

TEXAS YOUNG LAWYERS ASSOCIATION

HOW TO GET INVOLVED IN

NONPROFIT BOARDS



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THE TEXAS YOUNG LAWYERS ASSOCIATION



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I. FORMING A TEXAS NONPROFIT

A. Pre-formation: Association or Corporation

A client will likely first come to you with an idea for a nonprofit that they would like to form. Prior to forming the entity, you must advise the client as to what type of entity they should form. The most commonly referenced form is the nonprofit corporation. Although, this type of entity has many advantages such as a shield against personal liability for directors and volunteers, a nonprofit association may be another option to consider. Choice of entity should, of course, take into consideration state law in the state in which your client wishes to form their entity.

1. Nonprofit Association

If an organization is going to be very small, simple group, a nonprofit association may be a good fit. A nonprofit association (“association”) is defined under Section 252.001 of the Texas Business Organizations Code (“TBOC”) as “an unincorporated organization, other than one created by a trust, consisting of three or more members joined by mutual consent for a common, nonprofit purpose.” A nonprofit association can only exist in a state that has adopted the unincorporated nonprofit association act, which Texas has. In a state where the act has not been adopted, the individual members and managers would be the legal actors and no liability protection would apply. Texas recognizes nonprofit associations under TBOC Chapter 252.

A nonprofit association is the simplest formation path since the entity does not have to be registered with the state. Like a nonprofit corporation, an association can seek tax exempt status with the IRS as well as own and transfer property. In most cases, operating as a nonprofit association also shields members and directors from personal liability as a result of actions taken by the nonprofit association. This will not shield an individual from liability for actions taken personally.

2. Nonprofit Corporation

A nonprofit corporation under TBOC 22.001(5) is a corporation that cannot distribute any part of its income to members, directors, or officers of the corporation. A nonprofit corporation can be formed for any lawful purpose or any purpose not prohibited under TBOC 2.003. Corporations formed for the purpose of operating a nonprofit institution, including an institution devoted to a charitable, benevolent, religious, patriotic, civic, cultural, missionary, education, scientific, social, fraternal,

athletic, or aesthetic purpose, may be formed and governed only as a nonprofit corporation under the TBOC and not as a for-profit corporation.

If you incorporate, then the nonprofit and members of the nonprofit will have certain advantages—such as built in protection from personal liability for Directors and Volunteers from actions of the nonprofit corporation and the ability to seek tax exempt status with the IRS. The nonprofit corporation can still pay reasonable compensation for services provided to the nonprofit.

B. Formation of a Nonprofit Corporation

1. Choosing a Name

If a nonprofit corporation form is chosen, the next step is to check for the availability for names with the Texas Secretary of State (“SOS”). The organization can make sure the name for the nonprofit is available by calling (512) 463-5555 and dialing 7-1-1 for relay services; or e-mail your name inquiry to the SOS Corporations Section. If the name is available, the organization can reserve the name in advance by submitting a Form 501, found on the SOS website.

2. Certificate of Formation

Once the nonprofit is ready to incorporate, the next step is to file a certificate of formation with the SOS. The certificate of formation sets out the general structure of the nonprofit. The organization should file a Form 202 with the SOS.

The organizer will need the following information to file Form 202: the entity name and type; the initial registered agent and registered office; the initial Board of Directors; whether the nonprofit will have members; the nonprofit’s purpose (including the language needed to be tax exempt); when the filing will actually take effect; the organizer; and the signature of the organizer.

The registered agent of the nonprofit corporation must be either a Texas organization, a foreign organization registered with the Texas SOS, or an individual in the state of Texas. The registered agent must also complete a consent to be the registered agent of an organization, which can be found on the SOS website.

The registered office must also be in the state of Texas; and although it does not have to be the business address for the corporation, it commonly is.

A very important part of filing the certificate of formation is that it must also include language relating to the dissolution of the nonprofit, private inurement, and a statement that the corporation cannot take actions contradictory to the requirements for 501(c)(3) tax exemption, if tax exemption will be sought. Without this language included in the initial filing, a nonprofit corporation would have to amend its certificate before it would be eligible for an exemption from federal income taxes.

3. Purpose

The nonprofit corporation's purpose is extremely important since the language used on the certificate of formation will be used to qualify for tax exempt status with the IRS. The purpose statement should be broad enough to allow the nonprofit to act freely, but it should be narrow enough to qualify as an exempt nonprofit under the internal revenue code ("IRC"). An organization must have a one of the following purposes to qualify for an exemption under IRC 501(c)(3): charitable, religious, educational, scientific, literary, testing for public safety, fostering national or international amateur sports competitions, or preventing cruelty to children or animals. The term *charitable* is used in its generally accepted legal sense and includes relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency.

4. Bylaws

The Bylaws are the rules for the nonprofit's operations. The nonprofit is not required to have bylaws. If the nonprofit does not adopt bylaws then the nonprofit will be governed under the default rules under the TBOC, which may create unintended outcomes for the nonprofit operations. It is recommend, however, that a nonprofit adopt its own bylaws.

The bylaws should generally address, among any other number of items: a) time and place of annual business meetings; b) calling of special business meetings; c) notice for annual and special meetings; d) selection, term of office and removal of Officers and Directors; e) filling of vacancies; f) quorums; g) voting rights; h) responsibilities of Directors and Officers; i) purchase and conveyance of property; and j) amending bylaws. Other issues that are commonly addressed are: k) arbitration and mediation clause for disputes; l) approval of contracts and other legal documents; m) parliamentary procedures; and n) indemnification.

5. Membership List

If the nonprofit corporation elects to have members, a membership list should include active members of the organization as defined by the bylaws. The list should be well maintained since any power to makes decisions by members on behalf of the nonprofit will be given to the members listed.

6. Meetings and Minutes

An official meeting allows an official action taken by the Board or the members of the nonprofit to be officially recorded. Minutes are a record of what happens at the meeting and should be recorded, signed, and kept by the Secretary or someone appointed to handle the task. If the bylaws permit, a unanimous consent resolution signed by the appropriate parties may suffice in lieu of holding an official meeting or to conduct official business of the nonprofit.

An initial meeting of the board of directors should be conducted to authorize the formation, to apply for a tax id number, to open bank accounts, to elect officers, and to conduct any other initial business of the nonprofit.

7. Board of Directors

Because no one “owns” a nonprofit (like shareholders would own a corporation or members would own an Texas limited liability company), a Board of Directors will generally make decisions on behalf of the nonprofit corporation as set out in the certificate of formation, bylaws and TBOC. Thus, control of the board is always a very important part to consider when forming a nonprofit corporation. A minimum of three directors must be chosen to serve as the Board of Directors under the TBOC, but more can be required under the bylaws. The initial directors will serve until their term expires or successors are reelected per the bylaws.

The organization should be aware of the directors’ background, expertise, education, and other associations. Requiring detailed resumes and information statements when the director is elected would ensure that the information was properly documented. The information would ensure most biases or conflicts of interest would be readily apparent prior to decision made on the part of the Board of Directors. This allows the director to refrain from voting on decisions in which they have a conflict or bias. When forming a nonprofit corporation, it is important to find directors who are the right fit to successfully advise and guide the nonprofit organization.

C. File for a Federal Employer Identification Number

Once the nonprofit corporation has been formed, the organization must file a SS-4 form with the IRS to request an employer identification number (EIN). Whether the nonprofit will have employees or not, an EIN is needed to use as identification for federal tax purposes. The SS-4 form can be found on the IRS website. This tax id number can be used to open bank accounts, hire employees, to set up state sales tax accounts, and any other number of items.

D. Seeking Tax Exempt 501(c)(3) Status

Once the nonprofit has received their EIN, they are able to seek tax exempt status. The most common filing is a 501(c)(3)- Charitable, Religious or Educational organization exemption. When an organization files for exemption, the organization will file either IRS Form 1023 or Form 1023-EZ (a new “short form” exemption application that is only eligible to certain filers, depending upon annual receipts and assets, among other requirements).

To be eligible to file a 1023-EZ, a nonprofit corporation should fill out a 1023-EZ worksheet found in the 1023-EZ instructions. Generally, the nonprofit should reasonably anticipate less than \$50,000 of gross receipts for the next three years with total assets of less than \$250,000. There are twenty-four additional questions on the 1023-EZ worksheet that must all be false to qualify for the short track 1023-EZ form.

If the nonprofit corporation answers yes to any of the worksheet questions they must fill out the traditional Form 1023 that requires a much more lengthy set of disclosures/attachments. The nonprofit corporation will have to submit the following documents in addition to the application: certificate of formation, bylaws, financial statements/projections, a narrative description of the nonprofit’s purpose and intended activities, compensation of officers/directors/trustees/employees, and the EIN.

E. Other 501(c) Organizations

While a 501(c)(3) tax exemption is well known and widely used, certain other organizations are described in IRC 501(c), including for example: 501(c)(4) — Civic Leagues, Social Welfare Organizations, and Local Associations of Employees; 501(c)(6) — Business Leagues, Chambers of Commerce, Real Estate Boards, etc.;

501(c)(7) — Social and Recreational Clubs; and 501(c)(8) — Fraternal Beneficiary Societies and Associations. Note, however, that for each specific other section 501(c) organization, the exemption qualification requirements, membership requirements, the entity’s purpose, its organizational/governance requirements, and deductibility of charitable donations will vary. Refer to IRS Publication 557 for a more thorough overview of other 501(c) organizations.

II. HOW TO JOIN A NONPROFIT BOARD

A. Identify causes that are meaningful to you

Consider groups that you currently give money and/or volunteer for. Also consider groups that you have previously given to in the past or volunteered for. You may also want to consider groups that have hosted benefits or events that you have attended that benefited causes that were meaningful or impactful to you.

Learn more about a particular organization by reading promotional materials, as well as written board policies, bylaws and previous minutes.

Visit with members of the board and staff. Ask former and current members of the board for coffee, and find out what their experience has been like. Make sure that it is a good fit between you and the individuals involved with the board.

Matching services like volunteerpath.com pair volunteers with nonprofit organizations. Matching services also offer training courses for a nominal fee, so that volunteers can learn important skills to effectively serve nonprofit organizations.

B. Prepare yourself to join the board

1. Volunteer for the Organization

Volunteer for the organization, meet other volunteers and staff, or even participate in committee work. For instance, help the fundraising, finance, or marketing committees. Committees are usually governed by directors and officers of the board. Committee work is a great way to learn about the organization, and build relationships with existing directors and staff.

2. *Fundraise*

Help the organization with fundraising. Although typically a responsibility of directors, fundraising is appreciated wherever it comes from as fundraising is a skill that every nonprofit board needs.

3. *Offer to Take Meeting Notes*

Offer to take meeting notes. Serving as a note-taker gives you access and builds trust. The note-taker often grows into the secretary role, which often leads to chairing the committee.

C. Know what skills you have to offer.

Nonprofit organizations typically want leaders with specific skills. If you can identify your skill sets, you can better match and present yourself for prospective board opportunities.

The ability to understand financial issues pertaining to nonprofit organization is valuable to most organizations—regardless of professional background. Know the difference between an income statement and a balance sheet.

D. Understand what a board wants from you

1. *Know how much time is expected of you*

Don't underestimate the amount of time required to effectively serve a board. It is better to turn down a board position because you cannot commit to the board's time requirements than it is to accept a position and later leave the board hanging because you can't follow through on your obligations. Recognize that the time required to serve on a board is often substantial.

In addition to the committee work and projects that boards take on—board members are typically required to serve on one or more committees—most boards meet on a monthly or quarterly basis. Meetings may last an hour or upwards of multiple days. In addition to the time spent at board meetings, board members should allocate a few hours to preparing for upcoming board meetings (e.g., drafting committee reports, reviewing past and future projects of the board). It's not unusual to spend seventy-five to one hundred hours per year serving a single nonprofit board.

2. *Know what donation you will need to make to the organization, and how often*

Although some nonprofit organizations rely on government funding or endowments, many nonprofit organizations rely on donations from businesses or individuals. Those organizations typically ask their board members to donate or raise a specific amount of money for the organization.

3. *Know if you are expected to use your connections to raise funds*

Before accepting a board position, consider whether the organization's mission is important enough that you are willing to donate some of your own financial resources, as well as encourage your friends, family and colleagues to commit theirs, as well.

E. Put yourself out there, then keep your eyes and ears open

Don't be afraid to contact current board members/leadership of an organization and to share your interest. Ask how you can volunteer within the organization and learn more about how the organization operates.

Most of your friends and family won't assume that you're interested in joining a nonprofit board. Let them know. It's not a bad idea to send a personalized email to your contacts and share your interest.

III. BENEFITS OF SERVING ON A NONPROFIT BOARD

A. Business Development

You can increase your network and meet and develop relationships with other professionals and make key contacts for the future.

Through active participation in board meetings and board leadership, you might secure new clients or networking opportunities.

You can gain new perspective by interacting with people from diverse backgrounds.

You can expand your understanding of your community, its residents and their needs.

B. Professional Development

Building skill sets helps you improve your current skills as well as develop new skills to add to your resume. Such skills include but are not limited to marketing, finance, human resources, governance, public relations and grant writing.

Serving on a nonprofit board also provides you with a better understanding of the role and responsibilities of corporate governance and gives you hands-on experience.

Provides you with an opportunity to be a leader by chairing a committee or serving as an officer

C. Giving Back

Serving on a nonprofit board gives you the ability to make a substantial and ongoing impact in your local community by advancing a worthy mission.

Your participation while serving on a nonprofit board helps build awareness and endorsements for the particular nonprofit or cause through your participation. Your participation may introduce the cause to new individuals in the community who would not have been aware of the organization or the cause if you had not served on the board.

Helping others can provide personal fulfillment by improving your emotional health and well-being.

IV. MAKING THE MOST OF YOUR EXPERIENCE ON A NONPROFIT BOARD

A. Introduction

The timeless expression, “you get what you give” is no truer than in service on nonprofit boards.

“Nonprofits need, want and very much appreciate the work, wisdom and talent of committed and passionate volunteers. Nonprofits are almost always short staffed and overwhelmed, so the extra help is necessary. Taking the important first step and saying you want to help is key. Don't wait to be asked. Asking the staff about what they need and then helping the staff do those tasks is the next best step. Offering

your own creative and productive ideas can also lead to some exciting collaborations with staff. The most important part of the staff and volunteer relationship is trust and dependability. A staff person needs to know he or she can trust the volunteer to listen, do and complete the task at hand. The volunteer needs to know the staff person appreciates the volunteer and will allow the volunteer to bring his or her own creativity into the project. It takes a village to run a nonprofit . . . both staff and lay leaders...working together...can achieve more than they can on their own.”

-Jodi Bernstein, Senior Associate Director of the Southwest Region of the Anti-Defamation League

B. Hands-on volunteering – get to know the nonprofit

Nothing will motivate your service more than understanding the work the nonprofit does and as saying goes, “getting your hands dirty.” It is a great idea to try to have as many hands-on experiences with the actual work of the nonprofit so that when you advocate, fundraise, or even make decisions for the nonprofit you have a true understanding of the great work they do and where they can improve. So, if your organization volunteers in schools, try to attend a session, even if the actual “work” is more often left to staff, rather than lay leadership. If you’re serving on the board of an organization that raises money for medical research, try to work with the organization to tour research facilities funded by the nonprofit and/or visit patients affected by the disease. The more personal the work is to you, the better board member you will be.

C. Fundraising and development

Generally, it is expected that nonprofit board members participate in raising funds and development endeavors for the nonprofit. Each nonprofit fundraises differently, focusing on either event-based and/or campaign-driven fundraising. You will want to familiarize with what the organization has done in the past to raise money, how successful those efforts have been, and what the organization’s funding needs and goals are for the future.

“Give or get”

“Involving your network”

“Chairing fundraisers”

D. Lay leadership and staff – how to most effectively work together

Make sure what the roles and expectations are between staff and lay leadership.

E. Time-management

As professionals, especially as attorneys, it is often hard to make time commitments outside of your practice; however, by agreeing to serve on the nonprofit board, you have decided that you both have the time and that the service is worth your time. As such, it is important to block time in your schedule and understand what is expected of you. For example, determine if you will need to attend any other meetings other than regular board meetings. Will you be expected to do committee work? Is there a policy on attendance at board meetings? If you cannot attend a meeting and you serve in a voting capacity, can you give another board member your proxy? Are there any events that board members are expected to attend on behalf of the nonprofit or that specifically benefit the nonprofit such as a gala or a fundraiser dinner that you need to attend? These are all important questions to ask to demonstrate your commitment when trying to balance a hectic schedule with board service.

V. FIDUCIARY DUTIES WHEN SERVING ON A NONPROFIT BOARD

I've been asked to serve on a board but now? There are several things that you need to consider when joining a nonprofit board both in relation to what your role will be on the nonprofit board and what your fiduciary duties are while serving on the board.

A. Determine What Role You are Serving on the Board

It is important to determine whether you will be serving on the board as a member of the board or as an attorney who represents the organization. If you are serving in either capacity you will want to document it in a letter to the board setting out the capacity in which you are providing services to the organization. If you are serving as an attorney to the organization you will want to make it clear to the other board members that your client is the organization and not the individual board members.

B. Be Cautious in Inadvertently Forming an Attorney-Client Relationship

An attorney-client relationship is typically based upon what a client reasonably believes. If the board members reasonably believe that they are receiving legal advice

from an attorney, who is also a member of the board, an attorney client relationship may be found to exist. Since an attorney is often relied on for legal advice at board meetings, it important to periodically remind the board of your limited role as a board member only. If appropriate, you may also want to recommend that the organization seeks advice from a lawyer.

C. Conflict of Interest

If you are considering serving as a lawyer to the nonprofit it is important to identify whether any conflict exists with any current clients. Consider whether any of your clients or any of your firms clients would be or could be adversely limited by the lawyers or law firm's responsibilities to another client or to a third person or by the lawyer's or law firm's own interests. (Texas Disciplinary Rules of Professional Conduct 1.06(b)(2)). If you are only serving as a board member consider whether or not your responsibility as a board member would materially limit your ability to represent your clients.

D. Fiduciary Duties as Board Member

A director of nonprofit corporation shall discharge the director's duties in good faith, with the ordinary care and the in manner the director reasonably believes to be in the best interest of the corporation. (Texas Business Organizations Code §22.221)

1. Duty of Care

The duty of care requires a director to act with the care a person in a like position would reasonably believe to be appropriate under similar circumstances. This requires a director to act in good faith and in a manner that a director reasonably believes to be in the best interest of the organization. The duty of care requires that a director make informed decisions and exercise independent business judgment.

2. Duty of Loyalty

The duty of loyalty requires that when directors are acting on behalf of the nonprofit that the directors put the interests of the nonprofit before any personal or professional concerns. The duty of loyalty requires that a director should attempt to resolve any potential conflict of interest related to any transaction or action that may be taken by the Board.

3. Duty of Obedience

The duty of obedience means that a director has a responsibility to be faithful to the organization's stated mission and not act or use its resources in incompatible ways or purposes to the organization's stated mission.

— NOTES —

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