

## **AG and DCCA Guidance: Think Twice Before Forming A New Charity**

The Attorney General and Department of Commerce of Consumer Affairs ("DCCA") frequently get calls from persons interested in how to form a new nonprofit or charitable organization. The DCCA's Business Registration Division's ("DCCA") website provides form articles of incorporation that may be used by the incorporators of a charitable organization to form a nonprofit corporation and you can even accomplish this task online.

<http://hawaii.gov/dcca/areas/breg/registration/dnc/>

However the Attorney General and DCCA generally recommend that persons who are considering forming a new charitable organization think carefully before doing so. Here are some issues to consider before taking the next step:

1. When you start a charity, you are responsible for the nuts and bolts of it too. Sometimes people decide to start a charity because they want to have a significant say in shaping mission and direction. They do not view volunteering as a satisfying alternative because they want to avoid stuffing envelopes, calling prospective donors, and the other nuts and bolts work that new volunteers often are asked to do. But unless you have lots of friends and colleagues who are willing to volunteer, you will find

yourself doing the administrative work that you may have hoped to avoid when you decided to start the charity.

Volunteering may actually be a good alternative. Consider that Hawaii has over 5,000 tax exempt nonprofit organizations. They cover a lot of causes and many are similar in their missions. For example, as of the date of this guidance, there were 22 nonprofits with the word "environment" or "environmental" in their names.

- Giving your time, resources, or talents to an existing charity rather than starting a new one may be the best fit for you if the responsibilities of running a charity don't really fit your resources.
- If the financial resources of the proposed new nonprofit are modest, the funds might be better or more efficiently utilized by an existing nonprofit.
- Have you considered the possibility of creating a donor advised fund at an existing community foundation instead of starting a new organization?
- Are you trying to benefit a school or animal humane organization? If so, have you considered partnering with a Parent Teacher Student Association or one of many animal humane organizations?

2. Know the facts on taxes. Sometimes people decide to form a nonprofit in order to get the tax exempt benefits. Before doing this, you should know that tax exempt status requires both a state filing and a 28 page Form 1023 with the Internal Revenue Service. Filling the forms and waiting for a response may take some time and effort. Be sure you know what it takes and how long it takes.

3. In addition, not all of a charity's revenue is tax exempt. Donations are, but income from fundraising activities is subject to federal and Hawaii's general excise tax (GET). For example, if the purpose of your charity is to run an animal shelter and you have a bake sale fundraiser for the animal shelter, profits from the bake sale fundraiser

would be subject to the GET and federal tax. In addition other types of “unrelated business income” is subject to federal income taxation.

4. Forming a new charity comes with administrative burdens and costs, including but not limited to:

- Annual corporate reports to the DCCA
- The cost to prepare and file IRS Form 1023 to seek federal tax exempt status.
- Annual tax reporting (Form 990, 990EZ) and the accounting costs associated with the preparation and filing of such forms.
- The cost of seeking an exemption from Hawaii's General Excise Tax and filing periodic and annual tax returns to report fundraising income (which is not exempt from GET).
- Compliance with Workers Compensation, Unemployment Insurance, Income Tax Withholding, Pre-paid health care insurance if the nonprofit will have employees.
- Compliance with Hawaii's charitable solicitation law.
- Possible registration requirements, registration fees, and annual reporting requirements in other states if you intend to solicit funds from the public.
- Notifying the Attorney General of mergers, acquisitions and proposed dissolutions.

5. Your responsibilities for the nonprofit corporation continue even if you dissolve the corporation. If you decide not to continue the nonprofit, the liabilities of the corporation continue even if you stop filing annual reports or you actively dissolve it. Under the law, failing to file annual corporate reports or dissolving a corporation does not mean that the corporation and its liabilities cease to exist. If you just stop filing your annual corporate reports, the corporation will not be in good standing but the

corporation and its directors and officers are still responsible for the corporation. Even after a formal dissolution, the corporation continues until all liabilities are properly wound up.

Additional considerations to carefully think about before forming a new charitable organization can be found in a leading charity governance consultant's governance blog.

[http://charitygovernance.blogs.com/charity\\_governance/2004/09/starting\\_a\\_char.html](http://charitygovernance.blogs.com/charity_governance/2004/09/starting_a_char.html)

If after all your careful consideration of the information above, you still want to proceed to starting your nonprofit charity and you'd like some help with the filings and other information, please contact the DCCA's Business Action Center at 586-2545.