who has a significant influence or relationship with the nonprofit, such as employees or directors. An excess benefits transaction occurs when an economic benefit provided by the nonprofit exceeds the value received by the nonprofit. The penalties for such transactions include tax liability, interest, and loss of tax-exempt status. For more information, see www.rodentia.com\nporegulation\accounting.html#expenses_excess_benefits.
 - **Monitor activities of any project for which the nonprofit agrees to serve as a fiscal sponsor.** When a nonprofit agrees to become a fiscal sponsor of another nonprofit, the IRS will consider the two nonprofits to be one legal entity. Each can be held responsible for the actions of the other. For more information on fiscal sponsors, see www.genie.org.
- ◆ **Nonprofits are subject to restrictions on changes to the organization.**
- **Any material change in the organization may lead to revocation of tax exempt status.** If the nonprofit wants to significantly change its purpose, activities, or method of operation, review the nonprofit's original Form 1023 (exemption application) to determine whether the new purpose and activity were mentioned in the application. If they are included, there is probably no need to file a new application with the IRS. If not included, the IRS may require the nonprofit to get a new determination letter. A nonprofit should also review its articles of incorporation and bylaws. If the new purpose and activity are not authorized by these documents, they must be amended. **Note:** If a nonprofit transacts business beyond the scope of the purposes listed in its articles of incorporation, the Texas Attorney General can sue the nonprofit for involuntary dissolution.
 - **Notify the IRS of changes in the name, articles of incorporation, and bylaws of the nonprofit.** If a nonprofit changes its name, articles, or bylaws, the nonprofit should notify the IRS exempt organizations manager for Texas at IRS, Exempt Organizations, 1100 Commerce, Dallas, Texas 75242, (214)767-1490 or (877) 829-5500, or send the updated information with the nonprofit's next Form 990.
 - **Changes in proposed budgets may affect public charity status.** The IRS classifies a nonprofit as a public charity on the basis of budget information supplied when the nonprofit applied to receive its 501(c)(3) status as a public charity. If the level of

public support that enabled the nonprofit to qualify as public charity changes substantially, the nonprofit could be reclassified as a private foundation. For more information, see Section Six.

- **Notify the IRS of a change in the nonprofit's accounting period.** If the nonprofit wants to change its fiscal year, it must file IRS Form 1128 by the 15th day of the 5th month following the close of the new fiscal year. **Example:** Current fiscal year runs from January 1 to December 31; new fiscal year to run from October 1 to September 30. Form 1128 is due on February 15th of the following year.

State Tax Matters

- ◆ **Pay sales and use taxes or obtain a sales tax exemption from the Texas Comptroller.** A nonprofit is exempt from paying sales and use tax on certain items only if it applies for an exemption and receives a letter from the Texas Comptroller stating that the organization is exempt from paying the taxes. The Comptroller does not have an application form. Instead, a nonprofit must send a written request to the Tax Policy Division, Exempt Organizations Section, Texas Comptroller of Public Accounts, P.O. Box 13528, Austin, Texas 78711-3528, with the following information:
 - detailed description of the activities conducted;
 - copy of the articles of incorporation;
 - copy of the letter from the IRS granting an exemption; and
 - any other information requested by the Comptroller.

To obtain an exemption from a retailer from whom the nonprofit is purchasing items, the nonprofit must present a sales tax exemption form. Forms can be downloaded from the Comptroller's web site at www.cpa.state.tx.us.

- ◆ **Obtain a seller's permit and resale certificate if selling goods subject to the Texas sales tax.** Generally, exempt groups must obtain sales tax permits and collect and pay sales tax on all items they sell. **Exceptions:**
 - Up to two, one-day rummage sales or auctions each year.
 - One annual banquet if the banquet:
 - is not professionally catered;
 - is not held in a restaurant, hotel, or other similar place of business;
 - is not in competition with a retailer required to collect tax; and
 - the food is prepared, served, and sold by members of the organization.

This exception does not apply to the sale of alcoholic beverages.
 - Up to four sales each year (lasting a total of 20 days) of items made and sold by

senior citizen groups (persons 65 and over).

- Membership dues and fees.
 - Publications.
- ◆ **Pay property taxes or obtain an exemption in a timely manner from the county tax assessor's office.** Property taxes are assessed on both real estate and equipment owned by a nonprofit, unless the nonprofit applies and qualifies for an exemption from the county tax assessor's office. Exemption forms may be obtained at www.window.state.tx.us/taxinfo/taxforms/50-115.pdf.

Other State Legal Matters

- ◆ **Do not hold unauthorized charitable raffles, which are considered gambling under the Texas Penal Code.** A nonprofit may not hold a raffle unless it meets each of the following requirements:
- it is a membership organization that has been in existence for at least 3 years as a 501(c)(3) nonprofit;
 - it does not distribute any of its income to its members, officers, or governing body;
 - it does not devote a substantial part of its activities to influence legislation; and
 - it does not participate in any political campaign.

A qualified nonprofit may hold only **two** raffles a year; the raffles cannot be at the same time. Raffle tickets must contain certain language required by law. The total value of the prizes purchased for the raffle cannot be over \$50,000. There is no limit on the value for donated items. The prize cannot be money. The organization must have each raffle prize in its possession or must post a bond for the full amount of the value of the prize with the county clerk of the county where the raffle will be held. The nonprofit may not compensate anyone for organizing a raffle or selling tickets. **Penalty:** Conducting an unauthorized raffle is a Class A misdemeanor. Participating in an unauthorized raffle is a Class C misdemeanor. **Suggestion:** Because the requirements of charitable raffles are tricky and the penalties for violations are severe, seek legal advice before holding a raffle. For more information, see the Texas C-BAR Resource Center at www.texasbar.org.

- ◆ **File a 9.01 Report with the Secretary of State.** Approximately every four years, the Secretary of State's office sends to nonprofits a 9.01 report (Form 802) for the nonprofit to complete and return to the Secretary of State. This report is sent to the nonprofit's registered agent. On this report, the nonprofit must provide the names and addresses of

the corporate officers, the address of the corporation's principal office, and the name and address of the agent for service of process.

- ◆ **Obtain charitable solicitation permits from selected cities in Texas.** Texas does not require persons soliciting on behalf of nonprofit organizations to register with the state, but several cities do impose such requirements. Check with your city or local chamber of commerce to determine whether there is a requirement in your area.
- ◆ **Notify the Attorney General of any lawsuit in which the nonprofit is involved.** This notification is required for all lawsuits in which the nonprofit is a plaintiff or defendant. The Attorney General can choose to intervene in a case if she decides that it is in the public interest.
- ◆ **File amendments to the articles of incorporation with the Secretary of State.** Any changes to the name of the nonprofit or other provisions of the articles must be filed in duplicate along with a \$25 fee.
- ◆ **File changes of a registered agent or agent's address with the Secretary of State.** Changes should be filed using the Secretary of State's form, available at www.sos.state.tx.us. The fee is \$5.
- ◆ **Notify the Secretary of State if the nonprofit dissolves.** Nonprofits that voluntarily dissolve must provide the Secretary of State with two copies of the Articles of Dissolution (Form 603) and a filing fee of \$5.

Employment Law Matters

- ◆ **Comply with laws affecting employers.** Nonprofits are subject to all employment laws in the same manner as for-profit companies. Nonprofits must comply with wage, anti-discrimination laws, and other laws applicable to employers. Some of the laws to be on the lookout for are listed below.
- ◆ **Register for unemployment compensation if the nonprofit has more than 4 employees for at least 20 weeks during the year.** A nonprofit may elect to pay reimbursements instead of contributions to the unemployment compensation commission. The election must be made within 45 days after the Texas Workforce Commission notifies the employer that it is subject to the unemployment compensation laws. For more information see, www.twc.state.tx.us.

- ◆ **Comply with workers' compensation insurance laws.** Provide all employees with notice of whether the nonprofit has insurance coverage.
- ◆ **Post required employment law posters in the workplace.** Most of the posters are available on the Texas C-BAR website.
- ◆ **Nonprofits with 15 or more employees must have a drug abuse policy in place.** For more information, see www.twcc.state.tx.us.
- ◆ **For more information on employment law requirements, see the Texas C-BAR Resource Center at www.texasbar.org.**

Duties of the Board of Directors

- ◆ **The Board of Directors manages the affairs of the nonprofit, unless limited by the articles of incorporation or bylaws.**
- ◆ **Directors are required to perform their duties:**
 - **In good faith.** Good faith is shown by honesty and faithfulness to duties and obligations and whether there is an intent to take advantage of the nonprofit.
 - **With ordinary care.** Ordinary care is the use of good judgment and common sense. Directors should devote a reasonable amount of time and attention to their responsibilities, attend meetings, and review and understand material submitted to them. They should ask questions, if necessary, to obtain enough information to fulfill their responsibilities. Ordinary care may differ from director to director based on their background and experience and the role they play in the organization.
 - **In the best interest of the nonprofit.** A director acts in the best interest of the nonprofit if the director reasonably believes that the action will benefit the nonprofit. The director should have a proper motive and base the belief on sufficient information. Hindsight is not the test, even if the action turns out badly, as long as the action was taken with the best interest of the nonprofit in mind at the time the vote was made to approve the action.

Protections for Directors

- ◆ **Reliance on certain information prepared by others.** In performing a duty, a director may in some cases rely on information prepared by certain other persons. If the director is acting in good faith and with ordinary care, she may rely on information, reports, financial statements, and other data prepared by another director or an employee of the organization, a board committee of which the director is not a member, legal counsel, accountants, or other professionals and experts. The director is not protected from liability if she has knowledge that makes the information unreliable.

- ◆ **Delegation of Investment Authority.** The board of directors has no liability arising from any action taken or omitted by an investment advisor who invested the funds of the nonprofit if the board acted in good faith and with ordinary care in selecting the advisor.

- ◆ **A nonprofit may pay for or indemnify a director for legal expenses.** Sometimes a person is sued simply because the person is or was a director of a nonprofit. A nonprofit must indemnify the director (pay the director's costs of legal expenses) in some circumstances and may do so in others.
 - A nonprofit **must** indemnify a director against reasonable expenses incurred in a lawsuit filed against the director if the director was successful in defending the lawsuit.

 - A nonprofit **may** indemnify a director who is not wholly successful in a civil lawsuit for legal expenses if the director conducted himself in good faith and reasonably believed the conduct was in the best interest of the nonprofit.

 - A nonprofit **may** indemnify a director for expenses in a criminal case, if the director had no reason to believe that his conduct was unlawful.

 - A nonprofit **may** prepay the legal expenses if the director affirms in writing that he met the appropriate standard of conduct to qualify for indemnification.

 - A nonprofit **may not** indemnify a director if the director:
 - engaged in wilful or intentional misconduct; or
 - received an improper personal benefit.

 - A nonprofit may provide the above discretionary protections for directors only if such indemnification is authorized by the nonprofit's articles of incorporation, bylaws, corporate resolution, or agreement.

- ◆ **Insurance and other protections.** A nonprofit may provide additional protection for directors by providing director's and officer's liability insurance. For more information, see Section Eight.

Legal Compliance Checklist for 501(c)(3) Nonprofits

Based in part on materials prepared by the National Economic Development & Law Center, 2201 Broadway, Suite 815, Oakland, CA 94612; 510-251-2600; fax 510-251-0600; www.nedlc.org

The following checklist is distributed for informational purposes only and should not be construed as legal services to any organization or individual. The checklist should be used as a starting point for a nonprofit to evaluate whether it is following Texas and federal reporting requirements and laws. Some of the items listed below are not mandated by law but are sound business practices an organization should follow to help ensure that the organization avoids problems. There are numerous other laws and reporting requirements that a nonprofit may have to comply with which are not included in this checklist.

Nonprofits should regularly assess their compliance with the following legal formalities:

◆ Monitoring by the Board

- The corporation furnishes each director and officer with a copy of the corporation's articles of incorporation and bylaws.
- The corporation assigns the responsibility for meeting all filing and reporting requirements to appropriate directors and staff.
- The board or a board committee regularly determines that all filing and reporting requirements have been met in a timely manner, or that appropriate and timely corrective action has been taken.

◆ Personnel/Employment

- The corporation has applied for and been assigned a federal identification number by the Internal Revenue Service (IRS).
- The corporation complies with the reporting requirements of the Texas Workforce Commission, including the filing of Form C-1 and, if required, quarterly wage reports along with the payment of unemployment insurance tax.
- The corporation withholds federal income taxes and federal social security and medicare taxes from taxable wages paid to employees, pays the employer share of taxes, and deposits all such funds in a timely manner and with the appropriate IRS forms.
- The corporation maintains personnel records for at least four years.
- The corporation obtains a completed IRS Form I-9 and Form W-4 from all new employees.

- The corporation furnishes each employee with a completed IRS Form W-2 by January 31 for the previous calendar year.
- The corporation files quarterly wage reports (IRS Form 941) with the IRS.
- The corporation posts or provides to its employees the required employment notices, including notices and posters required by the Texas Workers' Compensation Commission, Texas Payday Law, EEOC, OSHA, and US Department of Labor. See www.twc.state.tx.us/ui/lablaw/posters.html for a list of required posters.
- The corporation complies with wage and hours laws (including the Fair Labor Standards Act and Texas Payday Act), workplace safety laws, and nondiscrimination laws (including Title VII and the Americans with Disabilities Act).
- The corporation complies with its employee benefit plan requirements.
- The corporation has adopted an updated personnel policy manual and complies with the personnel policies and procedures contained in the manual.
- The corporation complies with the IRS rules governing the status of independent contractors, prepares proper documentation of all independent contractor agreements, and reports compensation to independent contractors on IRS Form 1099 MISC.
- The corporation provides to each employee from whom the corporation did not withhold any income tax a notice about the Earned Income Tax Credit, by providing the employee with IRS Notice 797.

◆ Federal Tax and Financial Filings and Reports

- The corporation files annual tax information returns (IRS Form 990 or 990-EZ). If the corporation has unrelated business income, it files IRS Form 990-T.
- The corporation obtains an annual financial audit from an independent auditor and, if required by federal funding sources, the corporation obtains an A-133 audit.
- The corporation engages legal counsel to conduct an annual review of its past year's operations and coming year's proposed operations to identify any conflicts and inconsistencies with the information previously provided to the IRS, and for an opinion on whether the corporation is or will be engaged in unrelated business activity.
- The corporation complies with IRS disclosure, substantiation, and reporting requirements for charitable contributions received.
- The corporation observes the IRS prohibition on political campaign activities.
- For corporations within the IRS advance ruling period, the corporation conducts an annual review to determine its compliance with public charity status requirements and obtains a final ruling on its public charity status from the IRS in a timely manner.
- The corporation observes the limitations on lobbying activities and maintains appropriate records to document its lobbying expenditures and activities.
- If the corporation lobbies and utilizes the 501(h) election, it makes appropriate filings with the IRS to comply with lobbying registration, disclosure, and reporting requirements.
- If the corporation has an employee benefit plan, the corporation makes annual benefit plan filings (IRS Form 5500) as required.

◆ Other Filings and Reports

- The corporation has applied for and maintains the appropriate property tax exemptions with the county assessor.
- The corporation files Form 9.01 with the Secretary of State every four years.
- The corporation has obtained a nonprofit mailing permit to use special bulk postal rates.

◆ Liability Protection

- The corporation understands the policy limits of insurance policies, including: the events covered, exclusions, amount of coverage, deductibles, whether policies are “occurrence” or “claims made” policies, and any gaps in coverage.
- The corporation maintains appropriate commercial general liability insurance, with reasonable exclusions and limitations, with coverage for the acts and omissions of the organization and its employees and volunteers in the amount of at least \$500,000 for each person, \$1,000,000 for each single occurrence for death or bodily injury, and \$100,000 for each single occurrence for injury to or the destruction of property.
- The corporation maintains appropriate bonding for those persons who handle its funds, with reasonable limitations and exclusions.
- The corporation maintains, as applicable, errors and omissions or other professional liability insurance, with reasonable exclusions and limitations.
- The corporation maintains appropriate director's and officer's liability insurance, with reasonable exclusions and limitations, or annually reviews the affordability of such insurance.
- The corporation maintains appropriate property and automobile insurance, with reasonable limitations and exclusions.
- The corporation maintains appropriate workers' compensation insurance, with reasonable limitations and exclusions.
- The corporation maintains appropriate employment practices liability coverage, with reasonable limitations and exclusions.
- The corporation has copies of executed waivers of liability for volunteers and clients.
- The corporation has adopted policies and procedures to modify risks and monitors their implementation.
- The corporation promptly advises insurance companies of facts that could give rise to claims in accordance with notice provisions of the policies.

◆ Operations

- The corporation has selected a bank after comparing and negotiating rates and fees.
- The corporation has authorized at least two persons as check signers.
- The corporation appropriately invests its assets that are held for investment.
- The corporation maintains an up-to-date copy of its articles of incorporation, bylaws, 501(c)(3) tax exemption application and determination letter, and franchise tax exemption letter from the Texas Comptroller and keeps a copy at its principal office.

- The corporation maintains a seller's permit from the Texas Comptroller for items it sells.
- The corporation maintains on record with the Texas Secretary of State a current name and address for its registered agent.
- The corporation has obtained a sales tax exemption from the Texas Comptroller.
- The corporation has obtained other federal, state, or local licenses as required for its activities.
- The corporation prepares and maintains for at least three years adequate and correct books and records of account, including records relating to all income and expenditures, and prepares or approves an annual report of financial activity.
- The corporation, unless it falls under a state statutory exception, makes all of its financial records available to members of the public for inspection.
- The corporation prepares and maintains minutes of board, committee, and member meetings for a minimum of three calendar years following the end of the fiscal year.
- The corporation maintains copies of notices of board and member meetings, written waivers of notice, consents to votes taken without a meeting, and approvals of all minutes.
- The corporation maintains copies of written director and officer resignations, proxies, and similar documents.
- The corporation maintains an alphabetized list of members (if any), with name, address, and class of membership.
- The corporation makes available for public inspection a copy of its federal tax exemption application, IRS tax exemption determination letter, and IRS Forms 990 from the previous three years, and provides a copy on request.
- The corporation complies with its bylaws, including the provisions on the terms of directors, election of officers, quorums, and obtaining approval for certain actions. The corporation holds all meetings it is required to hold and provides proper notice of meetings.
- The corporation has at least three directors, and has two different directors serving as president and secretary.



Transactions

- The corporation maintains a procurement policy to ensure that purchases are at a fair market value or are otherwise favorable to the corporation and, if applicable, the corporation complies with federal procurement standards.
- The corporation maintains a financial system that requires receipt of written invoices prior to payment for any services or goods.
- The corporation conducts appropriate investigations to ascertain that loans, leases, and other transactions are at fair market value or are otherwise favorable to the corporation.
- The corporation prepares appropriate documentation in support of all transactions with directors, officers, or other insiders, and to demonstrate the reasonableness of all compensation.
- The corporation has adopted a conflict of interest policy for transactions and meets all requirements for approval of transactions involving a conflict of interest including transactions with corporations under its control.

- The corporation engages legal counsel to review proposed contracts and agreements, corporate obligations to perform acts that might jeopardize its tax exempt status, and whether there are appropriate safeguards to assure that corporate funds granted to other organizations are being used for tax exempt purposes.
- The corporation receives the benefits of, and meets its obligations under, all leases, loans, contracts, partnerships, joint ventures, and similar agreements.
- If the corporation is the fiscal agent for another organization, it monitors the other organization's performance and compliance with all corporate formalities.



SECTION: TWO

Articles of Incorporation & Bylaws

Articles of Incorporation and Bylaws

The articles of incorporation and bylaws are the most important documents of a nonprofit organization. Like a birth certificate, the organization should keep track of these documents. All board members should have copies and the organization should keep the documents in a corporate record book. This notebook is designed to hold these documents. Any amendments or revisions should also be kept in the notebook. Additional information about amendments or revisions to articles of incorporation can be obtained from the Texas Secretary of State's Office, www.sos.state.tx.us/corp/nonprofits.html, which also contains model forms for articles and other nonprofit corporate documents.

Amending the Articles of Incorporation

If a corporation needs to add, delete, or alter provisions of its articles of incorporation, or change its name, it needs to file articles of amendment with the Secretary of State. If extensive amendments are needed, the corporation should consider filing restated articles of incorporation instead of articles of amendment. A form for articles of amendment, which was promulgated by the Texas Secretary of State's office, is included below.

The method of adopting articles of amendment depends on whether the corporation has members with voting rights:

- ◆ **Corporations with members having voting rights.** The board of directors adopts a resolution setting forth the proposed amendments. The resolution is submitted to a vote at a meeting of the members. The proposed amendments must be approved by at least two-thirds of the votes which members present (in person or by proxy) are entitled to cast. In the alternative, amendments may be adopted by the unanimous written consent of the members. In addition, there are certain specific nonsubstantive amendments, such as deleting the names of the initial directors, which may be adopted by a majority of the board of directors.
- ◆ **Corporations with no members or no members having voting rights.** Unless the articles provide otherwise, the amendments must be adopted by a majority vote of the board of directors.

The articles of amendment should be signed by an authorized officer of the corporation. Two copies of the articles should be submitted to the Secretary of State, along with a \$25 filing fee, to Statutory Filings Division, Corporations Section, P.O. Box 13697, Austin, Texas 78711-3697. If the documents conform to law, the Secretary of State will file the documents, note the date of their filing, and return a file-stamped copy along with a certificate of amendment.

Restating the Articles of Incorporation

A Texas nonprofit corporation which has made numerous amendments to its articles of incorporation or wishes to adopt all new articles of incorporation should adopt restated articles of incorporation, pursuant to Article 1396-4.06 of the Texas Non-Profit Corporation Act. After the restated articles are adopted by the board, two copies of the restated articles must be filed with the Secretary of State's office along with a \$50 filing fee. The Secretary of State, upon approval of the restated articles, will issue a restated certificate of incorporation. At the time the certificate is issued, the original articles of incorporation and all amendments are superseded, and the restated articles are deemed the articles of incorporation for the corporation.

The restated articles may take one of two forms. A sample form for each of the following is included in this section.

- a compilation of all previous amendments with no further amendments (simply a reinstatement of what has already been adopted by the corporation); or
- a compilation of all previous amendments with any new amendments included in the restated articles.

SAMPLE FORM ARTICLES OF AMENDMENT

Pursuant to the Texas Non-Profit Corporation Act, the undersigned corporation adopts the following articles of amendment:

ARTICLE ONE

The name of the corporation is _____.

ARTICLE TWO

The following amendments to the articles of incorporation were adopted on _____,

[Insert amendments in one of the forms set out in (a), (b), and (c)]

- (a) *[Insert the amendment in the following form if it alters any provision of the original or amended Articles of Incorporation:]* Article _____ of the Articles of Incorporation is hereby amended so as to read as follows: *[copy/insert new amendment here]*
- (b) *[Insert the amendment in the following form if it is an addition to the original or amended Articles of Incorporation:]* The Articles of Incorporation are hereby amended by adding thereto a new Article ____ to read as follows: *[copy/insert new article here]*
- (c) *[Insert the amendment in the following form if it is a deletion from the original or amended Articles of Incorporation:]* The Articles of Incorporation are hereby amended by deleting therefrom Article _____ which reads as follows: *(copy/insert here text of deleted article)*

ARTICLE THREE

The amendments were adopted in the following manner:

(If there are members having voting rights use statements (a) or (b); if no members have voting rights, use statement (c))

- (a) The amendment was adopted at a meeting of members held on _____, at which a quorum was present, and the amendment received at least two-thirds of the votes which members present or represented by proxy were entitled to cast.

-OR-

- (b) The amendment was adopted by consent in writing by all members entitled to vote.

-OR-

- (c) The amendment was adopted at a meeting of the board of directors held on _____, and received the vote of a majority of the directors in office, there being no members having voting rights.

Dated _____, _____.

(Enter name of corporation) _____

By: _____
President

By: _____
Secretary

STATE OF TEXAS
COUNTY OF _____

Before me, a notary public, on this day personally appeared _____, known to me to be the person whose name is subscribed to the foregoing document and, being by me first duly sworn, declared that the statements therein contained are true and correct.

Given under my hand and seal of office this _____ day of _____, _____.

Notary Public

**SAMPLE FORM
RESTATED ARTICLES OF INCORPORATION
WITHOUT NEW AMENDMENTS**

ARTICLE ONE

*(Insert name of Corporation)*_____, pursuant to Article 4.06 of the Texas Non-Profit Corporation Act, hereby adopts Restated Articles of Incorporation which accurately copy the articles of incorporation and all amendments thereto that are in effect to date and such Restated Articles of Incorporation contain no change in any provision thereof.

ARTICLE TWO

The Restated Articles of Incorporation were adopted in the following manner:

[Where there are members having voting rights insert either (a) or (b); for corporations with no members with voting rights, insert (c)]

- (a) The Restated Articles of Incorporation were adopted at a meeting of members held on *(insert date)* , at which a quorum was present, and the Restated Articles of Incorporation received at least two-thirds of the votes which members present or represented by proxy at such meeting were entitled to cast.

-OR-

- (b) The Restated Articles of Incorporation were adopted by consent in writing by all members entitled to vote.

-OR-

- (c) The Restated Articles of Incorporation were adopted at a meeting of the board of directors held on *(insert date)* , and received the vote of a majority of the directors in office, there being no members having voting rights.

ARTICLE THREE

The Articles of Incorporation and all amendments and supplements thereto are hereby superseded by the following Restated Articles of Incorporation which accurately copy the entire text thereof:

[Insert here entire text of restated articles]

Dated _____, _____.

(Name of Corporation) _____

By: _____
President

Secretary

STATE OF TEXAS
COUNTY OF _____

Before me, a notary public, on this day personally appeared _____, known to me to be the person whose name is subscribed to the foregoing document and, being by me first duly sworn, declared that the statements therein contained are true and correct.

Given under my hand and seal of office this _____ day of _____, _____.

Notary Public

**SAMPLE FORM
RESTATED ARTICLES OF INCORPORATION
WITH AMENDMENTS**

ARTICLE ONE

(Insert name of Corporation), pursuant to Article 4.06 of the Texas Non-Profit Corporation Act, hereby adopts Restated Articles of Incorporation which accurately copy the Articles of Incorporation and all amendments thereto that are in effect to date and as further amended by such Restated Articles of Incorporation as hereinafter set forth and which contain no other change in any provision thereof.

ARTICLE TWO

The Articles of Incorporation of the corporation are amended by the Restated Articles of Incorporation as follows:

[Set forth here the new amendment or amendments]

ARTICLE THREE

Each such amendment made by these Restated Articles of Incorporation has been effected in conformity with the provisions of the Texas Non-Profit Corporation Act and such Restated Articles of Incorporation were duly adopted in the following manner:

[Where there are members having voting rights, insert either (a) or (b); for corporations with no members with voting rights, insert (c)]

- (a) The restated articles and the amendments made by such restated articles were adopted at a meeting of the members held on (insert date), at which a quorum was present, and the restated articles and the amendments made by such restated articles received at least two-thirds of the votes which members present or represented by proxy were entitled to cast.

-OR-

- (b) The restated articles and the amendments made by such restated articles were adopted by consent in writing by all members entitled to vote.

-OR-

- (c) The restated articles and the amendments made by such restated articles were

adopted at a meeting of the board of directors (or trustees) held on (insert date), and received the vote of a majority of the directors (or trustees) in office, there being no members having voting rights.

ARTICLE FOUR

The articles of incorporation and all amendments and supplements thereto are hereby superseded by the following restated articles of incorporation which accurately copy the entire text thereof and as amended as above set forth:

[Insert here the entire text of the articles of incorporation as they have been amended to read.]

Dated _____, _____.

(Name of Corporation) _____

By: _____
President

Secretary

STATE OF TEXAS
COUNTY OF _____

Before me, a notary public, on this day personally appeared _____, known to me to be the person whose name is subscribed to the foregoing document and, being by me first duly sworn, declared that the statements therein contained are true and correct.

Given under my hand and seal of office this _____ day of _____, _____.

Notary Public

Amending the Bylaws

Overview

These model bylaws are meant to serve as a guideline for nonprofit corporations in Texas which are drafting or revising their bylaws. Bylaws govern the internal operations of a corporation. As a result, before drafting bylaws, you need to first consider how you want your corporation to operate. The Important Issues to Consider section below outlines many of the most important issues you need to first consider. After answering the questions below, you may then need to add, delete, or modify provisions in the model bylaws to fit the needs of your organization.

Some of the provisions included in the model bylaws are dictated by state law, while other provisions are optional. Moreover, the law often provides that “unless the articles or bylaws state otherwise, then” In these circumstances, when the articles and bylaws are silent on a topic, state law governs as the default. When the articles or bylaws are not silent on a topic, the provisions in the articles and bylaws apply, provided they are not illegal. In the event that the articles conflict with the bylaws, the articles govern.

Important Issues to Consider

The following are some of the more important issues to consider when drafting or revising bylaws:

- ◆ **Members:** Does the corporation have voting members? If so, what are their qualifications, voting rights, method of selection, terms, dues and fees, method of removal, etc.?
- ◆ **Meetings:** When will the corporation hold its meetings and how will the meetings be called; where will meetings be held; how will directors or members be notified?
- ◆ **Directors:** How many directors will the corporation have, how will they be elected and removed, what are their qualifications, what is their term of office, will there be term limits, and will they serve staggered terms? State law requires that nonprofit corporations have at least three directors.
- ◆ **Officers:** What officers will the corporation have and what are their qualifications, duties, and methods of selection and removal? State law requires that nonprofit corporations have at least a president and secretary, which cannot be the same person.
- ◆ **Committees:** What committees will the nonprofit have, what is the scope of the committees, who is eligible for service on the committees, and how are they managed?
- ◆ **Quorum:** How many members or directors are required for a quorum to conduct business, and what proportion of votes is required to take action on a matter?

- ◆ **Internal control:** What types of processes can help the corporation adequately control its internal operations? For example, who can sign checks and in what amount; what signatures are required to purchase or sell property?
- ◆ **Fiscal year:** What is the corporation's fiscal year?
- ◆ **Amendments to bylaws:** What are the procedures for amending the bylaws?
- ◆ **Other considerations:** Specific government programs may require specific bylaw provisions. For example, nonprofit corporations seeking certification as Community-Based Housing Development Organizations (CHDOs) are generally required to include in their bylaws a specific provision governing the types of persons who can and cannot serve as directors on the board (a sample provision is included in the model bylaws). Check with specific government programs for more information.

SAMPLE BYLAWS FOR TEXAS NONPROFIT CORPORATION

ARTICLE I

These bylaws constitute the code of rules adopted by the *[insert name of corporation here]* for the regulation and management of its affairs.

ARTICLE II

Purpose

[Enter purpose here; can list purpose contained in articles of incorporation, or list a more detailed purpose here.]

[Example:] The ABC Corporation (“the Corporation”) shall exist for the purpose of expanding opportunities available to low- and moderate-income residents in the ABC Neighborhood of the City of Austin, Texas, to obtain affordable housing by constructing, rehabilitating, preserving, and providing decent, safe, and sanitary housing for such residents. Through related activities, the Corporation shall also seek to preserve the character of the ABC Neighborhood, and engage in community projects for the benefit of the ABC Neighborhood. The Corporation shall be and is a non-profit corporation under the laws of the State of Texas. The service area of the Corporation is the ABC Neighborhood, which consists of *[enter geographic boundaries of corporation’s service area here]*.

ARTICLE III

Board of Directors

(1) Powers

The Board of Directors (“Directors”) of this Corporation is vested with the management of the business and affairs of this Corporation, subject to the Texas Non-Profit Corporation Act, the Articles of Incorporation, and these bylaws.

(2) Qualifications

Directorships shall not be denied to any person on the basis of race, creed, sex, religion, or national origin. Employees of the Corporation are ineligible to serve on the Board of Directors.

[For CHDOs, add the following:] At least one-third of the Board of Directors shall be composed of residents of the *[insert name of neighborhood here]*, a low-income neighborhood. At no time shall more than one-third of the Board of Directors be composed of public officials or public employees. No governmental body shall have any power to appoint any member of the Board of Directors. No board member who is a public official or employee shall have the power to appoint any other member of the Board of Directors other than through the individual vote of that board member as a director.

(3) Number of Directors

The Board of Directors will consist of *[insert number of Directors here—cannot be less than three]* Directors. Upon majority resolution of the Board of Directors, the number of Directors may be increased or decreased from time to time, but in no event shall a decrease have the effect of shortening the term of an incumbent Director, or decreasing the total number of Directors to less than three Directors. Until the first meeting for electing the Directors occurs, the initial Board of Directors shall consist of the persons listed in the Articles of Incorporation as constituting the initial Board.

(4) Term of Directors

[Insert terms of Directors here. The following two options clarify whether the directors have term limits: one option provides for term limits and the option provides for no term limits]:

[Term limits:] Directors shall serve terms of *[enter # here]* years. A Director may succeed himself for only one consecutive term. After serving two consecutive terms, a Director must vacate his position for at least one year before seeking re-election to another term.

[No term limits:] There are no term limits and, therefore, Directors may serve any number of consecutive terms.

(5) Election of Directors

Elections for Directors filling expired terms shall be held at the last meeting of the fiscal year. Any directorship to be filled by reason of an increase in the number of Directors shall be filled at the next regular meeting of the Board of Directors or at a special meeting called for that purpose. When a re-appointment or replacement is made, the re-appointment or replacement shall be considered effective on the date that the prior term expired (i.e., the new term does not begin on the date of the election). Board members whose terms have expired may continue serving until they are either re-appointed or until their successors are chosen.

(6) Staggered Terms (optional)

There shall be staggered terms of office for Directors so that one-third of the directorships shall be up for election each year (or if the number does not evenly divide by thirds, the board shall be divided as close to thirds a possible). The system for staggered terms of office shall be implemented as follows: At the meeting of the Board of Directors at which these bylaws are adopted there shall be a drawing in order to determine the initial terms of the Directors. *[The following clause is for boards with five original members—adjust accordingly for boards with more members]*. After the drawing, one board member shall have an initial term of one year, two board members shall have terms of two years, and two board members shall have terms of three years. The minutes of this board meeting shall show the results of the drawing. *[Add, if term limits:]* Initial directors serving less than a full three-year term as their initial term (i.e., directors who draw a one-year term or two-year term), shall be considered to have served a full three-year term for purposes of the limits on more than two successive terms.

(7) Resignation

Any Director may resign at any time by delivering written notice to the Secretary or President of the

Board of Directors. Such resignation shall take effect upon receipt or, if later, at the time specified in the notice.

(8) Removal

Any Director may be removed without cause, at any time, by a majority of the entire Board of Directors, at a Regular or Special Meeting called for that purpose. Any Director under consideration of removal must first be notified about the consideration by written notice at least five days prior to the meeting at which the vote takes place.

(9) Vacancies

Vacancies shall be filled by majority vote of the remaining members of the Board of Directors, though less than a quorum, and the Director filling the vacancy shall serve for the remainder of the term of the directorship that was vacated. Vacancies shall be filled as soon as practical. Any Director may make nominations to fill vacant directorships.

(10) Compensation

Directors shall not receive any salaries or other compensation for their services, but, by resolution of the Board of Directors, may be reimbursed for any actual expenses incurred in the performance of their duties for the Corporation, as long as a majority of disinterested Board of Directors approve the reimbursement. The Corporation shall not loan money or property to, or guarantee the obligation of, any Director.

ARTICLE IV **Committees**

(1) Executive Committee

The President, Vice President, Treasurer, and Secretary of the Corporation shall constitute the executive committee. The executive committee shall have the authority to act on behalf of the Corporation in between Regular Meetings of the Board of Directors. The Board of Directors must validate the actions of the executive committee at its next Regular or Special Meeting. Any such action not so validated will not be legally binding on the Corporation. The President shall act as chairperson of the executive committee. A majority of the Executive Committee shall constitute a quorum for the transaction of business, and all decisions shall be by majority vote of those present.

(2) Standing Committees *[Optional]*

The Corporation shall have three standing committees which shall assist the Board of Directors in carrying out the management of the Corporation: The Finance and Resource Management Committee, the Development Committee, and the Program Committee. The Board of Directors shall appoint the members of each committee. Each standing committee shall have at least three Directors as members, and the Directors must comprise a majority of the committee membership. Employees of the Corporation and members of the community may also be appointed to serve as committee members. Committees shall meet upon call of the Board of Directors or the chair of the Committee, review the activities of the Corporation in the Committee's respective areas, and make recommendations to the Board of Directors for the Board's final approval. The Treasurer of the Corporation shall serve as the Chair of the Finance and Resource Management Committee. Other standing committees shall elect a Chair by a majority vote. The Chair of each committee shall

ensure that minutes of the committee meetings are taken and present a copy of the minutes to the Secretary within the two weeks following the meeting. Committee meetings shall be open to all members of the Board of Directors.

- (a) The Finance and Resource Management Committee shall assist the Executive Director in preparing and presenting the annual budget to the Board of Directors, make necessary investment choices, and generally protect the soundness of the corporation's finances and fiscal operations.
- (b) The Development Committee shall be responsible for fundraising and capital campaigns, public relations, maintaining the visibility of the corporation, and governmental relations.
- (c) The Program Committee shall be responsible for planning, developing, and evaluating the Corporation's programs.

(3) Additional Committees

The Board of Directors may from time to time designate and appoint additional standing or temporary committees by majority vote of the Board of Directors. Such committees shall have and exercise such prescribed authority as is designated by the Board of Directors. The Directors may authorize these committees to exercise any powers, responsibilities, and duties consistent with the Articles of Incorporation and these bylaws.

ARTICLE V
Code of Ethics

The corporation and its Directors and Employees will comply with the Corporation's Code of Ethics, attached as Exhibit A.

ARTICLE VI
Board Meetings

(1) Place of Board Meetings

Regular and Special Meetings of the Board of Directors will be held at *[enter location here]* or at any other place that the President may designate *[optional:]* within the city limits of *[enter city's name here]*.

(2) Regular and Special Meetings

Regular meetings of the Board of Directors shall be held each month, or more frequently as deemed necessary by the Board of Directors. Special Meetings may be called by the President or any three Directors. An orientation meeting will be held each year for the new members of the Board of Directors.

(3) Notice of Board Meetings

Notice of the date, time, and place of Regular Meetings shall be given to each board member by regular mail, telephone (including voice mail), facsimile, or e-mail no less than *[enter # here]* days notice prior to the meeting. Notice of the date, time, and place of special meetings shall be given to each board member using the same methods, but with no less than *[enter # here]* days notice prior to the meeting, with the exception of special meetings held to amend the Articles of Incorporation or bylaws, for which a *[enter # here]*-day written notice by mail or facsimile shall be

required specifying the proposed amendment.

(4) Waiver of Notice

Attendance by a Director at any meeting of the Board of Directors for which the Director did not receive the required notice will constitute a waiver of notice of such meeting unless the Director objects at the beginning of the meeting to the transaction of business on the grounds that the meeting was not lawfully called or convened.

(5) Quorum

A majority of the incumbent Directors (not counting vacancies) shall constitute a quorum for the purposes of convening a meeting or conducting business. At Board meetings where a quorum is present, a majority vote of the Directors attending shall constitute an act of the Board unless a greater number is required by the Articles of Incorporation or by any provision of these bylaws.

(6) Actions without a Meeting

Any action required or permitted to be taken by the Board of Directors under the Texas Non-Profit Corporation Act, the Articles of Incorporation, and these bylaws may be taken without a meeting, if [*enter either "all" or "a majority of"*] Directors individually and collectively consent in writing, setting forth the action to be taken. Such written consent shall have the same force and effect as a unanimous vote of the Board.

(7) Open Meetings

Meetings shall be open to the general public, except when personnel, real estate, or litigation matters are being discussed.

(8) Proxy Voting Prohibited

Proxy voting is not permitted.

ARTICLE VII

Officers

(1) Roster of Officers

The Corporation shall have a President, Vice President, Secretary, and Treasurer. The Corporation may have, at the discretion of the Board of Directors, such other officers as may be appointed by the Directors. One person may hold two or more offices, except those serving as President or Secretary.

(2) Election and Removal of Officers

All officers shall serve one-year terms. The election shall be conducted at the Board of Directors' first meeting of the fiscal year and following the election of the new Board of Directors filling expired terms, or as soon as practical thereafter. Officers shall remain in office until their successors have been selected. Officers may serve consecutive terms without limit. The election of officers shall be by majority vote of the Board of Directors attending the meeting.

(3) Vacancies

If a vacancy occurs during the term of office for any elected officer, the Board of Directors shall elect a new officer to fill the remainder of the term as soon as practical, by majority vote of Directors present.

(4) President

- The President will supervise and control the affairs of the Corporation and shall exercise such supervisory powers as may be given her by the Board of Directors.
- The President will perform all duties incident to such office and such other duties as may be provided in these bylaws or as may be prescribed from time to time by the Board of Directors. The President shall preside at all board meetings and shall exercise parliamentary control in accordance with Roberts Rules of Order.
- The President shall serve as an ex-officio member of all standing committees, unless otherwise provided by the Board of Directors or these bylaws.
- The President shall, with the advice of the Board of Directors and in accordance with the requirements of these bylaws, set the agenda for each meeting of the Board of Directors.

(5) Vice President

- The Vice President shall act in place of the President in the event of the President's absence, inability, or refusal to act, and shall exercise and discharge such other duties as may be required by the board.
- The Vice President shall serve as the parliamentarian and interpret any ambiguities of the bylaws.

(6) Secretary

- The Secretary will perform all duties incident to the office of Secretary and such other duties as may be required by law, by the Articles of Incorporation, or by these bylaws.
- The Secretary shall attest to and keep the bylaws and other legal records of the Corporation, or copies thereof, at the principal office of the Corporation.
- The Secretary shall take or ensure that someone takes minutes of all meetings of the committees and Board of Directors, and shall keep copies of all minutes at the principal office of the Corporation.
- The Secretary shall keep a record of the names and addresses of the Directors at the principal office of the Corporation.
- The Secretary shall, with the approval of the Board of Directors, set up procedures for any elections held by the Corporation. The Secretary shall keep a record of all votes cast in such elections.
- The Secretary shall ensure that all records of the Corporation, minutes of all official meetings, and records of all votes, are made available for inspection by any member of the Board of Directors at the principal office of the Corporation during regular business hours.
- The Secretary shall see that all notices are duly given in accordance with these bylaws or as required by law.
- The Secretary shall see that all books, reports, statements, certificates, and other documents and records of the Corporation are properly kept and filed.
- In the case of the absence or disability of the Secretary, or the Secretary's refusal or neglect to fulfill the duties of Secretary, the Vice President shall perform the functions of the Secretary.

(7) Treasurer

- The Treasurer will have charge and custody of all funds of the Corporation, will oversee and supervise the financial business of the Corporation, will render reports and accountings to the Directors as required by the Board of Directors, and will perform in general all duties incident to the office of Treasurer and such other duties as may be required by law, by the Articles of Incorporation, or by these bylaws, or which may be assigned from time to time by the Board of Directors.
- The Treasurer shall give to the Corporation a bond with one or more sureties for the faithful performance of the duties of the office and for the restoration to the Corporation—in the case of his or her death, resignation, retirement, or removal from office—all books, papers, vouchers, money, and other property of whatever kind in his or her possession or under his control belonging to the Corporation. The amount of the bond shall be determined by the Board of Directors.
- The Treasurer and the staff of the Corporation shall devise a plan providing for the acceptance and disbursement of all funds of the Corporation which shall be approved by the Board of Directors.
- The Treasurer, with the approval of the Board of Directors, shall set up all checking, savings, and investment accounts of the Corporation and deposit all such funds in the name of the Corporation in such accounts.
- The Treasurer's signature shall be the authorized signature for all checking, savings, and investment accounts of the Corporation unless the Treasurer, with the approval of the Board of Directors, designates another member of the Board of Directors or employee of the Corporation as the authorized signatory for a particular type of disbursement.
- The Treasurer shall prepare a monthly report for the Board of Directors, providing an accounting of all transactions and of the financial conditions of the Corporation.
- The Treasurer shall keep all financing records, books, and annual reports of the financial activities of the Corporation at the principal office of the Corporation and make them available at the request of any Director or member of the public during regular business hours for inspection and copying.

ARTICLE VIII**Members**

[The following is a form clause for a corporation with members. If the corporation does not have members, this clause should be deleted. This Article is for a corporation that has members with limited voting rights. A corporation may choose to provide its members with broader voting rights, in which case the following article needs to be redrafted accordingly. State law has very specific provisions regarding the rights of members. Before drafting or revising bylaws, a corporation with members should review these provisions to make sure it is in compliance with the law].

(1) Eligibility

[enter eligibility guidelines here]

[Example:] All residents of the ABC Neighborhood who are eighteen years of age or older are eligible for membership in the Corporation.

(2) Rights of Members

Each member of the Corporation shall be entitled to one vote on each matter submitted by the Board of Directors to a vote at a Regular or Special Membership meeting, except to the extent that the voting rights are limited or denied by the Articles of Incorporation. No member shall be entitled to any dividend or any part of the income of the Corporation or to share in the distribution of the corporate assets upon dissolution. The Board of Directors has the discretion to decide which, if any, matters shall be submitted to the members for a vote, except that the following decisions will always be submitted to the membership for a vote: dissolution of the corporation, merger or consolidation with another corporation, sale of substantially all the corporation's assets, and most amendments to the corporation's articles of incorporation. *[Under Texas law, the above items must be submitted to members for a vote, except that some minor amendments to the articles of incorporation do not require a vote by the members. See the Texas Non-Profit Corporation Act for more information].*

(3) How the Membership can Legally Act

The membership may act only at a properly called meeting of the membership where a quorum is present. At such a meeting, a vote of a majority of the members in attendance shall be an act of the membership, except that a two-thirds majority of the members in attendance shall be required for the following: dissolution of the corporation, merger or consolidation with another corporation, sale of substantially all the corporation's assets, and most amendments to the corporation's articles of incorporation *[state law requires two-thirds vote for these items unless the percent is changed in the articles of incorporation]*. The attendance of *[enter # or percent here]* members shall constitute a quorum for the conduct of business at either a Regular or Special Membership Meeting.

(4) Regular Membership Meetings

The Membership shall meet at least once a year during the month of *[insert month here]*, at a time designated by the Board of Directors, for the purpose of transacting any business that the Board of Directors may submit to the members. Regular Membership Meetings shall take place at *[enter location here; meetings must be held at the registered office of the corporation or the location listed in the bylaws]*.

(5) Notice of Regular Membership Meetings

Written notice of the Regular Membership Meeting shall be given not less than 10 calendar days nor more than 60 calendar days before the date that such a meeting is to be held *[can change the notice period, but under Texas law, notice cannot be less than 10 days nor more than 60 days]*. Such written notice shall be delivered by mail, in person, or by facsimile, and shall state the place, day, and time of the meeting. The Board of Directors, in the alternative, may provide notice through other means such as by posting notice in a conspicuous place at the principal office of the Corporation, newsletter, newspaper, church bulletins, or such additional means as the Board of Directors shall deem effective.

(6) Special Membership Meetings

Special Membership Meetings may be called at any time by the President, by a majority of the Board of Directors, or on written request of *[enter # or % here]* members.

(7) **Notice of Special Meetings**

Notice of Special Membership Meetings shall be given in the exact same manner as notice for the Annual Membership Meeting as provided for above, except that the notice shall contain the purpose for which the meeting is called.

(8) **Enrollment of Members**

The Board of Directors shall adopt a membership application form. The application form shall require the name, address, and telephone number of each applicant. There shall be a space for the secretary to sign certifying that the secretary believes the applicant to be eligible for membership. The applicant becomes a member upon the secretary's signature of the application form. The secretary shall keep an up-to-date membership list.

ARTICLE IX

Rules of Procedure

The proceedings and business of the Board of Directors shall be governed by Robert's Rules of Parliamentary Procedure unless otherwise provided herein.

ARTICLE X

Executive Director

The Board of Directors may, upon resolution, appoint an Executive Director to serve at the board's discretion and to carry out whatever tasks the board from time to time resolves. The Executive Director shall be paid an annual salary set by the Board of Directors. Subject to such supervisory powers as are vested in the Board of Directors, the Executive Director shall supervise, direct, and control the business of the Corporation and actively manage its business, and shall have such other powers and duties as may be prescribed by the Board of Directors or by these bylaws.

The Executive Director may engage in negotiations involving commitments of the resources of the Corporation or the acceptance of money or resources by the Corporation in furtherance of the purposes of the Corporation as set out in the Articles of Incorporation and these bylaws. The Executive Director shall generally be expected to attend all meetings of the Board of Directors and meetings of the general membership.

ARTICLE XI

Indemnification [Optional]

(1) **Insurance**

The Corporation will provide indemnification insurance for its Board members, and the Board shall select the amount and limits of such insurance policy.

(2) **Indemnification**

To the extent permitted by law, any person (and the heirs, executors, and administrators of such person) made or threatened to be made a party to any action, suit, or proceeding by reason of the fact that he is or was a Director or Officer of the Corporation shall be indemnified by the

Corporation against any and all liability and the reasonable expenses, including attorney's fees and disbursements, incurred by him (or by his heirs, executors or administrators) in connection with the defense or settlement of such action, suit, or proceeding, or in connection with any appearance therein.

(3) Limits on Indemnification

Notwithstanding the above, the corporation will indemnify a person only if he acted in good faith and reasonably believed that his conduct was in the corporation's best interests. In the case of a criminal proceeding, the person may be indemnified only if he had no reasonable cause to believe his conduct was unlawful.

ARTICLE XII

Operations

(1) Execution of Documents

Unless specifically authorized by the Board of Directors or as otherwise required by law, all final contracts, deeds, conveyances, leases, promissory notes, or legal written instruments executed in the name of and on behalf of the Corporation shall be signed and executed by the Executive Director and the President (or such other person designated by the Board of Directors), pursuant to the general authorization of the Board. All conveyances of land by deed shall be signed by the President or two other members of Executive Committee and must be approved by a resolution of the Board of Directors.

(2) Disbursement of Funds

Financial Transactions which have a value of *[insert value here]* or more shall require majority approval of the Board of Directors or Executive Committee if a majority of the Board of Directors is not immediately available to vote on the transaction. In all other transactions, the Executive Director may dispense with the funds of the Corporation in accordance with the annual budget approved by the Board of Directors and the purposes of the Corporation as set out in the Articles of Incorporation and these bylaws. Notwithstanding the above, all checks of more than *[enter value here]* disbursing funds from any of the Corporation's accounts shall require the signatures of at least two of the following: the Executive Director, President, Vice President, Secretary, or Treasurer.

(3) Procurement Policy

The Corporation shall abide by its procurement policy, set forth in Exhibit B.

(4) Records

The Corporation will keep correct and complete records of account and will also keep minutes of the proceedings of the Board meetings and Committees. The Corporation will keep at its principal place of business the original or a copy of its bylaws, including amendments to date certified by the Secretary of the Corporation *[add if members: and a membership roster giving the names and addresses of members.]*.

(5) Inspection of Books and Records

All books and records of this Corporation may be inspected by any Director for any purpose at any reasonable time on written demand.

(6) Loans to Management

The Corporation will make no loans to any of its Directors or Officers.

(7) Amendments

The Board of Directors may adopt Articles of Amendment (amending the Articles of Incorporation) by a vote of two-thirds of Directors present at a meeting where a quorum is present. *[If Members, Members must vote on most amendments to the Articles of Incorporation]*. The bylaws may be amended at any time by a vote of the majority of Directors at a meeting where a quorum is present.

(8) Fiscal Year

The fiscal year for the Corporation will be *[enter fiscal year here, e.g., "the calendar year, January 1 to December 31"]*.

(9) Audit

The Corporation shall have an annual audit to be completed by *[enter date here]* of each year for the previous fiscal year.

CERTIFICATION

I hereby certify that these bylaws were adopted by the Board of Directors of the *[insert name of corporation here]* at its meeting held on *[enter date here]*.

Secretary



SECTION: THREE

Minutes and Agendas

Overview

A nonprofit organization must keep correct and complete records of the actions of its governing board and committees at its principal or registered office. The records should be kept for a minimum of three years after the end of the fiscal year. Minutes of board meetings and committees should be kept in this notebook or another corporate record book.

Sample Minutes of the Board of Directors of ABC Corporation

I. Date of Meeting:

II. Place: [Insert location of meeting], Texas

III. Attendance and Quorum

The following directors were present at the meeting, and their attendance constitutes a quorum:

Also present were: [Insert names of others present at meeting and titles, if any].

IV. Business

[Insert here a record of matters discussed at the meeting. For any votes taken on matters, insert the names of persons voting for and against the transaction.]

V. Adjournment

On a motion duly made by _____ and seconded by _____, the meeting was adjourned. The next meeting will be called by the Chair in accordance with the bylaws.

Secretary

VI. Approval of Minutes

The above minutes were approved by a majority of board members at a board meeting held on _____, at which a quorum was present.

Secretary

Sample Agenda of the Board of Director's Meeting

Date: _____

Place: _____

- I. Call to Order
- II. Introductions of Any New Board Members
- III. Roll Call (*note whether a quorum is present*)
- IV. Approval of Minutes
(*This process is followed for all votes or resolutions*)
 - a. Chair asks for motion and second
 - b. Chair asks for discussion and calls the vote
 - c. Chair notes the result of the vote
- V. Treasurer's Report
- VI. Committee Reports
- VI. Executive Director Report
- VII. Old Business
- VIII. New Business
- IX. Final Announcements/Adjournment



SECTION: FOUR

Corporate Resolutions

Corporate Resolutions

Overview

State law requires the board of directors to adopt a corporate resolution to take certain actions. Additionally, a nonprofit often needs a certificate of a corporate resolution as proof that the board of directors has authorized a particular action on behalf of an employee or officer of the nonprofit. Certain types of corporate resolutions require a notary public to witness the signing of the certificate. Check with the person requiring the certificate to see whether this is required.

The following are actions that must be documented by a certificate of corporate resolution:

- ◆ Approving the conveyance of land;
- ◆ Approving a voluntary dissolution of the organization; and
- ◆ Revoking a voluntary dissolution of the organization.

The following are actions that must be documented by a certificate of corporate resolution if the nonprofit has members:

- ◆ Calling a vote of members on a proposed amendment to the articles of incorporation or restated articles of incorporation;
- ◆ Calling a vote on a recommended plan for the distribution of assets;
- ◆ Authorizing any pledge, mortgage, deed of trust, or trust indenture;
- ◆ Approving the sale, lease, or exchange of assets (unless insolvent); and
- ◆ Approving a merger or consolidation.

The following are other actions that should be documented by a certificate of corporate resolution:

- ◆ Designating check signers;
- ◆ Approving corporate borrowing;
- ◆ Investing corporate funds; and
- ◆ Opening a checking account.

Sample Corporate Resolutions

SAMPLE CERTIFICATE OF CORPORATE RESOLUTION TO BORROW MONIES AND PLEDGE PROPERTY AS COLLATERAL

Date: August __, 1974
 Corporation: ABC Nonprofit Organization
 President: Richard Nixon
 Vice-President: Gerald Ford
 Secretary: Henry Kissinger
 Treasurer: John Connally
 Date of Meeting of Board of Directors: August 9, 1974

We, the President and the Secretary of the Corporation, certify the following facts:

1. ABC Nonprofit Organization is a Texas non-profit corporation, is organized and operating under the laws of Texas, is qualified to do business here, and is in good standing.
2. No proceedings for forfeiture of the certificate of incorporation or for voluntary or involuntary dissolution of the corporation are pending.
3. Neither the articles of incorporation nor bylaws of the corporation limit the power of the Board of Directors to pass the resolutions below.
4. The President, Secretary, and (other corporate officers) are the persons authorized to adopt and sign this resolution.
5. The Secretary keeps the records and minutes of the proceedings of the Board of Directors of the Corporation, and the resolutions below are an accurate reproduction of the ones made in those proceedings: they have not been altered, amended, rescinded, or repealed, and are now in effect.
6. The resolutions below were legally adopted on the above-referenced date of the meeting of the Board of Directors, which was called and held in accordance with the law and the bylaws of the Corporation, and at which a quorum was present.
7. The following resolutions have been legally adopted by the Board of Directors:

RESOLVED, that the Corporation authorizes its president, Richard Nixon, and vice-president, Gerald Ford, to enter into a loan agreement in the amount of \$____, at an annual interest rate of ___ percent, for a period of __ months from the date of settlement with _____ Bank to develop for placement and sale of ___ housing units for low-income home buyers. They are hereby, authorized, empowered, and directed to execute, acknowledge, and deliver for and on behalf and in the name of the Corporation such deeds, assignments, bills of sale, promissory notes, deeds of trust, financing statements, security agreements, guaranties, and instruments, containing such other terms and conditions which the President, or the Vice-President of the Corporation may, in accordance with the above terms, in each of his sole discretion, deem necessary or desirable, his approval thereof to be conclusively presumed by his execution thereof (except that only those properties listed below may be encumbered in this transaction). The attestation by the Secretary of the Corporation and the affixation of the seal of the Corporation shall not

be necessary;

RESOLVED, that the President and Vice-President of the Corporation be, and is hereby specifically authorized, to execute real estate lien notes and deeds of trust to secure the lien notes on those certain real properties situated in ___ County, Texas, described below:

[Enter Property Description Here]

RESOLVED, that the Board of Directors of the Corporation finds that these authorized transactions shall directly or indirectly benefit the Corporation;

RESOLVED, that the foregoing powers and authority shall continue in full force and effect until written notice of revocation has been given by the Corporation to the Lender, and the Lender's written acknowledgment of receipt is obtained.

- 8. The following individuals are duly elected officers of the Corporation holding the offices set forth opposite their respective names, as of the date hereof; the signatures set opposite the respective names and titles of the officers are their true, authentic signatures; and the Corporation does not have a seal.

NAME	TITLE	SIGNATURE
Richard Nixon	President	_____
Gerald Ford	Vice-President	_____
Henry Kissinger	Secretary	_____

IN WITNESS WHEREOF, I have duly executed this Certificate of Corporate Resolution this _____ day of _____, 1974.

Henry Kissinger, Secretary

I, Richard Nixon, President of the Corporation, do hereby certify that Henry Kissinger is the duly elected Secretary of the Corporation. I also certify that the signatures set forth above are the correct signatures of the persons therein designated. I further certify that I have executed this resolution for the purpose stated herein for and on behalf of the Corporation.

IN WITNESS WHEREOF, I have duly executed this Certificate this _____ day of _____, 1974.

Richard Nixon, President

STATE OF TEXAS
COUNTY OF _____

This instrument was acknowledged before me on the _____ day of _____, 1974, by Richard Nixon, President of the Corporation, on behalf of the Corporation.

Notary Public, State of Texas

**SAMPLE
RESOLUTION OF THE BOARD OF DIRECTORS OF ABC CORPORATION
TO CERTIFY GROSS RECEIPTS**

WHEREAS, ABC Corporation, a Texas nonprofit corporation, is applying to the Federal Home Loan Bank of Dallas for support under the Partnership Grant Program;

BE IT RESOLVED, that the Board of Directors of ABC Corporation certifies that the gross receipts of ABC Corporation are less than \$25,000 and that ABC Corporation is not required to file a Form 990.

Signed and dated by the President of the ABC Corporation's Board of Directors on this the ____ day of _____, 2002.

June Smith, President
ABC Corporation

Date

Witness

**SAMPLE
RESOLUTION OF THE BOARD OF DIRECTORS OF ABC CORPORATION
IN SUPPORT OF GRANT APPLICATION**

WHEREAS, the need for affordable housing in the city is documented through the Affordable Housing Study;

WHEREAS, ABC Corporation, a Texas nonprofit corporation, is committed to building its capacity to provide affordable housing and community development programs to the ABC Neighborhood as documented by the ABC Neighborhood Plan and the mission and bylaws of ABC Corporation;

BE IT RESOLVED, that the Board of Directors of ABC Corporation hereby grants authorization for its Executive Director to apply for the Federal Home Loan Bank Partnership Grant through Texas Bank. The Board affirms that ABC Corporation was approved as a 501(c)(3) tax exempt organization on October 1, 1998, began operations on January 1, 1999, and has been in operation less than 60 months as of July 15, 2002. The board further affirms that the operating budget for the calendar year ending December 31, 2002 will be at or below \$200,000.

BE IT FURTHER RESOLVED, that the Executive Director of ABC Corporation is hereby authorized to furnish Texas Bank and the Federal Home Loan Bank with a copy of our most recent completed IRS Form 990 and current audited financial statements.

Signed and dated by the President of the ABC Corporation's Board of Directors on this the ____ day of _____, 2002.

June Smith, President
ABC Corporation

Date

Witness



SECTION: FIVE

Conflict of Interest and Procurement Policies

Conflicts of Interest

When a director assumes office, the law requires that the best interest of the corporation prevail over the director's personal or business interests. A conflict of interest can arise in many situations including leasing property, buying goods and services, and borrowing or lending money. Conflicts can also arise with employees and family members of directors. Conflicts of interest have both legal consequences and public perception consequences. Nonprofits should adopt policies and procedures to ensure that those with decision-making power in the organization do not take actions that could benefit themselves, their families, or their business interests. For a sample conflicts of interests policy, see below.

Prohibited Transactions

- **Loans to directors.** There is an absolute prohibition on paying dividends or lending the money of a nonprofit to a director. Directors who allow the making of a loan to a co-director will be personally liable for the full amount of the loan until it is repaid.
- **Private inurement.** There is also an absolute prohibition against "private inurement." In order for a corporation to be recognized as a public charity by the IRS, no part of the net earnings of the corporation may inure to the benefit of a private individual. Private benefits may occur when the nonprofit pays more for goods and services than they are worth. Violations of this restriction may result in severe penalties and substantial legal problems for the nonprofit and directors approving the transaction.

Permitted Transactions

- **Reasonable compensation for services.** A nonprofit may pay reasonable compensation to a director for services the director provides on behalf of the nonprofit. The key qualification is "reasonable," which will be determined by the IRS, the Attorney General, donors, and the public on the basis of all the facts and circumstances of the situation.
- **Interested director transactions.** Texas law permits transactions with directors under certain circumstances. The three things to remember with regard to an interested director transaction are:
 - Disclose material facts;
 - Ensure that the transaction is fair to the nonprofit; and
 - Document the decision-making process.

The material facts of the director's interest in the transaction should be disclosed to the board before a vote on the transaction, and a majority of disinterested directors should

approve the transaction in good faith and with ordinary care. A transaction may be approved only if it is fair to the nonprofit when it is authorized. Any transaction with an interested director should be carefully documented in the minutes of a meeting at which the transaction is considered.

Sample Minutes for an Interested Director Transaction

"A motion was made by Richard Nixon to rent an office from ABC Leasing. Board member, Spiro Agnew, stated that he owned the building in which the office was located. The board compared the rental rates with other comparable offices and determined that the rent was lower than other similar spaces. A second to the motion was made by Gerald Ford. The vote to approve the lease was 6-0 and Spiro Agnew did not participate in the vote."

Sample Conflicts of Interest Policy

I. Purpose

It is imperative to the success of the Corporation that there be a fully informed and responsive Executive Committee and Board. To accomplish this end, all Board members shall conduct themselves at all times in the best interest of the Corporation. In this regard, each Board member shall abide by the following "Code of Ethics." While no code or set of rules can be framed which will particularize all the duties of a Board member, the following code of ethics shall serve as a general guide.

II. Code of Ethics

It is imperative to the success of the Corporation that there be a fully informed, responsive, and reasonable Executive Committee and Board. To accomplish this end, all Board members shall conduct themselves at all times in the best interest of the Corporation. In this regard, each Board member shall abide by the following "Code of Ethics." While no code or set of rules can be framed which will particularize all the duties of a Board member, the following code of ethics shall serve as a general guide. The enumeration of particular duties should not be construed as a denial of the existence of others equally imperative, though not specifically mentioned.

III. Conflicts of Interest

- A. **Financial Interests.** Each Director, Officer, and committee member shall fully disclose any and all financial interests involving themselves or one of their family members in regard to any matter which is presented to the Board or a committee for a vote and shall abstain from voting on such matters. "Financial interests" include, but are not limited to:
1. An ownership, investment interest, or compensation arrangement with any entity with which the Corporation has a transaction or arrangement;
 2. A compensation arrangement with the Corporation or with any entity or individual with which the Corporation has a transaction or arrangement; or
 3. A potential ownership, investment interest, or compensation arrangement with any entity or individual with which the Corporation is negotiating a transaction or arrangement, including a commission or fee, share of the proceeds, the prospect of promotion or profit, or any other form of financial reward.
- B. **Family Relationships.** The term "family member" as used herein includes: parents, in-laws, children, siblings, spouses, aunts, uncles, nieces, and nephews.
- C. **Duty to Disclose.** In connection with the actual or potential conflict of interest, an interested person must disclose the existence of his financial interest and all material facts to the Directors and members of committees with board-delegated powers considering the proposed transaction or arrangement.
- D. **Determining Whether a Conflict if Interest Exists.** After disclosure of the financial interest and all material facts, and after any discussion with the interested person, the interested party shall leave the board or committee meeting while the determination of a conflict of interest is discussed and voted upon. The remaining board or committee members shall decide if a conflict of interest exists.

E. Procedures for Addressing the Conflict of Interest

1. An interested person may make a presentation at the board or committee meeting, but after such presentation, he shall leave the meeting during the discussion of, and the vote on, the transaction or arrangement that results in the conflict of interest.
2. The President or Chair of a committee shall, if appropriate, appoint a disinterested person or committee to investigate alternatives to the proposed transaction or arrangement.
3. After exercising due diligence, the board or committee shall determine whether the Corporation can obtain a more advantageous transaction or arrangement with reasonable efforts from a person or entity that would not give rise to a conflict of interest.
4. If a more advantageous transaction or arrangement is not reasonably attainable under circumstances that would not give rise to a conflict of interest, the board or committee shall determine by a majority vote of the disinterested Directors whether the transaction or arrangement is in the Corporation's best interest and for its own benefit and whether the transaction is fair and reasonable to the Corporation. The Corporation shall make its decision as to whether to enter into transaction or arrangement in conformity with such determination.

F. Violations of the Conflict of Interest Policy

1. If the board or committee has reasonable cause to believe that a person has failed to disclose actual or possible conflicts of interest, it shall inform the person of the basis for such belief and afford the member an opportunity to explain the alleged failure to disclose.
2. If, after hearing the response of the person and making such further investigation as may be warranted in the circumstances, the board or committee determines that the person has in fact failed to disclose an actual or possible conflict of interest, it shall take appropriate disciplinary and corrective action.

G. Recordings and Proceedings. The minutes of the board and committees with board-delegated powers shall contain:

1. The names of the persons who disclosed or otherwise were found to have a financial interest in connection with an actual or possible conflict of interest, the nature of the financial interest, any action taken to determine whether a conflict of interest was present, and the board's or committee's decision as to whether a conflict of interest in fact existed; and
2. The names of the persons who were present for discussions and votes relating to the transaction or arrangement, the content of the discussion, including any alternatives to the proposed transaction or arrangement, and a record of any votes taken in connection therewith.

IV. Gifts

Directors and employees of the Corporation may not receive a gift, or a series of gifts, valued at more than \$25 from contractors or businesses who have performed services for the Corporation within the past 12 months without prior approval of a majority vote of disinterested Directors. Directors and employees of the Corporation shall also gain approval by majority vote of

disinterested Directors to personally employ contractors and businesses which have performed services for the Corporation within the past 12 months.

V. Additional Provisions

- A. Directors shall put forth their best effort to attend all meetings and constructively participate in the meetings.
- B. Directors shall be responsible for insuring that adequate and correct information is presented to their constituents and the public.
- C. Directors shall exercise good judgment in the control and use of confidential information that may from time to time come into their possession. No Director shall use confidential information gained by reason of being a member of the Board of Directors for personal gain to the detriment of the Corporation.
- D. Each Director shall serve as a public relations agent for the Corporation and therefore shall work diligently and properly to promote its goals and objectives while keeping abreast with its overall progress.
- E. Except for voting at properly called meetings of the Board of Directors, board members shall refrain from entering into the direct day-to-day administration of the program unless they are doing so upon express authority given to them by Resolution of the Board of Directors.
- F. The Executive Committee shall be charged with the responsibility of reviewing any allegations of Directors violating this code or acting in any way which is detrimental to the success of the Corporation and make recommendations to the full Board for final action.

VI. Annual Statement

Each Director, officer, and committee member with board-delegated powers shall annually sign a statement which affirms that such person:

- A. Has received a copy of the Code of Ethics/Conflicts of Interest policy;
- B. Has read and understands the policy;
- C. Has agreed to comply with the policy; and
- D. Understands that the Corporation is a charitable organization and that in order to maintain its federal tax exemption it must engage primarily in activities which accomplish one or more of its tax-exempt purposes.

Sample Procurement Policy

The following policies and procedures shall be followed when the nonprofit purchases equipment, materials, supplies, property, or services from an outside source.

A. General Policy

- ◆ **No Conflict of Interest.** All directors, employees, or agents who participate in the selection or acceptance of a contract for equipment, materials, supplies, or services must comply with the nonprofit's conflict of interest policy. No director, employee, or agent will participate in the selection or acceptance of a contract involving a conflict of interest without the approval of the board. "Conflict of interest" includes situations in which the employee, family member, or board member has a financial interest in the business or individual selected for the contract.
- ◆ **No Purchase of Items for Personal Use.** No director, employee, or agent who participates in the selection or acceptance of a contract for equipment, materials, supplies, or services shall use such items for personal use.
- ◆ **No Receipt of Gratuities.** No director, employee, or agent shall solicit or accept gratuities, favors, or anything of value from contractors, potential contractors, or parties to agreements with the nonprofit.
- ◆ **No Purchase of Items Not Approved in the Budget.** No director, employee, or agent shall solicit or accept any equipment, materials, supplies, or services that have not been approved by the Board of Directors in the annual budget without prior approval of the board.
- ◆ **Document Cost Analysis.** The nonprofit shall conduct a cost analysis and document the analysis in the procurement files in conjunction with every purchase. The procurement file should include a justification for the lack of competition if competitive bids or offers are not obtained.
- ◆ **Contract with Winning Bidder.** If a contract is competitively bid, the nonprofit will enter into a contract with the winning bidder that specifies the equipment, materials, supplies, property, or services to be purchased and the payment terms.
- ◆ **Evaluate Each Contractor.** The nonprofit will evaluate each contractor at the completion of each contract. The evaluation will be utilized to make decisions to award future contracts.

B. Acquisition Procedure

The nonprofit will conduct all procurement transactions in a manner that maximizes opportunities, increases quality, and reduces the cost of purchase. The nonprofit reserves the right to reject any bids or offers, if deemed to be in its best interest.

- ◆ **Pricing Procedures.** One of the following procurement procedures shall be utilized for all purchases of equipment, materials, supplies, property, or services involving federal funds or involving amounts over \$500:
 - **Open Market Inquiry.** The nonprofit will inquire in the open market to ensure an advantageous price and quality. The file shall document the inquiries made and offers received.
 - **Request for Competitive Quotes.** The nonprofit will request competitive quotes, orally or in writing, from at least three different sources. The file shall document each invitation made and offer received.
 - **Formal Proposal Procedure.** The nonprofit will solicit competitive responses through a formal bid procedure. Bids will remain sealed until the time designated in the proposal. All requests for proposals shall contain the phrase “Equal Opportunity Employer.”

- ◆ **Document Prices.** The nonprofit shall maintain files on all quotations solicited and offers or bids received and any criteria for selection. In all instances in which the lowest bid is not awarded in the contract, justification for the selection must be contained in the file.

- ◆ **Purchases over \$_____.** The Board of Directors must approve purchases over _____ [*enter amount here*].

- ◆ **Two Signatories on Checks.** There must be two approved signatories on all checks for purchases over \$_____ [*enter amount here*].

C. Property and Equipment Policy

When purchasing property (both real estate and equipment), the following procedures must be followed:

- ◆ **Title in the Name of the Nonprofit.** All property purchased belongs to the nonprofit and title vests with the nonprofit.

- ◆ **Property Inventory.** A list of all property owned by the nonprofit shall be kept showing the type of property, identification number, original cost, and depreciated

value. The inventory list must be completed at the time of purchase and annually at the end of the nonprofit's fiscal year.

- ◆ **Insurance Coverage.** The nonprofit will maintain insurance coverage for all property owned by the nonprofit and maintain documentation of each policy in a safe deposit box.

D. Additional Policies When Using Federal Funds to Purchase

- ◆ **Federal Debarment.** Before purchasing goods using federal funds, the nonprofit must review the Federal Government's General Services Administration's "List of Parties Excluded from Federal Procurement of Non-Procurement Programs" and document that the bidder is neither debarred or suspended from doing business with the federal government nor delinquent in a debt to the United States as defined in OMB Circular A 1-29.
- ◆ **Property of Federal Government.** Equipment purchased with federal funds that costs more than \$5,000 is generally considered the property of the federal government and must be disposed of through the applicable federal procedure.
- ◆ **Expanded restrictions on conflicts of interest.** Because specific federal programs, such as the HOME program, require approval from the federal government before engaging in a transaction in which a conflict of interest exists, the nonprofit shall check with the relevant federal agency before engaging in a transaction with a conflict of interest.



SECTION: SIX

Federal Tax Matters

IRS 501(c)(3) Application and Exemption Letter

The Application

After a nonprofit receives its IRS tax exemption letter from the IRS, the board's interest in the exemption application (Form 1023) often disappears. After a few years, many nonprofits have no idea where the application is located. Nonprofits must maintain a copy of the application in an accessible location because federal law requires nonprofits to make the application available for public inspection. For more information, see this Section on public disclosure requirements.

Nonprofits should review the application annually to verify whether the activities and mission of the organization match the representations made to the IRS in the application. Material changes to these items and other corporate changes must be reported to the IRS and included as attachments to the annual Form 990 filing. Questions about changes to the nonprofit's operations should be directed to: IRS Exempt Organizations, 1100 Commerce Street, Dallas, Texas 75242, (214) 767-1490 or (877) 829-5500. For other questions about charitable organizations, see the IRS website and Publication 557 at www.irs.gov.

Advance Ruling on Public Charity Status

Start-up organizations often file their request for tax-exempt status from the IRS before the organizations have a record of their operations. These organizations may obtain an “advance ruling” from the IRS stating that their nonprofit organizations are public charities rather than private foundations. If an organization receives an advance ruling that it is a public charity, the IRS will re-evaluate the operations of the organization when the advance ruling expires.

A nonprofit must obtain a permanent ruling to continue operations as a public charity. Otherwise, upon the expiration of the advance ruling period, the nonprofit will be considered a private foundation. Donations and reporting requirements for differ from those of public charities.

The difference in qualifying as a public charity rather than a private foundation is based on the variety and percentage of sources of monetary support for the organization. Therefore, it is important that the organization keep careful records of all donations, including small ones, to substantiate its public charity status.

Expiration of Advance Ruling

The advance ruling covers the first five fiscal years of an organization. The expiration date should be included on the tax exemption letter sent by the IRS. The nonprofit should designate someone to monitor the expiration date. If a nonprofit cannot locate the expiration date, the following information can be utilized to determine the date:

- ◆ The first year begins on the date of incorporation—not the date the exemption was granted.
- ◆ The ruling expires at the end of five fiscal years after the date of incorporation.

Example: Date organization incorporated: March 15, 2002
 Fiscal year: October 1-September 30
 First fiscal year ends: September 30, 2002
 Advance ruling ends: September 30, 2006

Process to Obtain a Permanent Ruling on Public Charity Status

Within 90 days after the expiration of the advance ruling period, submit Form 8734 to the IRS, available on the IRS website at www.irs.ustreas.gov/forms_pubs/forms.html. Send the form to the IRS at PO Box 192, Covington, Kentucky 41012. The IRS will then send back a final letter ruling regarding public charity status.

Public Disclosure Requirements

A nonprofit is required to make certain types of information about the organization available to the public upon request. A nonprofit must make the information available during normal business hours. The information must be made available at the main office for the nonprofit, in addition to each office of the nonprofit with more than three paid employees on site, unless the nonprofit obtains an exemption from the IRS.

Types of information that must be disclosed

- ◆ IRS Form 1023 (the application for tax exempt status filed by 501(c)(3) organizations), in addition to any correspondence between the organization and the IRS relating to the application;
- ◆ IRS determination letter;
- ◆ IRS Form 990 or 990-EZ (annual returns), including all attachments and supporting documents (except 990-T for unrelated business income), for the past **3 years**; and
- ◆ **Under Texas Law:** Nonprofits must also make available to the public all records, books, and annual reports of the financial activity of the corporation. **Exception:** the names and addresses of contributors.

Methods of disclosure

- ◆ Allow public inspection in nonprofit's office; and
- ◆ Provide copies of documents upon request.

Time for complying with the document request

- ◆ If request is made in person, the nonprofit must comply the same day.
- ◆ If request is made by mail, the nonprofit must comply within 30 days of receiving the request.
- ◆ If request is made by mail and nonprofit charges for copies, the nonprofit must comply within 30 days of receiving payment.

Reasonable fee for copies

- ◆ A nonprofit may charge a reasonable fee for copies. The IRS considers reasonable to be:
 - \$1 for first page; and
 - \$.15 for each additional page.

Federal exemptions to access requirements

The nonprofit does not need to make the information available for inspection if:

- ◆ The IRS application, IRS determination letter, and the past three years of 990s are widely accessible. To be considered “widely accessible” each of the following must be met:
 - Nonprofit publishes the materials on the internet;
 - The information can be downloaded at no cost; and
 - The requestor is told the web site address where the information is located.
- ◆ The requestor is engaged in a harassment campaign.
 - A nonprofit can ignore multiple requests for the same information from the same person or address.
 - A nonprofit can apply to the IRS to investigate whether a harassment campaign is going on.

Texas exemptions to access requirements

The broader Texas law requiring disclosure of all the records, books, and annual reports of financial activity does not apply to:

- ◆ Nonprofits that:
 - solicit funds only from members; or
 - do not receive contributions outside of membership in excess of \$10,000 a year.
- ◆ Information regarding:
 - the names and addresses of contributors; or
 - the names and addresses of members.
- ◆ A few other exemptions may also be applicable which a nonprofit should confirm with legal counsel.

Penalties for failure to comply

- ◆ Federal law: \$20 per day per Form 990 return.
- ◆ Federal law: \$5,000 for willful failure to allow inspection or copies.
- ◆ Texas law: Class B misdemeanor.

Free Internet Disclosure

Guidestar offers free internet disclosure for charitable organizations to comply with the federal disclosure requirements. See www.guidestar.org.

Disclosure to Members

Membership organizations must make books and records of account available to members of the organization. The member must make the demand in writing and state the purpose of the demand. The member has the right to examine and copy the books and records at any reasonable time at the expense of the member.

Donations

Nonprofit organizations rely on the financial support and generosity of donors. Federal tax law imposes two primary requirements on organizations that receive charitable donations and on the taxpayers who make contributions:

Disclosure for some contributions over \$75

A charitable organization is required to provide a written disclosure to a donor who makes a contribution greater than \$75 and receives goods or services in exchange. The nonprofit must provide a good faith estimate of the value of goods or services provided to the donor.

- ◆ The disclosure must contain the following information:
 - amount of the contribution or description of a non-cash contribution;
 - whether any goods or services were provided in return for the donation; and
 - a good faith estimate of the value of the goods or services provided.
- ◆ **Example:** A donor makes a \$100 contribution to attend a dinner with a fair market value of \$25. The donor is entitled to deduct \$75.
- ◆ **Exception:** Token goods or services do not have to be described in a written disclosure. This exception applies in two situations:
 - the value of the goods is less than 2% of the amount of the donation; or
 - items that meet the following requirements: the donor gives at least \$38; the only goods provided in return are items inscribed with the nonprofit's logo; and the items cost less than \$7.60.

The dollar amount of token exceptions changes frequently. Contact the IRS Exempt Organizations Customer Account Services at (877) 829-5500 for updated information.

- ◆ **Exception:** Membership benefits received in exchange for annual dues do not have to be described in a written disclosure if:
 - the dues are \$75 or less;
 - the benefits consist of privileges such as free or discounted admissions to the nonprofit's events, discounts from purchases, or parking privileges.
- ◆ **Penalties:** A penalty of \$10 per contribution, not to exceed \$5,000 per fundraising event or mailing, is imposed on nonprofits that fail to meet the written disclosure requirement.

Written acknowledgment for donations of \$250 or more

A donor is responsible for obtaining a written acknowledgment from a nonprofit for any single contribution of \$250 or more in order to claim the donation as a deduction from federal income taxes. A donor must receive the acknowledgment by the earlier of: the date on which the donor actually files his individual federal income tax return for the year of the contribution; or the due date (including extensions) of the return. A nonprofit may provide either a separate acknowledgment for each contribution of \$250 or more or an annual summary of all contributions from the donor of \$250 or more. The acknowledgment should contain the following information:

- name of the nonprofit;
- amount of contribution or description of the non-cash contribution;
- whether any goods or services were provided in return for the contribution; and
- a good faith estimate of the goods or services provided in return.

Written acknowledgment for unreimbursed expenses of \$250 or more

If a donor incurs expenses in order to perform donated services for an organization, the donor must also obtain a written acknowledgment from the nonprofit in order to deduct the expenses on her tax return. This acknowledgment must also contain a description of the services provided by the donor.

- ◆ **Example:** A director purchases an airline ticket and spends the night at a hotel to attend the annual conference of community development corporations. The director makes a report at the next board meeting regarding funding opportunities, technical assistance, and ideas for new strategies that he learned at the conference. The ticket costs \$300 and the nonprofit does not reimburse the director. The nonprofit should give the director a written acknowledgment for the unreimbursed expenditures in order for the director to deduct the expenses on his personal income tax return.
- ◆ **Example of written acknowledgment with no return goods or services:**

Cash contribution. "Thank you for your contribution of \$300 to ABC Corporation received on October 16, 2001. No goods or services were provided in exchange for your contribution."

Non-cash contribution. "Thank you for your contribution of a used oak baby crib and matching dresser to ABC Corporation received on October 16, 2001. No goods or services were provided in exchange for your contribution."

- ◆ **Example of written acknowledgment with return goods or services.** "Thank you for your cash contribution of \$300 to ABC Corporation received on October 16, 2001. In exchange for your contribution, we gave you a book with an estimated fair market value of \$60."
- ◆ **Penalties:** Obtaining a written acknowledgment is the donor's burden. However, if a nonprofit does not provide the donor with a written acknowledgment, the donor may make contributions elsewhere.

Other Considerations

Nonprofits should respect the privacy of donors and safeguard the confidentiality of information. Individual donors should have the opportunity to remain anonymous and to restrict the disclosure to the public of their name, amount of donation, or other similar information. For more information on charitable contributions, see IRS Publication 526, Charitable Contributions, or visit the IRS web site at www.irs.gov/eo.



SECTION: SEVEN

Reporting and Filing Requirements

Reporting and Filing Requirements

Nonprofit corporations in Texas are required to file a number of reports with state and federal agencies. The following is a list of common requirements. This is not, however, a comprehensive list of all reporting requirements for nonprofits.

IRS Reports

- ◆ **Annual information return: IRS Form 990.** Unless a nonprofit has gross annual receipts of less than \$25,000 or falls within other specific exemptions, a nonprofit must file an annual return with the IRS, either a Form 990 or Form 990-EZ (Form 990-EZ is also called the "Short Form"). If your gross receipts are less than \$25,000 and you receive a Form 990 package in the mail, simply attach the label provided, check the box indicating that you are exempt from filing, sign the return, and mail it to the IRS. A small nonprofit can file the Form 990-EZ if its annual gross receipts for the prior fiscal year were less than \$100,000 and its total assets at the end of the year were less than \$250,000.
 - **When the annual return is due.** The return must be filed by the 15th day of the 5th month after the end of the nonprofit's fiscal year. Depending on when a nonprofit filed for tax exempt status, the nonprofit may be required to file the form before the end of its first year of operation.
 - **Penalty for failure to file.** Most nonprofits that fail to file a return or submit incorrect or incomplete information are subject to a penalty of \$20 a day. Nonprofits with gross receipts of more than \$1,000,000 are subject to a penalty of \$100 a day.

- ◆ **Tax return for unrelated business income: IRS Form 990-T.** A nonprofit that has more than \$1,000 in gross income from an unrelated business must file IRS Form 990-T. If a nonprofit expects the unrelated business income tax to exceed \$500, it must make quarterly payments of the estimated tax. For assistance with this form, call (877) 829-5500. The form must be mailed to the Internal Revenue Service Center, Ogden, Utah 84201-0027.
 - **When the return is due.** The form must be filed by the 15th day of the 5th month after the end of the nonprofit's fiscal year.
 - **Penalty for failure to file.** A nonprofit that fails to pay the proper tax may be charged an underpayment penalty for the period of underpayment.

- ◆ **Federal wage income tax: IRS Forms 941, W-2, W-3, and 1099 MISC.** Each nonprofit that pays wages to employees is responsible for withholding, depositing, paying, and reporting federal income taxes and social security taxes. Organizations must file with the IRS the Employer's Quarterly Federal Tax Return (Form 941), Wage and Tax Statements (Form W-2), and Transmittal of Wage and Tax Statements (Form W-3). Nonprofit organizations are not

subject to federal unemployment tax and are not required to file Form 940. If a nonprofit pays more than \$600 a year to an independent contractor, the nonprofit must also file Form 1099-MISC. For further information, call 1-866-455-7438.

- **When Form 941 is due.** The form must be filed within 30 days after the last day of each calendar quarter.
 - **When Form W-2 and W-3 are due.** Form W-2 must be sent to the employee by January 31st for the income earned the preceding year. In addition, Form W-2 must be filed along with Form W-3 with the Social Security Administration (Data Operations Center, Wilkes-Barre, Pa. 18769-0001) by January 28th and with the IRS by April 1st.
 - **When Form 1099-MISC is due.** Form 1099 MISC must be sent by January 31st to an independent contractor who received payment of more than \$600 for the income earned the preceding year. The form must also be filed with the IRS by February 28th.
 - **Penalty for failure to file.** Nonprofits who fail to file the above forms, file incorrect forms, or fail to deposit withheld taxes on a timely basis are liable for fines that range from \$15 per form to \$300,000. Individuals, including directors, who fail to collect, truthfully account for, or pay any payroll taxes can also be held personally liable.
- ◆ **Special returns.** There are a number of special IRS forms required depending on the types of activities the nonprofit engaged in during the fiscal year, including:
- **Excess Benefits Transactions: IRS Form 4720.**
 - **Election of Expenditure Test of Lobbying: IRS Form 5768.**
 - **Reporting Political Activities: IRS Form 1120-POL.** Nonprofits that spent any resources or time on political activities must file this form.
 - **Donee Information Return: IRS Form 8282.** Nonprofits that sell or dispose of donated property within two years of the contribution date are required to file IRS Form 8282 if a donor of property (other than money or publically-traded securities) presents a nonprofit with an appraisal summary of the property (IRS Form 8283) and the value is over \$500. The nonprofit must file the form with the IRS within 125 days of the nonprofit's sale or disposition of the property. A copy of the completed Form 8282 must also be provided to the donor of the property and, if the property is transferred to another nonprofit, the nonprofit must give a copy to the successor donee. The penalty for failure to file Form 8282 is generally \$50.
 - **Exception for food banks, disaster assistance and other distributors of donated property:** If a nonprofit distributes the donated property for free in furtherance of its tax-exempt purposes, Form 8282 does not have to be filed.
 - **Cash donations over \$10,000: IRS Form 8300.** This form is designed to catch money-laundering activities.

- ◆ **Status Report: Secretary of State Form 802 (Report 9.01).** Every four years, a nonprofit must provide Report 9.01 to the Secretary of State, which includes the names and addresses of the nonprofit's officers, the address of the nonprofit's principal office, and the name and address of the agent for service of process. The Secretary of State should send Form 802 for this report approximately every four years to the address of the nonprofit's registered agent.
 - **When the report is due.** The report must be filed along with a \$5 fee within 30 days after the Secretary of State mails the notice stating the report is due.
 - **Penalty for failure to file.** Nonprofits who fail to file the report forfeit their right to conduct business in Texas. If the report is not filed within 120 days after the notice is mailed, the nonprofit will be involuntarily dissolved. (Because the penalty is severe, the nonprofit should appoint someone to monitor the four-year period in case the nonprofit does not receive the notice.)

- ◆ **Texas Taxpayer Questionnaire.** The Texas Comptroller sends this questionnaire to new organizations. Fill it out and return it.

- ◆ **Texas New Hire Report.** Nonprofits must file a Texas New Hire Report with the name, address, date of birth, salary, and social security number of each new employee to the Texas Employer New Hire Reporting Program. For more information, see www.newhire.org/tx.
 - **When the report is due.** The report is due within 20 days after a new employee is hired. For nonprofits that report electronically, new hires must be reported at least twice a month.
 - **Penalty for failure to file.** A nonprofit that fails to file a new hire report is subject to a civil penalty of \$25 for each unreported employee, or \$500 if the failure is the result of a conspiracy between the employer and the employee not to file the report or to supply false or incomplete information.

- ◆ **Employer's Status Report: TWC Form C-1.** Nonprofits with employees must file Form C-1, Employer's Status Report, with the Texas Workforce Commission. Nonprofits should also notify the Commission if and when the nonprofit no longer has employees. Forms are available at www.twc.state.tx.us.
 - **When the report is due.** A nonprofit must file Form C-1 within ten days after an employee begins work.
 - **Penalty for failure to file.** The failure to file a report is a Class A misdemeanor.

- ◆ **Employer's Quarterly Report: TWC Form C-3.** Nonprofits with more than 4 employees for 20 weeks in a year are required to file Form C-3, Employer's Quarterly Report, with the Texas Workforce Commission and pay the applicable state unemployment insurance tax.
 - **When the report is due.** The report must be filed before the last day of the month following the end of January, April, July, and October. Approximately six weeks prior

- to the due date, TWC mails reporting forms to the employer. Failure to receive the forms does not relieve the nonprofit from responsibility for filing the reports.
- **Penalty for failure to file.** Nonprofits who fail to file their quarterly reports are subject to penalties which can result in a higher computed tax rate.
- ◆ **Workers' compensation notice.** Nonprofits that obtain workers' compensation insurance must file notice of coverage with the Texas Workers' Compensation Commission ("TWCC"). For more information, see www.twcc.state.tx.us.
 - **When the notice is due.** A nonprofit must file notice of coverage in person or by certified mail within 30 days of the effective date of the policy.
 - **Penalty for failure to file.** Nonprofits who fail to file are subject to administrative penalties of \$500.
 - ◆ **Election to pay reimbursements.** Nonprofits with more than four employees have an option to pay reimbursements instead of contributions for unemployment insurance. A nonprofit must file an election with the Texas Workforce Commission ("TWC") in order to take advantage of this option.
 - **When the election is due.** A nonprofit must make an election between paying contributions and paying reimbursements within 45 days after TWC mails a notice to the nonprofit stating that the nonprofit must participate in the unemployment compensation program.
 - **Penalty for failure to file.** Nonprofits who elect to not pay reimbursements must pay contributions into the unemployment compensation system.
 - ◆ **Workplace injuries.** Nonprofits with workers' compensation insurance coverage must report to the insurance carrier each death, occupational disease, and injury that results in more than one day's absence from work for the injured employee. If a nonprofit does not carry workers' compensation insurance ("a non-subscriber"), it must report work-related injuries to the Workers' Compensation Commission. If a nonprofit has more than 10 employees, the nonprofit must also report work-related injuries to the Occupational Safety and Health Administration ("OSHA"). All fatalities or hospitalization of three or more employees must also be reported to OSHA.
 - **When the reports are due.** A nonprofit must report employee injuries within eight days to the carrier.
 - A non-subscriber must report to TWCC all injuries that have occurred during a calendar month not later than the seventh day of the following month.
 - Fatalities must be reported to OSHA within eight hours of learning of the death. The toll-free number is 1-800-321-6742.
 - **Penalty for failure to file.** Nonprofits who fail to file reports are subject to fines imposed by the state of up to \$500 per occurrence. OSHA penalties are higher.

- ◆ **Drug abuse policy.** A nonprofit must adopt a drug abuse policy within 45 days after a nonprofit hires at least 15 employees and obtains workers' compensation insurance.
 - **When the policy is due.** A nonprofit must provide a copy of the drug abuse policy to the Texas Workers' Compensation Commission within 30 days after receiving a written request from the Commission for a copy.
 - **Penalty for failure to file.** The TWCC can impose an administrative penalty of up to \$500 against a nonprofit that does not have a policy.

- ◆ **Changes to the nonprofit's name, address, registered agent, and articles of incorporation.** A nonprofit that changes its name, address, or registered agent, or adopts amendments to the articles of incorporation is required to file notice of the changes with the Secretary of State and pay the applicable fees. Forms for change of name and registered agent are available on www.sos.state.tx.us
 - **When the filing is due.** A nonprofit should file changes and amendments as soon as possible after their adoption by the board of directors or members.
 - **Penalty for failure to file.** The above changes do not take effect until they are filed with the Secretary of State. The Secretary of State can involuntarily dissolve the nonprofit and the Attorney General can sue the nonprofit for dissolution for transacting business outside the scope of its articles of incorporation. A nonprofit might also not receive copies of important correspondence for notice of lawsuits if it does not have a current address or registered agent on file with the Secretary of State.

- ◆ **Changes that affect a nonprofit's tax exempt status.** A nonprofit must provide written notification to the Comptroller of any change that may affect its tax exempt status for purposes of the State's franchise tax exemption.

- ◆ **Sale of taxable items.** A nonprofit must obtain sales tax permits, collect and pay sales taxes on items it sells, and file reports with the Texas Comptroller. There are some exemptions. For more information, see www.cpa.state.tx.us.
 - **When the report is due.** Reporting periods vary, depending on the volume of sales. However, all reports are due by the 20th day of the month following the applicable reporting period. Reports are due even if no sales are made. Payment of the applicable sales taxes is due at the same time the report is due.
 - **Penalty for failure to file.** Failure to file the reports timely can result in a five percent penalty on taxes due, an additional \$50 penalty for two or more late reports, suspension of sales permits, and involuntary dissolution.

- ◆ **Articles of Dissolution: Secretary of State Form 603.** A nonprofit that voluntarily dissolves must file two copies of the Articles of Dissolution on Form 603 with the Secretary of State, along with a \$5 filing fee. The Secretary of State will then issue a certificate of dissolution.
 - **When the articles are due.** The Articles of Dissolution should be filed as soon as

- possible after their adoption by the board of directors or members.
- **Penalty for failure to file.** The corporation only ceases to exist after the Secretary of State receives the Articles of Dissolution and issues a certificate of dissolution.



SECTION: EIGHT

Risk Management

Risk Management

All nonprofit organizations and their directors are exposed to risks such as injured employees or volunteers, theft, property damage, and lawsuits from disgruntled employees. The board should first evaluate the types of risk which the nonprofit is exposed to in the course of its activities. The board then has three options to address the risk: avoidance of the activity, modification of the risk, and transfer of the risk to another entity.

Evaluation of Risks

The board of directors should regularly evaluate the types of risks faced by the nonprofit. The board should consider the probability of occurrence and the extent of losses that could arise from each risk. The types of risk may include:

- ◆ loss or damage of property by fire, water, or accident;
- ◆ fraud or embezzlement;
- ◆ lawsuits by employees and clients;
- ◆ lawsuits arising from an automobile accident;
- ◆ injury to an employee or volunteer;
- ◆ theft or vandalism of property;
- ◆ failure of a contractor to pay its subcontractors or for materials;
- ◆ loss of information from computer breakdown.

Protections Against Risk for Directors

- ◆ **Acting in Accordance with the Duties of Directors.** Directors are protected from liability if they:
 - act in good faith; and
 - do not commit an act that breaches a duty of loyalty to the nonprofit.
- ◆ **Indemnification of Directors.** Directors, even those who work under the protection of a corporate form, can still be sued. Even if they cannot be held liable, they may be responsible for paying for attorney's fees and court costs. Indemnification means that the organization will reimburse a director for any fines, money damages, or attorney's fees that the director incurs as a result of the things the director did in the service of the nonprofit.
 - **Mandatory Indemnification.** A nonprofit is required to indemnify a director for reasonable expenses incurred in a lawsuit filed against the director, after a court order and all appeals are exhausted, as a result of actions made in his capacity as a board

member if:

- the director was wholly successful in the defense of the lawsuit; or
- a court orders indemnification.

- **Permissive indemnification.** A nonprofit may reimburse legal expenses of a director if:
 - in a civil proceeding, if the articles, bylaws, corporate resolution or agreement permit reimbursement, even if the director was not wholly successful in defense of the lawsuit, if it is determined that the director conducted himself in good faith and reasonably believed that his conduct was in the best interest of the nonprofit;
 - in a criminal proceeding, if the articles, bylaws, corporate resolution or agreement permit reimbursement if the director had no reasonable cause to believe that his conduct was unlawful;
 - the articles, bylaws, corporate resolution, or agreement permit reimbursement incurred by a director in connection with his appearance as a witness;
 - a majority of disinterested directors approve advance payment of expenses prior to the final disposition of the lawsuit if the director affirms in writing to the nonprofit that he met the standard of conduct necessary for indemnification.
- **Exception.** Indemnification is prohibited for directors who acted in their own self-interest or engaged in intentional wrongdoing.

Protections Against Risk for Volunteers

- ◆ **Immunity for Personal Injury and Property Damage.** A volunteer serving as an officer, director, trustee, or volunteer is immune from money damages for an act or omission resulting in death, damage, or injury if the person was acting:
 - in the course and scope of her duties or functions; and
 - the organization maintains insurance coverage of at least \$500,000 for each person, \$1,000,000 for each single occurrence of death or bodily injury, and \$100,000 for each single occurrence of injury or destruction of property.
- **Exception.** The volunteer is not immune for damages resulting from "intentional or wantonly negligent acts" or the operation of a motor vehicle.

- ◆ **Immunity for Damages Arising from Rotten Food.** A person, gleaner (a person who harvests the food), grower, or nonprofit organization that provides free food to the needy is not liable for damages arising from food that goes bad if:
 - the condition of food appeared to be wholesome; and
 - the food was donated to a nonprofit organization for distribution to the needy.
- **Exception.** The immunity from liability does not apply to intentional misconduct or grossly negligent acts.

- ◆ **Immunity for Damage, Death or Injury to a Patient.** Volunteer health care providers and physicians who are licensed to practice medicine or retired and eligible to provide health care services may be immune from liability when providing services to nonprofit organizations. A volunteer health care worker is immune from damages for any action that results in death, damage, or injury to a patient if:
 - the volunteer acted in good faith;
 - the volunteer acted within the scope of the volunteer's duties;
 - the act was committed in the scope of providing health care services;
 - the services provided were within the scope of the volunteer's license; and
 - the volunteer has submitted a written notification to the patient stating the limitation of liability and that the volunteer does not expect any payment for services, and has obtained a signed copy of the notification from the patient

Addressing the Risks

- ◆ **Avoidance of Risk**
A nonprofit may address each type of risk in a different manner. Aside from incorporating and other statutory protections, avoidance of the risk is an option. For example, the nonprofit could lease a space rather than own it, or the board could decide not to operate a daycare center for its low-income tenants.
- ◆ **Modification of Risk**
A second and more common option is to modify the risks. One method of modifying risk is to isolate riskier activities by forming a separate organization. **Example:** A nonprofit organization establishes a new entity for the operation of a daycare center or for construction activities.

The board can adopt other risk management strategies, which may include:
 - relying on expert advice regarding investment decisions;
 - utilizing an outside auditor;
 - requiring two signatures on checks written over a specified dollar amount;
 - storing computers in a secure location and backing up data daily;
 - instituting training for all employees on sexual harassment and other employment laws;
 - implementing job safety programs.
- ◆ **Transfer of Risk**
The third option to manage risk is to transfer the risk to another entity. The primary method of transferring risk is to shift risk to an insurer. Other methods include using service contracts, requiring tenants to carry adequate insurance, or hiring independent contractors to perform some necessary functions.

The board should become familiar with the types of insurance coverage and policies available that address the nonprofit's risks. The application for insurance is part of the insurance contract. The board should understand the limits of coverage, deductibles, exclusions, the difference between replacement or market value of damaged property, and whether there are any gaps in the coverage.

◆ **Types of Policies**

There are two primary types of liability policies: "claims made" and "occurrence" policies. "Occurrence" policies provide coverage for a claim that occurs within the time period covered by a premium payment. A "claims made" policy provides coverage for claims made during the policy period, even if the event giving rise to the claim occurred outside the period.

◆ **Major Types of Insurance Coverage**

■ **Commercial General Liability Insurance:** Pays for the legal defense and any settlements or judgments as a result of negligent acts committed by the organization, employees, and volunteers that cause members of the public to suffer a bodily injury, property damage, or personal injury such as libel or slander. Wrongful termination is typically not covered. The policy limits should cover the acts of the organization, employees, and volunteers for \$500,000 per person, \$1 million for death or bodily injury, and \$100,000 for each single occurrence for damage to property, or else liability protections under state law do not apply.

■ **Automobile Insurance:**

- **Business Automobile Insurance:** Similar to commercial general liability, this type of insurance is used when coverage is needed by an incorporated entity for ownership, operation, maintenance, and general use of vehicles owned by the nonprofit.
- **Hired and Nonowned Automobile Coverage:** The "hired" automobile endorsement to an auto policy covers bodily injury and property damage resulting from accidents that occur when the nonprofit rents or leases a car. The "nonowned" automobile policy protects the nonprofit for damages caused by volunteers driving their own vehicles on business for the nonprofit. This is very important coverage for nonprofits which utilize volunteers.

■ **Property Insurance:** Covers damages to property owned by a nonprofit after construction has been completed and is based on the type of occupancy. Covered losses include fire, hail or vandalism.

Exclusions: Property insurance may limit or exclude coverage for items such as mold testing or remediation and loss or damage to electronic data and associated systems and equipment.

■ **Workers' Compensation:** Protects the nonprofit and provides benefits to paid workers for job-related injuries and illnesses. Maintaining this insurance limits the amount of

money that is paid to an employee for the injuries. Nonprofits that do not provide workers' compensation insurance have no liability limit if an employee is injured on the job.

- **Fidelity Bond:** Protects the nonprofit if employees embezzle or steal assets of the nonprofit. The bonding company will replace the missing funds and then try to collect from the employee. Depending on the amount of funds handled, a nonprofit should consider conditioning employment in a position of financial responsibility upon the ability to obtain a bond.
- **Director's and Officer's Insurance (D&O):** Covers the costs of defense and damages for wrongful acts and omissions committed by directors, employees, and volunteers. Nonprofits should ask for two different coverages:
 - **Full entity coverage:** Reimburses the nonprofit for amounts paid to indemnify its directors and covers claims against the nonprofit; and
 - **Directors and officers coverage:** Protects the directors and officers for losses for which they are not indemnified.

D & O policies are often "claims made" policies, which means that coverage is provided for claims made within the policy period rather than when the act occurred. If the nonprofit discontinues a policy, a director could be uninsured for acts that occurred during the director's term of office, if the claim is made after the policy is discontinued. Some policies have "retroactive dates" or "extended reporting period" clauses.

Exclusions: D & O policies typically do not provide for the payment of legal expenses until after a final determination of liability. The insurance company has no duty to defend a lawsuit, only to reimburse legal expenses. Lawyer board members who act as counsel to the nonprofit should also examine whether the D & O policy applies to them and whether legal malpractice policies exclude claims that arise if the attorney is acting as a director of a nonprofit. Other exclusions in D & O policies may include: libel or slander actions, fines and penalties, fair employment claims, and punitive damages.

- **Employment Practice Liability (EPL):** Protects nonprofits, directors, and employees. This insurance covers employment discrimination claims, suits of wrongdoing in employment hiring and firing, and other employment practices. Since employment claims are the most common types of insurance claims against nonprofits, it is important to obtain EPL coverage. One of the main values of this coverage is that it covers litigation expenses. Nonprofits should buy a D&O policy that includes EPL.
- **Errors and Omissions:** This type of policy protects the nonprofit, its officers, directors, and employees from acts or omissions arising out the provision of professional services. Professional services could include construction consulting, surveys, or architectural designs.

- **Surety and Performance Bonds:** Protect the nonprofit from acts or omissions of others. For example, surety and performance bonds can be issued to guarantee that a contractor will conduct activities in accordance with all laws and ordinances or will complete a project in a timely and workmanlike manner. A performance bond could also guarantee performance on subcontracts and that all bills incurred by a contractor will be paid at the completion of a project.

- **Specialty Insurance Lines:** Provide coverage for special events such as a fun run or liquor liability. Certain types activities, such as childcare, may not be covered by general liability insurance and, therefore, require a specialty line of coverage.
 - **Owners and Contractors Protective Liability Policy:** Covers the owner or general contractor handling a construction project.
 - **Builder's Risk Insurance:** Covers losses to property while property is being built, e.g., hail, vandalism, etc.

- **Umbrella Policy:** An option for directors to provide additional personal coverage. An umbrella policy may be purchased to provide coverage in excess of the individual director's homeowner's and automobile policies. A commercial umbrella policy might also be useful for the nonprofit.



SECTION: NINE

Useful Resources on Nonprofit Management

Useful Resources on Nonprofit Management

Texas Nonprofit Resources

Texas C-BAR: www.texasctbar.org

Texas Nonprofit Management Assistance Network: www.texasnetwork.org

Texas Association of Nonprofit Organizations: www.tano.org

Center for Community-Based and Nonprofit Organizations: www2.austincc.edu/npo

Nonprofit Resource Center of Texas: www.nprc.org

National Nonprofit Resources

Alliance for Justice: www.afj.org

Alliance for Nonprofit Management.: www.allianceonline.org

Foundation Center: www.fdncenter.org

Guidestar: www.guidestar.org

Independent Sector: www.indepsec.org

National Center for Nonprofit Boards: www.boardsource.org

Nonprofit Genie: www.genie.org

Nonprofit Issues: www.nonprofitissues.com

Nonprofit Risk Management Center: www.nonprofitrisk.org

Nonprofit Solutions: www.npsolutions.org

Nonprofit Zone: www.nonprofitzone.com

Tools for Nonprofits: www.idealists.org

Information on Miscellaneous Legal Issues

Federal and State Laws for Nonprofit Organizations: www.muridae.com/nporegulation

U.S. Postal Service Regulations: www.nonprofitmailers.org

Charitable Raffles: www.oag.state.tx.us/child/consumer/brochure/raffle.html

Laws for Small Business: www.tded.state.tx.us

Texas Nonprofit Corporation Act: www.capitol.state.tx.us/statutes/vn/vn0003201.html#top

Government Agencies

Texas Secretary of State: www.sos.state.tx.us

Internal Revenue Service: www.irs.gov

Department of Labor: www.dol.gov

Occupational Safety: www.osha.gov

Texas Comptroller: www.cpa.state.tx.us

Texas Workforce Commission: www.twc.state.tx.us

Texas Workers' Compensation Commission: www.twcc.state.tx.us

