

# Small Business Success Podcast: NON-PROFITS



The [SCORE Small Business Success Podcast](#) features interviews with the best and brightest in the world of small business, covering topics such as business plans, financing, marketing, human resources, SEO, social media and more. In this podcast, SCORE mentors chat with Jack Dunigan.

\*Jack Dunigan has spent more than 30 years in the non-profit sector. In that time, he guided more than 2 dozen groups through the process of becoming tax-exempt non-profit organizations. His experience and skill in the development of charities, faith-based organizations and educational institutions make him the go-to guy for advice and guidance. He's a valuable resource for understanding the dynamics of making an impact on society through non-profit ventures.

Dennis Zink: Jack, let's start with what is the difference between a non-profit and a business.

Jack Dunigan: This is probably one of the most often received questions that I get. Having worked with organizations for 30 years, a lot of organizations that are non-profit organizations, after 30 years, really are bankrupt. They seem to have the idea that, in order to be a non-profit organization, they don't have to actually make any money. Non-profit organizations, like any business has to make money. They have to be able to meet budgets. They have to meet payroll. They have to pay for the objectives and the activities of their mission. The problem is that, if you think that you don't have to make any money, it begins to affect your planning.

The difference between a non-profit organization and a business is that, if I own a business, quarterly, semiannually or annually, if there's money left over, I, as the owner, can take some of that money. In a non-profit organization, I cannot do that. That money belongs to the organization. The IRS, in its regulations, is very specific that there can no inurement to the benefit of an individual, which means I can't take that money. I can get paid for the work that I do, but the money always belongs to an organization.

I was talking to a client maybe 2 weeks ago who was concerned about that, that if she decided to close her organization after a couple of years, then what happens to the money. I said, "Well, you don't get it. That money has to be given to another non-profit." Non-profits are permanent and they are never allowed to distribute the funds or any of its assets to any of the members of that. It all has to remain in the non-profit sector. Other than that, they do have to make money in the sense that their revenues have to exceed their expenditures, or they soon will fail in their mission.

Dennis Zink: You hear the numbers and letter 501(c)(3). Can you explain what that means or where that comes from?

Jack Dunigan: It comes from the IRS regulations. 501(c)(3) is the most prevalent type of non-profit organization recognized as a tax-exempt organization by the Internal Revenue Service. There are 501(c)(4) organizations, but most organization are 501(c)(3), which is usually religious, charitable or educational organizations.

One of the problems that many people have with tax-exempt organizations is just where do they qualify as a tax-exempt organization. There's one sort of guiding factor, and that is the intent to spend a major portion of your money influencing legislation. 501(c)(3) organizations are expressly prohibited from spending a major portion of their revenues for influencing legislation. The IRS is rather reluctant in defining what "major" means. It's usually around 10%. If you exceed 10%, you may be in danger of losing your tax exemption. The 501(c)(3) is the IRS number for those tax-exempt organizations of religious, charitable, educational institutions.

Dennis Zink: What if you lose your status? What happens then?

Jack Dunigan: It's a very unfortunate situation. If you lose your status, first of all, you cannot give tax-deductible receipts to any of the donors. Any of the revenues that you receive will be treated as income rather than revenues and it will be taxable at any normal corporate or business rate that might be applicable, depending on where you are in the United States. It varies from state to state. You would owe federal taxes and you would also owe local taxes.

Fred Dunayer: Can I assume that that would be retroactive?

Jack Dunigan: It could be. It depends on how particular an IRS examiner might be. Usually, it doesn't. Usually, if you are found to be in violation of some of the criteria for being a non-profit organization, then they could go back to the date of the first violation and make the tax-exempt status end at that point. It would depend on the circumstances by which you would lose your tax exemption. It very seldom happens, by the way. The IRS is actually quite reluctant to do that and usually gives a lot of room for you to correct any issues that might be there so that they don't have to do that. It almost never happens. There are a few cases where there had just been blatant fraud, but that's very, very rare.

Dennis Zink: It's nice that they give the opportunity to correct the default. If I'm confronted with starting a non-profit or a business, what are some of the determining factors that should make me choose one versus the other?

Jack Dunigan: In the mid-'90s, there were 750,000 non-profit organizations in the United States. Today, there's about 1.6 million, so we have a lot of non-profits. The first question I ask potential members who might want to start a non-profit is, "Do you really need to do this?" It's not only complicated, it can be expensive to start a non-profit. The question would be, "Isn't there already a non-profit that might parallel what it is you want to do, and you could work either for them or in conjunction with them or with them as an umbrella?"

I was with a client just last week. That was a question we really did pose to him is that, "Are you sure you need to do this? This is going to be complicated and expensive. And there are associations in this community who are doing largely what you want to do. You could work with them rather than starting a whole process and engaging in all of the requirements and maintaining them, because, year by year, you have a lot you have to do in order to keep your non-profit up to date." That's the first question is, should you start a non-profit?

The other is, "Are you suited for a non-profit?" Like the one I alluded to earlier, she was concerned about a couple of things. One is, if the non-profit didn't work out, what happened to the money? You don't get it. The other was, if I start this non-profit and I have to have a board of directors, which you do, can't they take it away from me? The answer is, yes, they can. That's the nature of a non-profit is it's not run solely by an individual like you might have a sole proprietor of a business. It is, by law, required to be managed and overseen by a board of directors of no less than three people who are responsible for the fiduciary responsibility to the IRS and to all of the constituents to execute the non-profit according to its purposes that got them the tax-exempt status.

If maybe you're concerned about that, and I run into this especially with educational institutions or people who are wanting to do some sort of thing in conjunction with the schools, I suggest why don't you just start a business and contract your services to the school and you're going to have to pay the taxes, but, in the end, you're going to be happier and it's going to be easier for you to run than to negotiate your way through all of the many steps to get this thing up and going. Many of them have decided, "I think a non-profit is a bad idea. I'm going to go with the business or I'm going to associate with somebody else."

If you want to and you feel like there's no nobody else can do what you're doing in the area that you want to do it, then go ahead with the non-profit.

Dennis Zink: I know you mentioned the board of directors. My understanding is that you're pretty much better off having an odd number as opposed to an even number to break ties and that kind of thing. Is there an optimum size, depending on the size of the non-profit, of whether you should have three directors as in the case you mentioned or as many as 13 or even more?

Jack Dunigan: Many organizations, especially the large ones, have a large board of directors. You do need an odd number because, if you're going to vote on things, you don't want to end up with a tie. You're going to have to have an odd number so that you can come down for or against some particular proposal.

If you're going to have a non-profit that meets the rules of the IRS, it has to have at least three. This is where it'll vary because, if you go to the state, for instance, if you're in the state of Florida, and you go and you ask them, they want three members of the board of directors as well. Some states will let you incorporate with less. You only need two or maybe even one to incorporate, but that won't pass muster with the Internal Revenue Service. Three is the minimum

number. The maximum number, it can get so big that it gets unwieldy. The larger the organization, the more people that you may need to run it.

Boards of directors, they have three purposes. One is to watch over the organization to make sure that it remains consistent with its vision, that it's doing what it is that it said it would do. In that sense, they are financially responsible. By that, I mean, they have to spend the money in accordance with that. They can't raise the money for one purpose and spend it for another that's completely outside the stated purpose of the organization. They have to remain consistent.

The other two other reasons is they're either there to give or to get. That is, they're going to raise money, they're going to give money to the organization. There are many organizations in this part of Florida that if you become a board member, it is expected that each year you come up with \$3,000 or \$4,000, \$5,000. If you don't raise it, you get it somewhere else. The other (reason) is that you're going to get volunteers. You are going to be able to influence other people to come along and help out with your organization, oversee, give and get.

Fred Dunayer: Would it be correct to say then that a board directors for a non-profit would typically not be paid whereas a board of directors for a corporation typically is?

Jack Dunigan: That is correct. The board of directors for a non-profit cannot be paid except for the work that they do. You can pay them their expenses for coming to a meeting, but you can't pay them for being a member of the board. If they do something specific in terms of work for the organization, they can be paid for that and be a member, but they cannot be paid just to be a member of the board of directors.

Dennis Zink: When you talk about making a contribution as part of the obligation, is that a federal requirement?

Jack Dunigan: No. That's just the way it's evolved here in this country, that if you're going to be a part of an organization, we need money and we're going to bring you on and we'll give you a seat on the board because we value your presence and we value your input and we need your money.

Dennis Zink: Are you seeing more non-profits moving towards earned income in any way?

Jack Dunigan: There were a lot of non-profits that were engaged in earned income. Typically, they owned property apartment houses or businesses. That's pretty well-shaken out given the economy of the past several years, but there are many that still do so. That has to be reported differently and, by the way that money earned from non-related business expenses can be, depending on how things work, subject to tax.

Dennis Zink: If I start a non-profit, how do I make money? What's the best way to get money out of the entity in a legitimate way, of course?

Jack Dunigan: It's always a challenge to raise enough money. I talked to a young man who wanted to start an organization. He had no money. I said that the Catch 22 is you can't do anything till you get some money and you can't get anybody to support you until you do something. You're going to have to probably work and fund the initial part of it yourself. Once you can clearly state the vision of the organization so that it resonates with people what it is that you want to do, then you find angels if you can, business people who will invest in you, who will give some seed money. Organizations can raise money by just donations. They can raise money by events that they would hold. There are golf tournaments and other events that people have that are fundraisers for non-profits. They have cattlemen's balls and all this sort of stuff that helps to raise money for organization.

I try to paint a very bleak picture because it is exceedingly difficult these days to raise money. With the multiplication of non-profits, there's a huge demand for more money and fewer places to get it from.

Dennis Zink: What would be an example of doing some activity that would be taxable? If you can give me just one example?

Jack Dunigan: It wouldn't be an activity, it would be a business that you might own. For instance, the Southern Baptist Convention owns a lot of apartment buildings. Those apartment buildings are not in pursuit of their mission. They're not

used to house Southern Baptist ministers. They're not used to house Southern Baptist congregants or retired people. They are simply there to raise money, and so that's subject to tax like a normal business would be and then the proceeds from that go in to the Southern Baptist Convention, but it's an unrelated business expense. If they were doing that as part of their mission, to provide housing for the homeless or whatever and they charge people a few dollars, that would be a problem, a problem in the sense that it could be subject to tax.

Dennis Zink: If I'm a non-profit, do I need a tax exempt number? If so, how do I get one?

Jack Dunigan: I get this question a lot. It's interesting. I used to do a lot of work with developing Native American churches in the Southwest. One of the things they wanted to incorporate was to become a non-profit for is so they could avoid income taxes. I said, "Here's the thing. Organizations are non-profit, individuals are not. I can be paid from a non-profit for the work that I do, but that salary or wages that I receive from the non-profit is subject to income tax just like I went to work Circle K or McDonald's. It's the same. The organization itself can be tax exempt.

There is no such thing as a tax-exempt number except for sales tax, which is allowed in some entities. In Florida, tax-exempt organizations can get a tax-exempt sales tax number and they do not have to pay sales tax on the items they purchase in pursuit of their mission. The IRS does not issue a tax-exempt number. It issues a letter of tax exemption. That letter will be signed by the director of the Internal Revenue Service. You keep that letter on file. Guard that. That letter needs to go and part of the archives hidden away in some safe, deep, dark vault because it is the authorization you have to function as tax exempt. The tax-exempt number would be sales tax for the state. The tax exempt letter comes from the IRS.

Dennis Zink: What forms would I have to fill out and where shall I file them and when to do that?

Jack Dunigan: First of all, you're going to need the articles of incorporation. You can have an attorney do them. In some cases, that's probably the right thing, but you don't have to. You can go to, usually, the Secretary of State in whatever state you happen to be in. They will have sample forms for a non-profit.

Many people who want to start a non-profit, they really want to nail down the specifics of their mission within the articles of incorporation. I usually recommend against that. I recommend some rather broad statements about what it is that you're going to do and then always include the clause that you are going to pursue any and all activities authorized and allowed for tax-exempt organizations because as you change, you may want to take on things that you didn't think of in the beginning.

You're going to need the articles of incorporation, which must include to meet IRS regulations, a statement that says, "No profits can inure to the benefit of an individual." There also must be a clear statement of nondiscrimination, that you are not going to discriminate against anybody. Even if your work is for Native Americans or for somebody, you still must state that you're really not going to discriminate against anybody else.

That's the first form you're going to have to have is the articles of incorporation. Those are going to be filed with the state. It's usually the Secretary of State, but, sometimes, it's another office. You need to go to your state website, the state government website, and they'll tell you there where those are filed. Then, you're going to have to file an application 1023, Form 1023, with the Internal Revenue Service. They will not grant you tax exemption permanently for at least 2 years. They will grant you a temporary tax exemption. That's because they want to see that you're actually going to do something and that what you're going to do is consistent with what you said you were going to do. In that 2-year period of time, you need to save all of the documents that you created in terms of press releases and annual reports and all of the forms that justify what it is that you're going to do.

If you're a small organization with revenues of less than \$5,000 a year, and almost nobody meets that anymore, and in some cases, less than \$25,000 a year, you can file a Form 1023-EZ. You need to be really careful about that because that gets in the way later. I really recommend that, if you anticipate your organization to survive and thrive, that you go ahead with the full Form 1023, which requires a lot of projections on your part. It's much like a business plan would be for a business in terms of your projecting your income.

Then there are forms that have to be filed every year in your state and to the federal government. That's Form 990, which is a tax return for tax-exempt organization. I think it's due in May, not April. I believe it's May 15th that it's due, not April 15th of every year. It's due a certain, I think, it's 5 and a half months after the end of your fiscal year. That tax return really needs to be carefully looked at and done correctly because you're reporting to the IRS where you got your money and how you spent it. In that will be a test of where the money come from. If the money comes from too few sources, then the IRS tends to regard you as a Foundation, not a non-profit, and that's subject to taxes on Foundations. They want to see that you have broader public support. That's what they look at among other things in that form.

Articles of incorporation, the Form 1023 for tax exemption and then the Form 990, and then the state will have a similar annual report form that has to be filed at the same time every year, and it's not as comprehensive as the federal government, but it does ask a lot of questions. Among them, "Who is on your board of directors?"

Dennis Zink: You keep mentioning articles of incorporation. Does that rule out an LLC cannot be under 501(c)(3)? Is that correct?

Jack Dunigan: That's what I understand is that it is not an LLC.

Dennis Zink: Is there any other form like a partnership or any other?

Jack Dunigan: No. Now, there's a little gray area about churches. Legally, technically, a church does have to incorporate, that they sort of stand separate and apart from the Internal Revenue Service. A set of articles of incorporation protects the group because it specifies who is actually in authority. For instance, a church can affiliate and it does not incorporate, and so it takes in members of the congregation, and one of the members can go down and decide that the church needs a bus to haul people around, and he or she can obligate the church, because he's a member, for the purchase of the bus. If it's incorporated, that's already eliminated. That can't happen. Therefore, most churches will incorporate, which then brings them under the fold legally of what they need to do.

Dennis Zink: Are there better states to do this in than other states or it doesn't matter?

Jack Dunigan: It doesn't really matter. If you're going to be a non-profit organization, you need to incorporate in the state in which you are going to do the majority of your work. If you move, for instance, maybe you incorporated it in Arizona and you upped and moved everything to Florida, then you do not re-incorporate and you do not have to refile and ask for another letter of exemption. What you do is simply notify the Internal Revenue Service of your new address and you file in your new state as a foreign corporation. That doesn't mean overseas. It means you're from a different state. They know that then you have moved and you come under their legislation, their cover.

Dennis Zink: How do I determine salaries? Is there any kind of thing, guidelines?

Jack Dunigan: The IRS does not have a guideline. They just say what is reasonable. Reasonable really doesn't mean reasonable. For instance, we know some rather prominent religious organizations that have crashed and burned because the payments they were taking out of the organization could not be construed by any stretch of the imagination as being reasonable. On the other hand, the head of the American Red Cross gets \$650,000 a year, which costs a bit of a curfuffle as well. Reasonable has a lot to do with the criteria that would sort of govern salaries in a regular business. How much do you do? What is your educational background? How large is the organization? To what extent are you responsible, and what is the budget of the organization?

If you live in certain high cost of living areas, the salaries are going to be higher than they are, say, in other parts of the country where it costs less to live. That's one thing you need to be aware of, that there's no set thing you can only make up to a certain amount. It comes under the good sense and wise choices of the board of directors who doesn't want to keep its leaders in poverty nor do they want to let them loot the treasury on the other side of it as well.

Dennis Zink: You mentioned board of directors several times. What's the best way for me to find potential members that would want to be on my board?

Jack Dunigan: Talk, networking, engaging in people and speaking to them and see if you can inspire them with the enthusiasm that you have for your cause. If you don't any enthusiasm for the cause, you really shouldn't be doing this. If you do have a great deal of enthusiasm, you will find sympathetic people who will come along and say, "I'd like to serve with you." You need to make clear your expectations right up front. What do you want from them? You expect them to oversee. You expect them to give, and you expect them to get.

Dennis Zink: What would it cost to start a typical non-profit?

Jack Dunigan: If you decide to hire a lawyer to write your articles of incorporation, that's begin at 1,500 bucks and go up from there. If you do them yourself, and you can, you're going to have to file them with the state. In Florida, I think you have to file to reserve the name. You want to make sure somebody else doesn't have the name you've picked, and then you file your articles with the state. It's \$75 at this point to do that. Then, when you file your Form 1023 in order to gain recognition as a tax-exempt organization, that filing fee is from \$400 to \$800, depending on the size of the organization with the Internal Revenue Service.

You will have other costs that would be incurred that you would in any business, your advertising cost, business cards, public relations, brochures, flyers, events that you might put on to get the thing up and going, and your board of directors should help you establish. In order to get started, we're going to have to do these things.

Fred Dunayer: I've seen certain websites that rate non-profits in terms of how much they spend on administrative costs, how much go to their causes and that sort of thing. Are you familiar with those, and do you believe in any specific things, or are there cautions both in reading and providing information to these services?

Jack Dunigan: Yes, there are cautions, but they are by and large good things to look at because you want to look for a light administrative side of things. Some organizations are very, very heavy in their administrative cost. There's one organization, which I don't need to mention, that has to do with pet and animal care. Its acronym, its letters sound remarkably similar to another one. I have friend who raises prized-winning German Shepherds, so he told me about this. This one that I first mentioned to you, huge amounts of money go to the administrative side and very little actually gets to animals. And the other side works the other way. Most organizations are not that way. They do a really good job at balancing out the money.

On the other side of it, they don't always tell you everything, unless you know what it is that you're looking for. For instance, there was one organization out on the West Coast who happened to mention to his constituents that, it was a religious organization, he was a minister, and what he did was live on... His salary was \$24,000 a year. Now, what he didn't tell anybody, and it was in the document, you could see it, was that, for ministers, your salary is taxable, but your housing allowance is not. He was getting \$30,000 a year for housing allowance, so his real income was between \$50,000 and \$60,000. Now, I don't think anybody would have cared really, but that was his way of getting around that.

There's another organization in the Midwest whose top officers make very large amounts of money, but, in order to make that more palatable with all of the donors, they actually ended up starting 3 separate non-profits that are affiliated, and they each get paid a relatively small amount from each one. If you know how to put them all together, they get quite a bit.

Fred Dunayer: Jack, this was really helpful and interesting. I think you've covered a lot of territory. If there was one thing that you would want our listeners to come away from this knowing or thinking about should they want to get involved in a non-profit, what would it be?

Jack Dunigan: Starting a non-profit is like having children or getting married. There's no going back. Once you have the baby, the baby is there. I run into this a lot where somebody, especially the young, has great enthusiasm and they're so excited about their cause and they birth the baby and, 15 years later, when the baby becomes an adolescent, they'd love to kill the baby off, but they can't because the baby is alive and thriving and going through growing pains like all organizations do. If you're going to start this, think long and hard. Starting is easy, relatively. Continuing is really difficult. Great good can happen, but you really need to think about this in the long term.

Dennis Zink: Jack, thank you for being our guest today on Been There, Done That and enlightening us about non-profits.

Jack Dunigan: Thank you. Glad to be here.

Fred Dunayer: Thank you.

Fred Dunayer: You've been listening to the SCORE Small Business Success Podcast, Been There, Done That. The opinions of the hosts and guests are theirs and do not necessarily reflect those of SCORE. If you would like to hear more Podcasts, get a free mentor, view a transcript of this Podcast or would like more information about the services we provide, you can call SCORE at 800-634-0245 or visit our website at [www.score.org](http://www.score.org). Again, that's 800-634-0245 or visit the website at [www.score.org](http://www.score.org).