



## **Incorporation: Questions and Answers; Or, How to Make Better Use of Your Lawyer When You Incorporate a State or Regional ACRAO**

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### **Introduction**

This checklist is addressed to officers of the State and Regional ACRAOs who have expressed interest in incorporating their organizations.

We offer this checklist as a means of identifying issues which you should pose to a local lawyer who is knowledgeable about incorporating nonprofit associations. Since incorporation is a creature of state law, it would be very inadvisable to attempt to create incorporation materials solely by yourself, from across-the-board “do-it-yourself” handbooks.

Thus, this list of issues and considerations is intended to be a starting-point for your discussion with a local lawyer who specializes in business law, especially incorporation of nonprofit entities. This Checklist is intended to help you address major issues you will need to raise, chronologically, with your lawyer. However, by its nature it cannot be comprehensive, since different issues may arise in different states. This material is not intended to constitute legal advice, but to help you identify issues which you will need to address through competent local counsel.

### **Checklist for Incorporation and Protection from Liability**

#### **1. Four ways in which a nonprofit organization can protect its officers and directors from liability for actions which they took in good faith (or failed to take), in the course of serving the organization**

##### **a. Incorporation**

The law recognizes corporations as separate legal entities, and the corporate form usually serves as a shield against personal liability. However, officers and directors are not absolved of responsibility for the consequences of gross negligence, or for violation of criminal law.

### **b. Indemnification**

A nonprofit organization may, if it chooses to incorporate, provide in its articles of incorporation and its bylaws, that it will pay the judgments and related expenses, including legal fees, of the officers and directors acting in its behalf. Note: Depending on the resources of the organization, this promise could be a hollow one.

### **c. Insurance**

Instead of shifting the risk of liability from individuals to the organization, insurance shifts the risk of liability to a third party: an insurance company. Review the policy's "exclusions" paragraph carefully. Many Officers and Directors liability insurance policies exclude not only criminal violations, but such civil law transgressions as libel and slander, and employment discrimination (if the organization has employees).

**d. Immunity** – Many states have enacted immunity laws for officers and directors of nonprofit organizations, protecting them from violations of civil law if their action (or inaction) was reasonable.

## **2. What laws are involved?**

Incorporation is governed by state law – the law of the state in which you incorporate. Generally, an organization is incorporated in the state in which it is headquartered. An entity can be incorporated in only one state at a time.

Most State and Regional ACRAOs will not have a free-standing headquarters. In other words, the headquarters in most cases will be in whatever college or university the association President for that year is located. In such instances, you should raise the following issues with the lawyer you are working with as you incorporate your association:

- a. Whether, in your state, the change of Presidency is equivalent to a change of headquarters; and
- b. For regional ACRAOs: If so, would state law or regulation require a new incorporation when the next President comes from a different state; and
- c. For state and regional ACRAOs: If the office of the registrar or admissions (or other) professional serving as President is considered to be the headquarters of the association for his or her term, does the law or case law of your state suggest that the school which is the functional equivalent of the headquarters of the association for that year would have any liability in the event that the state or regional ACRAO is sued for events occurring in that year?
- d. "Choice of law" provision – Articles of Incorporation sometimes state that "Any disputes will be adjudicated under the laws of the state of incorporation." Consult with your local lawyer as to whether this provision is advisable, especially for a regional ACRAO.

### **3. What about incorporating a regional ACRAO, which includes officers and directors from more than one state?**

Consult with a knowledgeable local attorney, to see which state within your regional grouping has law which would be most favorable to your incorporation, and also to make sure that you can incorporate in that state even if none of your officers or directors are located there.

### **4. Incorporating is not the same as becoming a “section 501(c)(3)” organization.**

Section 501(c)(3) is named after the section of the federal Internal Revenue Code which allows deductibility of charitable contributions made to entities which meet specific statutory and other regulatory criteria. The IRS grants recognition of this status on a case-by-case basis. It is also useful to have 501(c)(3) status if you wish to apply for grants (as an organization).

You need to file an application for 501(c)(3) status with the IRS. You should allow several months, at a minimum, for the transaction to be completed. Section 501(c)(3) is unrelated to questions of liability.

### **5. What do you need to do to create a nonprofit corporation?**

- a. Draw up Articles of Incorporation;
- b. Draw up Bylaws;
- c. File the Articles of Incorporation with the appropriate entity in your state. Consult with local counsel; often, the appropriate entity is the (State) Secretary of State’s office.
- d. File the Bylaws with the appropriate state entity, if state law so requires. If your state does have such a requirement, check also to see whether there is an ongoing requirement to file amendments to the Bylaws -- complete with date enacted and effective date -- to the appropriate state entity.

### **6. What the Articles of Incorporation should contain:**

- Article One.* The name of the corporation.  
*Article Two.* The period of its duration (“perpetual”).  
*Article Three.* Purposes for which the corporation is formed.  
 Suggested items for inclusion:

- 1.) Mission.

2.) “Necessary and proper” clause -- To take all actions necessary and proper for the accomplishment of the mission of [name of organization], provided that such actions are consistent with the provisions of law under which this corporation is organized. These actions may include, but are not limited to, the making and carrying out of contracts.

3.) Non-pecuniary profit clause – The purposes for which this corporation is formed are to be promoted, transacted and carried on without pecuniary profit.

4.) Non-limitation of powers to advance the mission of the association – The enumeration of specific purposes shall not be construed as limiting or restricting the undertaking of other such functions as shall advance the general purposes enumerated in the mission statement.

*Article Four. **Members***

This Article can state that all members of the predecessor nonprofit voluntary professional association named [ ] shall be deemed to be members of the newly-formed corporation.

*Article Five. **Classes of members***

Enumerate the various classes of members: Individual members? Institutional members? [Or any other categories determined by the association’s Board of Directors.]

*Article Six. **Directors***

This Article can state that Directors shall be elected in the manner provided by the Bylaws.

*Article Seven. **Regulation of internal affairs of the corporation***

1.) Indemnification clause -- The corporation, by resolution of its Board of Directors, may provide for indemnification by the corporation of any and all of its officers and directors as provided in its Bylaws.

2.) Non-distribution of net earnings -- No part of the net earnings of the corporation shall inure to the benefit of, or be distributable to, its directors, officers, or other private persons, except that the corporation is authorized to pay reasonable compensation for services rendered and for other expenses, and to make payments in furtherance of the objectives and purposes set forth in these Articles.

3.) Provision for distribution of assets upon dissolution of the corporation -- Consult local counsel for provisions in accordance with state law.

4.) Influencing of legislation – Renunciation of this practice is important if you wish to become a 501 (c) (3) organization. Often, such a statement consists of two parts: “No substantial part” of the activities of the corporation shall consist of attempting to influence legislation; and, The corporation shall not participate in, or intervene in (including any publishing or distribution of statements) any political campaign on behalf of, or in opposition to, any candidate for public office.

5.) Statement of non-discrimination -- Check with local counsel to see what categories of discrimination are prohibited by state law.

6.) Provisos related to sections of the Internal Revenue Code, if you choose to apply for IRS recognition as a section 501(c)(3) entity -- Notwithstanding any other provision of these Articles, the corporation shall not carry on activities not permitted to be carried on by either of the following two sections of the Internal Revenue Code, or their successor sections: Section 501(c) (3), or Section 170 (c)(2) [deductibility of charitable contributions].

*Article Eight.* **Address of the initial registered office of the corporation  
Address of the registered agent.**

The registered agent is the person who receives formal communications from the state, and who receives service of process, in the event of a lawsuit. Typically, the agent is either a resident of the state in which the entity is incorporated, or else a company that is licensed by the state to be a commercial registered agent. Unless the agent is also an officer or director (check with state law to see if whether the dual role of agent and officer-or-director is permitted), s/he has no liability for the corporation’s activities. The agent would be liable only for his or her own offenses, such as breach of contract.

*Article Nine.* **Number, and names, of the initial Board of Directors**

These are the people who will serve as the initial Directors until the first annual meeting.

Note: It is often a good idea for successor Directors to serve staggered terms, so that the membership of the entire Board does not turn over at one time. As an example: If state law permits, one third of the initial Directors could serve a one-year term, subject to re-election if the Board so desires; one third would serve an initial two-year term, subject to the same provisos; and one third could serve an initial three-year term, subject to the same provisos just set forth.

Also note: The subsequent Board of Directors may have more members than the initial Board of Directors (if state law permits).

*Article Ten.* **Names of the Incorporators**

The number of people required to be the incorporators varies according to the state.

*Article Eleven. Prohibited Transactions*

The corporation shall be specifically prohibited from engaging in the following transactions:

- 1.) Loaning any part of the corporation's income or corpus without the receipt of adequate security and a reasonable rate of interest; and making any loan to a officer or director of the corporation;
- 2.) Paying any compensation in excess of a reasonable allowance;
- 3.) Engaging in any transaction which results in a substantial diversion of the corporation's income or corpus, to any incorporator, director, or substantial contributor to the corporation; to their families; or to corporations or other entities controlled by them.
- 4.) Selling any substantial part of the corporation's securities or other property for less than adequate consideration, or purchasing any substantial part of the corporation's securities or other property for more than adequate consideration.

*Article Twelve. Choice of law provision*

See question 2, item d – Check with local counsel to see if it is advisable to include a proviso that disputes are to be adjudicated according to the laws of the state of incorporation.

**7. What the Bylaws should contain:**

1. Statement of the mission of the organization;
2. Membership and dues;

Categories of voting and non-voting memberships

Statement that dues will be set by the Board of Directors, with

[Sample provision: At least [ ] days notice in advance of voting, for approval by the membership, by majority vote, at the Annual Meeting].

3. Board of Directors – State number of directors; enumerate titles (President, President-elect, etc.); meetings and notice required for meetings; acceptable methods of notice; duties of the Board as a whole; duties of each officer;

vacancies; removal; compensation (“Directors shall not be compensated except that they may be reimbursed for reasonable and necessary expenses incurred in connection with their service as Directors.”)

4. Elections – This sections should cover: Eligibility to vote; function and structure of a Committee on Nominations and Elections; length of terms of directors.

#### 5. Meetings

Annual Meeting – Notice requirements (time frame); acceptable forms of notification [including electronic transmission, if the Board so desires]; authority of the Board to change or, in the case of emergency, cancel an Annual Meeting.

Business session – When it is to be conducted (at the Annual Meeting); by whom (voting members present); quorum (define how many voting members).

Business to be conducted at the business session – Election of Directors and officers; reports from committees; adoption of budget and resolutions; and action to any proposed amendments to the Bylaws and Articles of Incorporation.

Occurrences to be provided for: [The following are suggested provisions, not required ones]

Quorum not present at the business session? – Then, the slate of Directors will be considered elected and the proposed budget adopted.

Budget defeated when a quorum is present? – Then, the most recently adopted budget will be considered to be in effect.

Proportion of member votes required for adoption of any proposed amendment to the Articles of Incorporation or Bylaws – Sample provisions: Two-thirds majority of the votes cast if notice was given to the voting members at least thirty (30) days in advance, or a four-fifths majority if less or no advance notice was given.

Except for amendments to the Articles of Incorporation and Bylaws, decisions shall be made by simple majority vote. [Suggested, not required, language.]

6. Provision for appointment of committees and task forces

7. Miscellaneous provisions

a. Fiscal year – State what it is:

State the dates: July 1-June 30, as an example; or, calendar year, etc.

Note: Any change in the fiscal year will thus require a change in the Bylaws. You may also have to report the change to the state, if state law requires notification of Bylaws changes.

- b. Records and minutes – Topics to cover: Where the records and minutes are to be kept; what is to be made available to voting members: Articles of Incorporation; Bylaws; financial statements; Board or Member resolutions it adopts; and minutes.
- c. Contract authorization – Authorizes the Board of Directors to authorize any director, officer, employee or agent to execute contracts on behalf of the Association and to sign checks, drafts, loans or other orders of payment or evidence of indebtedness.
- d. Indemnification provision – Optional provision. The Board of Directors is authorized to pay the judgments and related expenses, including legal fees, incurred by the directors and officers when those expenses are the result of a commission or omission by those persons while acting in the service of the organization; provided, however, that such indemnification cannot extend to criminal acts, or to willful acts or acts of gross negligence that violate civil law.
- e. Location of office – See discussion in question 2, above.
- f. Parliamentary rules -- Except as otherwise provided in the Articles of Incorporation and the Bylaws, all meetings of the Association, its Board of Directors, and its committees shall be governed by the rules of parliamentary procedure.
- g. Amendments

Proposal of amendments to the Articles of Incorporation or Bylaws – Suggested language: Proposals may be made either by a simple majority vote of the Board of Directors, or by [a \_\_\_ percentage of] voting members of the Association.

Number of days prior to the Annual Meeting before which proposed amendments must be submitted to the Board of Directors or the President: [Suggestion: ninety days]



Requirements as to adoption of amendments to the Articles of Incorporation or Bylaws. [Sample: Two-thirds majority of the votes cast at the Business Session of an Annual Meeting at which a quorum is present, if notice was given to the voting members at least thirty (30) days in advance, or a four-fifths majority if less or no advance notice was given.]

At the close of the Bylaws:

Note any amendments to the Bylaws. State the Article(s) and Section(s) which were amended, and include the substituted language. Also include: Date on which the vote was taken; and effective date of the new provision.

### **8. File your Articles of Incorporation; and, if required, the Bylaws**

Check with a local lawyer, or directly with your Secretary of State's office, concerning the following:

1. Where to file.
2. How many copies to file – In some states, you need only submit an original of the Articles; the Secretary of State will file the original and send you a Certificate of Incorporation as proof of filing. In other states, you need to submit the original and one or more copies.
3. Filing fee, made out to the correct state office or officer, by title.
4. Check on the necessity of filing your Bylaws. (See discussion in question 5, item d.)