

CONFIDENTIAL
ATTORNEY-CLIENT PRIVILEGED COMMUNICATION

STEPS TO ESTABLISH AN EDUCATION FOUNDATION

- 1. Decide Whether to Incorporate.** An educational foundation is not strictly required to be incorporated as a Non-Profit Corporation. To enhance the likelihood that it will be treated as a separate entity and be eligible for recognition as a 501(c)(3) organization under the IRS Code, however, we generally recommend incorporation as a first step. By going through the formalities of incorporating and maintaining separation of the required governance processes, the line between the two entities is easier to maintain.

Under Texas law, a nonprofit corporation is simply a corporation in which no part of its income is distributable to a member, director or officer of the corporation. A nonprofit corporation may be organized in Texas for any lawful purpose. Being a nonprofit corporation does not alone qualify the Foundation to be tax exempt at either the state or federal level; these are separate privileges applied for after incorporation. An important distinction between nonprofit and for-profit corporations is that, a for-profit corporation has shareholders who own the corporation. On the other hand, no individual owns a part of the nonprofit corporation or has an interest in its property.

- 2. Prepare and File Certificate of Formation for a Non-Profit Corporation.** The next step in the process of setting up an educational foundation is to file a Certificate of Formation. As the name implies, the Certificate of Formation is the document filed with the Secretary of State to form the nonprofit corporation. The Certificate, which becomes a public document, defines what the corporation will do and who will be initially responsible for its management. After the Certificate of Formation for the Foundation received back from the Secretary of State, the Foundation is officially considered to be in existence.

To qualify for federal tax-exemption under Section 501(c)(3) of the Internal Revenue Code, a nonprofit must be organized and operated exclusively for one or more of the following purposes: religious, charitable, testing for public safety, literary, educational, or the prevention of cruelty to children or animals. The Foundation will likely qualify as based on its educational purpose. The nonprofit cannot be organized for the purpose of financial profit for its members or directors, although the members of directors can be paid a reasonable compensation for their work. Section 501(c)(3) nonprofit organizations are absolutely precluded from engaging in partisan political campaign activities and their lobbying activities are heavily regulated. This process can begin once the Foundation has established by-laws and had its organizational meeting.

- 3. Prepare Bylaws.** The initial Board of Directors for the Foundation should prepare bylaws for the corporation simultaneously with the preparation of the certificate of formation or soon thereafter. The bylaws contain the rules governing the internal structure and internal management of the corporation and will be adopted at the first meeting of the Foundation. A copy of the bylaws, signed by a corporate officer will be required when applying for the federal 501(c)(3) tax-exemption. Texas law requires certain provisions to be included in the bylaws, but most provisions are optional.
- 4. Have an organizational Board Meeting and Document with Minutes.** After the Certificate of Formation is received back from the Secretary of State, the Foundation is officially considered to be in existence. At that point, the Directors will need to take care of some initial housekeeping issues for the Foundation. These steps are generally completed at a meeting of the Board members that were named in the Certificate of Formation. This meeting is called an "Organizational Meeting." The directors named in the Certificate of Formation are required to receive at least three days' notice of the meeting, stating the time and place of the meeting or in the alternative, they must sign a waiver of notice at the meeting. Documentation of the notice should be kept in the Corporate Record Book with the Certification Form, copies of the minutes of all meetings, and other official Corporation Documents.
- 5. Apply for a Federal Employer Identification Number.** In order to be tax-exempt, an organization must obtain a Federal Employer Identification Number (EIN). An EIN is needed whether or not the organization has employees. This number is used on all federal tax returns and receipts. The EIN (together with the file stamped copy or certified copy of the Certificate of Formation) is also essential when opening a bank account for the corporation.
- 6. Apply for Federal Tax Exemption.** Having a state chartered Non-Profit Corporation does not automatically make the Foundation eligible for tax-exempt status under Section 501(c)(3) of the IRS Code. To obtain federal tax-exempt status as a charitable organization, a corporation will need to file IRS Form 1023 with the IRS. The form should be filed within 27 months from the date the certificate of formation is filed with the Secretary of State. The IRS has 270 days to rule on the application. Usually within two or three months, the IRS requests additional information or approves the organization's tax-exempt status by issuing a "determination letter" to the corporation formally approving the exemption.
- 7. Apply for Sales, Franchise and Hotel Tax-Exemption from Texas Comptroller.** Similarly, tax-exempt status must also be granted by the state. Without the exemption, nonprofit corporations are subject to the same state taxes that for-profit corporations are subject to, including sales/use, franchise and hotel occupancy tax, unless the nonprofit corporation obtains an exemption from the Texas Comptroller of Public Accounts.