



## Chapter 1

# State Law

---

### CHAPTER OUTLINE

1. Articles of Incorporation
    - A. State law requirement
    - B. Federal tax law requirements
    - C. Requirements after incorporation
    - D. Changes to the Articles
  2. Bylaws
  3. Fiduciary Duties
    - A. The Four Duties
    - B. Protections
  4. Recordkeeping
    - A. Financial records
    - B. Board minutes
    - C. Other records
  5. State taxes
  6. Legal Checklist: State Law
- Chapter 1 Summary: State Law
- 

### INTRODUCTION

Before you drive a car, you need to register it. You need to know the rules of the road. You need a license plate and a driver's license. We begin with state law because that is where a nonprofit first registers to become official. The Articles of Incorporation are filed to create the corporation and the board adopts Bylaws and sets out a plan to monitor money and keep records. The organization stays compliant with state corporation law and other state law requirements, including filing corporation and charity reports every year. In Washington state, the governing law is the Washington Nonprofit Corporation Act (RCW 23.04A), which was updated on January 1, 2022.



## 1. ARTICLES OF INCORPORATION

The Articles of Incorporation are the original document that creates a corporation. A nonprofit should keep a copy of the filed Articles. If the organization does not have a copy of the Articles on record, copies are available for download on the Secretary of State's website. The Articles set the parameters of the organization's charitable purposes and may describe whether the organization has members. If the Articles are filed after January 1, 2022, the Articles must state whether the organization has members meeting the definition of members under state law.

### A. State law requirement

- **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 or entity, and the address needs to be a stable 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, or Ltd. as part of the name.
- **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.
- **Members:** A nonprofit formed after January 1, 2022 must specify whether the organization has members as such term is defined under the Washington Nonprofit Corporation Act.
- **Limitation of liability** (recommended): This provision changes the standard for determining liability of directors to "gross negligence," making it harder to prove liability.

### 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. Additionally, the Articles of Incorporation must not empower the organization to engage, other than as an insubstantial part of its activities, in activities that are not in furtherance of one or more of those purposes. The IRS recommends that language prohibiting private benefit to persons involved in the organization as well as language prohibiting political activity and limiting lobbying activity be included. 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 if the corporation is dissolved. The assets must be distributed to another 501(c)(3) tax-exempt 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 hold directors liable.
- **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.” The annual report is due to be filed every year by the last day of the organization’s incorporation month. If the nonprofit does not file an annual report, 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 (and by the members if the organization has members with a right to vote on such matters) by a document called “Articles of Amendment.” The most common amendments to Articles are to change the corporation’s name or to add a new purpose(s).

## **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. A nonprofit should keep a file of the Bylaws and any associated amendments in the office. Each board member should have access to an up-to-date copy of the Bylaws. Bylaws 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 the Bylaws have a removal provision for directors.

- **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 remote communication, as long as everyone can hear everyone else speak at the same time. Chat rooms online are not permitted. You can also 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. Washington State Law gives appropriate procedures on how to execute such consents when a director has an interest in the action being considered (called a “conflict of interest”) and, under normal circumstances, would not be able to vote on such matters.
- **Committees:** Bylaws often cover the roles of committees. There are two kinds of committees: (1) board committees that can act for the board, upon delegation by the board. There must be at least two directors on a board committee. Non-board members can attend committee meetings and give input but cannot vote. (2) advisory committees, composed of directors and others, give advice and recommendations to the board. Advisory committees do not have the power to act or make decisions for the board.
- **Officers:** Officers specified by statute include a president, a treasurer, and a secretary and additional officers (vice-presidents are optional) can be added as necessary. Officer’s duties are described in the Bylaws. A person can hold more than one officer position, but the president and secretary cannot be the same person.
- **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.

### 3. FIDUCIARY DUTIES

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

#### A. The Four Duties

Directors must fulfill four main duties according to Washington law – the **Duty of Care**, the **Duty of Loyalty**, the **Duty of Obedience**, and with the new Washington Nonprofit Corporation Act as of January 1, 2022, an additional **duty to share relevant information**.

**1) 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 must exercise reasonable care when making a decision as a board member, using diligence and independent judgment.

**2) Duty of Loyalty:** A director should act in the best interest of the organization, putting the organization before their own 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 is a best practice for the board to adopt a Conflict of Interest Policy and for staff and board to sign annual disclosure statements.

**3) 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.

**4)\* Additional duty to share relevant information:** In addition to the duties described above, directors and officers of the organization each have an additional duty to convey information to the board, committee members or, in the case of officers, their superiors if such information is either known by the director or officer to be material to the operations of the organization or relates to a violation or probable violation of any law or regulation involving the organization.

## **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. While this protection is granted by operation of law and does not need to be written into the organization's Articles of Incorporation or Bylaws, it is recommended that the language be added.
- **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.

## **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 their programs, monitor their budget, and prepare financial statements and returns. As a best practice, organizations should 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
- Bank statements

### **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, the minutes 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 board minutes. A nonprofit keeps the minutes electronically or in a binder. The board minutes should be kept forever.

### **C. Other records**

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

## **5. STATE TAXES**

There are three state taxes that impact Washington nonprofits:

1. **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.
2. **Sales Tax:** Organizations that sell products must pay sales tax.
3. **Property Tax:** Unless a property is exempt, a nonprofit must pay property taxes on any property that it owns.

## 6. LEGAL CHECKLIST: STATE LAW

If YES, date sent or reviewed	NO	ITEM
<b>STATE</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 Directors and Officers Insurance and the board members have reviewed the policy and understand what is covered and what is not covered.
		Our organization files an annual report with the Washington Secretary of State. (You may also need to register as a Charitable Organization; see Chapter 3. Fundraising & Donations for more information.)
		Our organization has filed a Master Business License application with the Washington State Department of Revenue.
		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.



1. The Articles of Incorporation are the document that creates the corporation. The Articles need to meet both state requirements for a nonprofit corporation as well as federal tax law requirements to qualify as a 501(c)(3).
2. Bylaws refers to the document that sets out the rules of operation for your organization.
3. Board members have a set of legal obligations owed to the nonprofit corporation, called fiduciary duties, which include Duty of Care, Duty of Loyalty, Duty of Obedience, and with the new Washington Nonprofit Corporation Act, a duty to share relevant information.
4. A nonprofit board keeps records so the organization can report to funders, government agencies, or the community about decisions and actions made.
5. While a tax-exempt organization generally does not pay federal taxes, the nonprofit is responsible for applicate state taxes.



## Here are some questions to think about:

- Do you know where your organization's key documents are stored, and are the documents accessible to officers and board members?
- Does your organization have a Document Retention Policy? If yes, do you know what records should be kept and for how long? If not yet, does your organization have a clear recordkeeping system in place?

## Reflections



## Next steps:

- ☐ Review the *Stay Up-to-Date with the Secretary of State* diagram on the next page. Be sure to check which type of organization you are and remember you may qualify as both. Fill in your organization's key dates – incorporation date and accounting year end date. Nonprofit corporation reporting is based on your incorporation date, while charitable organization renewal is based on your accounting year end.



# 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.

1

## 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.

### ANNUAL REQUIREMENTS

1. **What:** Annual Report
2. **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.
3. **Fee:** \$20 (revenues <\$500k/year)  
\$60 (revenues >\$500k/year)

2

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 each year. File online!*

3



### ADD TO CALENDAR

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

## 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.

## 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.

### ANNUAL REQUIREMENTS

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

2

Your Accounting Year End: \_\_\_\_\_

Your Charities Filing Date: \_\_\_\_\_

*For example: an accounting year of Dec 31, 2022 would have an annual renewal filing date of Nov 30, 2023.*

Developed by:



Nonprofit Association  
of Washington



WASHINGTON  
Secretary of State  
Corporations & Charities Division

For more information, visit the  
[Office of the Secretary of State,  
Corporations & Charities Division](#) website.