



# 1: GOVERNANCE – STATE LAW

## KNOW

There are five key areas of **State Law** for nonprofits to be aware of:



1. **Articles of Incorporation:** Articles of Incorporation are the document that creates the corporation. It needs to meet both state requirements for a nonprofit corporation as well as federal tax law requirements to qualify as a 501(c)(3) organization.



2. **Bylaws:** “Bylaws” refers to the document that sets out the rules of operation for your organization.



3. **Fiduciary Duties:** Board members have a set of legal obligations towards the nonprofit corporation, called fiduciary duties.



4. **Recordkeeping:** A nonprofit board keeps records so that it can report to funders or government agencies or the community about decisions and actions made.



5. **State Taxes:** While a tax-exempt organization does not pay federal taxes, it is responsible for applicable state taxes.

## KNOW MORE

### 1. Articles of Incorporation

Since Articles are the original document that creates an organization, a nonprofit should keep a copy of the filed Articles. If it doesn't have one, it can order them from the Secretary of State. The Articles set the parameters of the organization's charitable purposes and may describe whether or not it has members.



#### A. State law requirements

- Registered Agent:** A nonprofit must have a registered agent and a registered office. This is the way that the state contacts the corporation. The registered agent needs to be a dependable person, and the address needs to be a stable

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street address in Washington State. The Registered Agent must sign a consent to serve in that role which is filed with the Articles.

- Name:** A nonprofit must have a name for the corporation that cannot be the same as or very similar to the name of any other corporation or legal entity in Washington and cannot have words like *Inc.*, *Co.*, *Company*, *Ltd.* in it.
- Initial Directors:** A nonprofit must give the name and address of at least one individual who will serve on the Board.
- Incorporator:** A nonprofit must give the name and address of at least one person who will serve as the incorporator. The incorporator is the person who signs the Articles.

## B. Federal tax law requirements

*While we go into more detail on federal law in the next section, let's review the elements of the Articles of Incorporation that relate to federal requirements.*

- Purpose:** A nonprofit must list purposes for the organization that meet the definition of charitable purposes under federal tax law. See the Sample Articles of Incorporation in our Key Documents, for specific language.
- Dissolution:** A nonprofit must provide for the distribution of any remaining assets in the event that the corporation is closed down. The assets must be distributed to another 501(c)(3) organization or to the federal or state government for a public purpose.
- Limitation of liability** (recommended): This provision changes the standard for determining liability of directors to "gross negligence," making it harder to prove liability.
- Indemnification** (recommended): This provision authorizes the corporation to pay costs of defending officers and directors who are sued and in some cases, any damages required to be paid by an officer or director.

## C. Requirements after Incorporation

- Annual Report:** A nonprofit needs to file an annual report with the Secretary of State to maintain "Active Status." It is due to be filed every year on the birthdate of your corporation. If the nonprofit doesn't file it, it will be administratively dissolved.
- Initial Meeting of the Board of Directors:** The individuals listed in the Articles as the initial directors meet to take actions necessary to start up the corporation. This includes adopting the Bylaws, electing officers and authorizing opening a bank account.

## D. Changes to the Articles

The Articles can be changed upon approval of the Board of Directors by a document called "Articles of Amendment." The most common amendments to Articles are to change the corporation's name or to add new purpose.

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## 2. Bylaws



The Bylaws are the rules of operation for the corporation and are required by State Law. Bylaws are not filed with the state. The nonprofit should keep a file of the Bylaws in the office, with any amendments. Each board member should keep up to date Bylaws. They are filed with the IRS when you apply for tax exemption.

- ❑ **Members:** Washington nonprofit corporation law permits nonprofit corporations to have members as voting or nonvoting members. If you have members, it is important to be clear why you have members and what their rights are. If you give members the right to vote, you need to clearly state what those voting rights are and provide appropriate provisions for holding meetings.
- ❑ **Board of Directors:** Under state law, only one director is needed; however, you will need at least three directors if you are seeking tax-exempt status. Usually the number of directors is described as a range, with a minimum number and maximum number of directors given. The Bylaws also provide for how the directors are elected, length of term, their qualifications, resignation, and removal. It is important to have removal provision.
- ❑ **Meetings:** The Bylaws provide for how the Board meets, how it gives notice of meetings, how it holds special meetings, what a quorum is, and the vote needed for the Board to act. Under Washington law, a Board can meet in-person, or by telephone or some other form of electronic communication, as long as everyone can hear everyone else speak. Chat rooms online are not permitted. You also can meet in the form of writing, called a “consent resolution.” Directors give their consent in writing or by email. Such a consent must be unanimous; that is, every director needs to vote, and everyone must vote in favor of the resolution proposed.
- ❑ **Committees:** Bylaws often cover the roles of committees. There are two kinds of committees: (1) board committees, composed only of directors that can act for the Board (non-board members can attend committee meetings and give input, but cannot vote), and (2) advisory committees that give advice and recommendations to the Board.
- ❑ **Officers:** Their duties are described in the bylaws.
- ❑ **Amendments:** There’s a provision that describes how the bylaws are amended. Usually amendments to the bylaws require a supermajority vote of the Board and sometimes special notice. If the corporation has voting members, this provision may require member approval as well.

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## 3. Fiduciary Duties

*The Washington Nonprofit Corporation Act* sets out the duties and protections of the directors.



### A. Three Duties

Directors must fulfill duties described as the Duty of Care, Duty of Loyalty, and Duty of Obedience:

- ❑ **Duty of Care:** A director is expected to have a level of **competence** described as exercising the “care of an ordinarily prudent person in like position” under similar circumstances. That means a director has to exercise reasonable care when making a decision as a board member, using diligence and independent judgment.
- ❑ **Duty of Loyalty:** A director should act in the **best interest of the organization**, putting the organization before self-interest. This is particularly important where there is the potential for personal gain and often arises when there is a conflict of interest. It’s a best practice for staff and board to sign a Conflict of Interest policy.
- ❑ **Duty of Obedience:** A director must make sure that the organization is in **compliance** with local, state, and federal laws and is staying true to its mission.

### B. Protections

Washington State law provides protections to make sure the directors are protected in the event the directors are threatened with legal action. In both cases, provisions should be written into the organization’s Articles of Incorporation.

- ❑ **Limitation of Liability:** These provisions eliminate or limit the personal liability of a director in cases where the director did not act with intentional misconduct or receive inappropriate personal benefit.
- ❑ **Indemnification:** These provisions permit a director who is a part of a legal proceeding related to the corporation to apply for indemnification, in other words, to be compensated for loss or damage, by the nonprofit. This would cover reasonable expenses incurred by the director in connection with a legal case before a court. This protection can extend to officers, employees or agents of the organization.

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## 4. Recordkeeping



A nonprofit must keep clear and complete records to ensure that it complies with tax rules. Good recordkeeping systems allow organizations to better evaluate its programs, monitor its budget, and prepare financial statements and returns. It is a best practice to have a Document Retention Policy that describes what records should be kept on file and for how long.

### A. Financial Records

The law does not require a certain kind of record system because it will vary by organizational size. The system, however, should include these items:

- Receipts: Amount received from all sources
- Purchases: Items bought, including any items resold to customers
- Expenses: Other costs to run programs
- Employment taxes (for staffed organizations)
- Assets: Property that an organization owns and uses in its activities

### B. Board Minutes

Board minutes are the written record of the actions and decisions taken at a board meeting. Once written and approved by the board, they are accepted as a true representation of the meeting they record and can be used as legal evidence.

Usually the Secretary is in charge of minutes. A nonprofit keeps them electronically or in a binder. They should be kept forever.

### C. Other records

Other key documents related to the organization should be kept for at least 7 years. A Documentation and Retention policy is considered best practice.

## 5. State Taxes



There are three state taxes that impact Washington nonprofits:

- a. **Business & Occupation Tax:** A nonprofit must file a **Master Business License** with the Department of Revenue if it will have employees or a revenue source on which it must pay State Business and Occupation Tax (B&O Tax) or Sales Tax. The B&O Tax taxes the gross income that your organization brings in. Donations, grants and proceeds from fundraising events are exempt.
- b. **Sales Tax:** Organizations that sell products must pay sales tax.
- c. **Property Tax:** Unless exempt, nonprofits must pay property taxes on any property that it owns.

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## KEY DOCUMENTS

- Articles of Incorporation
- Bylaws
- Conflict of Interest Policy
- Document Retention Policy
- Gift Acceptance Policy
- Minutes

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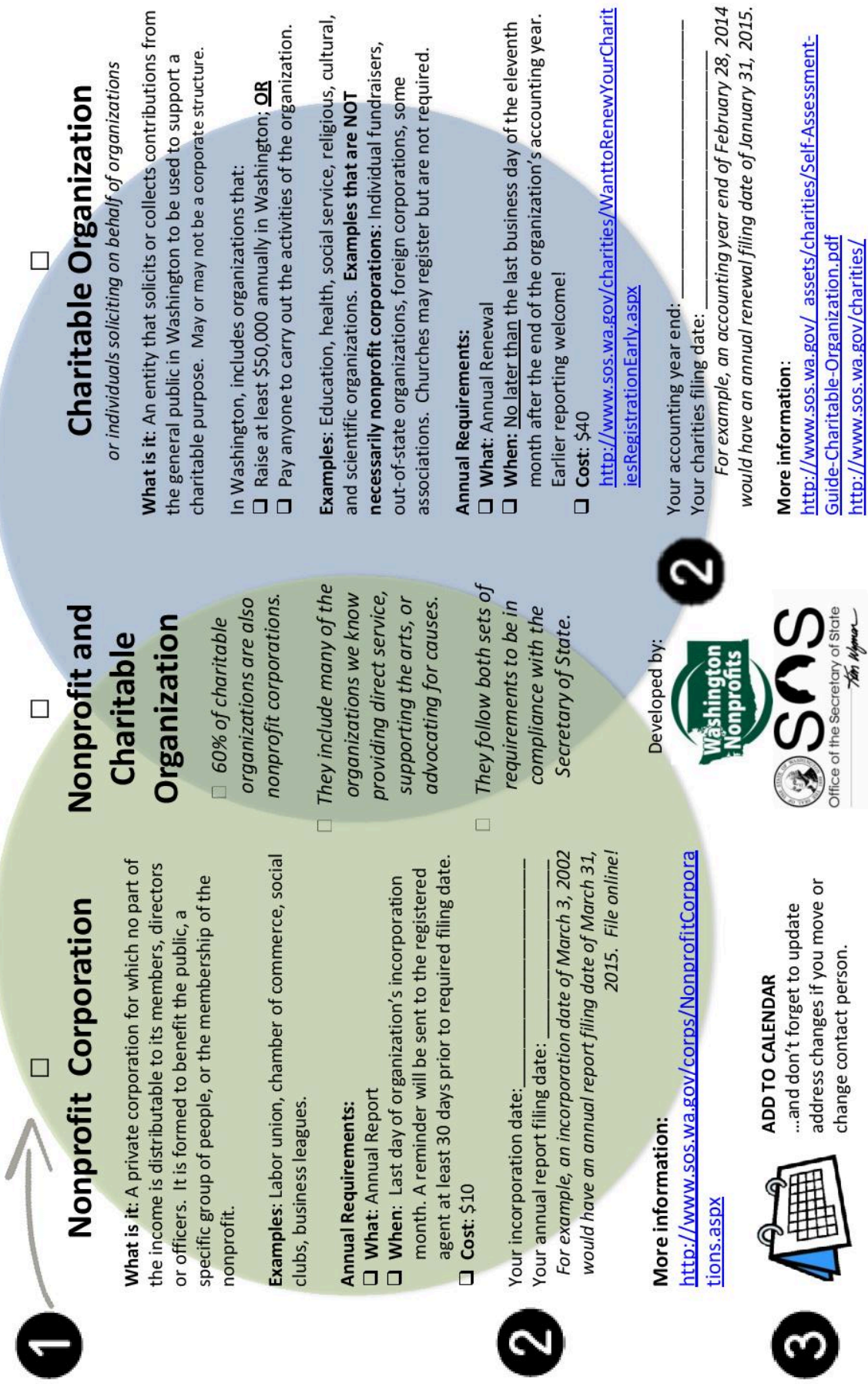
## ACTION

If Yes, Date sent or reviewed	No	<b>State Law Legal Checklist</b>
		Our board of directors reviews the Articles of Incorporation at least once a year to make sure that actual practice is consistent with these documents.
		Our Organization's registered agent is still at the address on file with the Secretary of State.
		The registered agent has signed a consent form that is on file with the Secretary of State
		We can rely on our registered agent to give us mail that comes to the corporation
		Our board of directors reviews the Bylaws at least once a year to make sure that actual practice is consistent with these documents.
		Our Organization prepares and maintains financial statements and statements of account on a regular basis.
		Our board has reviewed, and if necessary secured expert advice about, our financial controls, and regularly revisits this topic to assure adequate scope and compliance.
		Our Organization has adequate separation of financial duties. In particular, the person writing and signing checks is different than the person reviewing and reconciling bank statements.
		More than one person is an authorized signer on our Organization's bank accounts, and these signatories are up-to-date.
		Our Organization does not make loans to any of its officers or directors.
		Our Organization understands and carefully observes any use or spending restrictions on grants and other contributed funds.
		Our Organization has Officer and Director insurance, and the board members have reviewed the policy and understand what it covers and what it does not cover.
		Our Organization files an annual report with the Washington Secretary of State. (You may also need to register as a Charitable Organization; see "Fundraising" for more.)
		Our Organization has filed a Master Business Application with the State of Washington.
		Our Organization understands its obligation to pay any state sales or business and occupation taxes.
		Our organization understands whether it is entitled to any exemptions from these taxes
<b>LOCAL</b>		
		Our Organization has a current license to do business from the city/county where it is located.
		Our Organization understands its obligation to pay any local business and occupation or property taxes.

# Stay Up-to-Date with the Secretary of State

Nonprofit and charitable organizations need to register and stay up-to-date with the Office of the Secretary of State.

- 1 Check which type of organization you are.
- 2 Note your key dates.
- 3 Put those dates onto your organizational calendar.



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## Nonprofit Corporation

**What is it:** A private corporation for which no part of the income is distributable to its members, directors or officers. It is formed to benefit the public, a specific group of people, or the membership of the nonprofit.

**Examples:** Labor union, chamber of commerce, social clubs, business leagues.

**Annual Requirements:**

- What:** Annual Report
- When:** Last day of organization's incorporation month. A reminder will be sent to the registered agent at least 30 days prior to required filing date.
- Cost:** \$10

Your incorporation date: \_\_\_\_\_

Your annual report filing date: \_\_\_\_\_

*For example, an incorporation date of March 3, 2002 would have an annual report filing date of March 31, 2015. File online!*

**More information:**

<http://www.sos.wa.gov/corps/NonprofitCorporations.aspx>



**ADD TO CALENDAR**

...and don't forget to update address changes if you move or change contact person.

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## Nonprofit and Charitable Organization

60% of charitable organizations are also nonprofit corporations.

They include many of the organizations we know providing direct service, supporting the arts, or advocating for causes.

They follow both sets of requirements to be in compliance with the Secretary of State.

Developed by:



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## Charitable Organization

*or individuals soliciting on behalf of organizations*

**What is it:** An entity that solicits or collects contributions from the general public in Washington to be used to support a charitable purpose. May or may not be a corporate structure.

In Washington, includes organizations that:

- Raise at least \$50,000 annually in Washington; **OR**
- Pay anyone to carry out the activities of the organization.

**Examples:** Education, health, social service, religious, cultural, and scientific organizations. **Examples that are NOT necessarily nonprofit corporations:** Individual fundraisers, out-of-state organizations, foreign corporations, some associations. Churches may register but are not required.

**Annual Requirements:**

- What:** Annual Renewal
- When:** No later than the last business day of the eleventh month after the end of the organization's accounting year. Earlier reporting welcome!
- Cost:** \$40

<http://www.sos.wa.gov/charities/WanttoRenewYourCharitiesRegistrationEarly.aspx>

Your accounting year end: \_\_\_\_\_

Your charities filing date: \_\_\_\_\_

*For example, an accounting year end of February 28, 2014 would have an annual renewal filing date of January 31, 2015.*

**More information:**

<http://www.sos.wa.gov/assets/charities/Self-Assessment-Guide-Charitable-Organization.pdf>  
<http://www.sos.wa.gov/charities/>

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