



## City Council Agenda Item

**City Council Meeting Date:** March 19, 2019

**TO:** Mayor and City Council Members

**FROM:** Jim Throop, City Manager  
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**SUBJECT:** Discussion Concerning Formation of a Nonprofit Organization to Fund City Projects

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### **Recommendation:**

Staff recommends the City Council review the provided information and direct staff whether to proceed with forming a California nonprofit organization to fund City projects.

### **Background:**

The purpose of a nonprofit corporation is to raise money for charitable and/or public purposes in accordance with the specific mission of the organization. Several California cities have created California nonprofit corporations in order to facilitate grant writing and other means to fund special projects. Donors often prefer to donate to an IRS section 501(c)(3) (nonprofit) organization rather than directly to a city, even though the IRS considers contributions made to a city for a public purpose as tax deductible. The City Council has discussed creating a nonprofit corporation in the past to benefit recreation programs or park maintenance. However, a global nonprofit corporation could potentially fund those interests and many more.

### **Discussion:**

Formation of a nonprofit organization is not overly complicated and can be done without the assistance of a consultant, although staff would work with the City Attorney's Office to ensure compliance with requirements of state and federal law. The essential steps for forming a nonprofit organization and obtaining tax-exempt status are as follows:

1. Choose a name,
2. Draft and file articles of incorporation,
3. Apply for federal and state tax exemption,
4. Draft and adopt bylaws, and
5. Appoint directors.

1. Choose a Name

The name of the corporation must be unique and not used by any other entity. Once a name is chosen, it is recommended the Secretary of State database be consulted to determine whether the name is already in use. Staff recommends “Lompoc Community Foundation” or something similar. California does not require the name to include the word “Corporation” or “Inc.”

2. Draft and File Articles of Incorporation

The most important and probably most difficult part of preparing articles of incorporation is writing the purpose statement. The purpose statement establishes the parameters for the nonprofit corporation and establishes the uses for the funds raised. It is recommended to be 50 words or less so that it can be published and repeated as a catch phrase, yet to be specific enough to identify the purpose, while also being broad enough so it is not limiting. One possible purpose statement is as follows:

“The specific purpose of this corporation is to raise and manage funds in connection with civic purposes and projects that benefit the community within the present and future boundaries of the City of Lompoc.”

The balance of the articles of incorporation will contain standard language relative to formation of a corporation.

3. Apply for IRS and State Tax Exemption

Once the articles of incorporation are filed with Secretary of State, the newly formed corporation may then apply for the IRS section 501(c)(3) federal tax exemption and also for state tax exemption. The IRS approval is necessary for the corporation to be known as a nonprofit corporation. The nonprofit corporation will be exempt from certain taxes and will also receive additional benefits. For example, many banks offer free checking accounts to nonprofit corporations and the post office provides reduced postage rates for mass mailings.

4. Bylaws

Several provisions in the bylaws will be common to all similar organizations. However, some particular issues to consider are: who will be on the board of directors (discussed below), how long will their terms be, and what the method will be for appointing them.

5. Directors

Perhaps the single most important issue to consider when starting a nonprofit organization is who will be on the Board of Directors, as this has implications for the control of the board, the public perception of the board, the resources available to the board, and whether the board is subject to the Brown Act.

There are two main options for Board members:

- (1) City Council members, or
- (2) Non-City Council members (this could include private citizens or City staff).

The City can exercise control over the Board either by:

- (1) Requiring a certain number of City Council members to serve on the Board,
- (2) Requiring a certain number of City representatives (other than City Council members) to serve on the Board, or
- (3) Requiring a certain number of Board members to be appointed by the City Council (both when the Board is formed and when the Board positions become vacant).

The following discussion analyzes the benefits and drawbacks of three different possible options for structuring the Board.

A. Option 1: City Council Serves As Board

Under this option, the City would have complete control of the Foundation and the Foundation would be perceived as an arm of the City. Although the Board could reach out to the private sector for support and donations, the private sector would not be represented on the Board. A benefit of this structure would be Foundation meetings could be held at the same time as City Council meetings, and could also be noticed simultaneously with the notice for City Council meetings. Any change in the makeup of the City Council (i.e. a City Council election) would automatically change the makeup of the Board. A drawback of this approach is private entities may be hesitant to donate to an organization that is perceived as political, and the willingness of donors to donate to such a Foundation might be influenced by whether the donor agrees or disagrees with the politics of specific Council members at any given time.

A Foundation with this Board structure will be subject to the Brown Act.

B. Option 2: One or Two Council Members Serve On The Board

A Board with this structure would include both City Council members and non-City Council members. The City's control over the Board would depend on the size of the Board, the amount of City Council members on the Board, the amount of City representatives on the Board (other than City Council members), and the amount of Board members appointed by the City Council. A Board with both public and private members would likely be perceived as a public-private partnership. A Board with only City Council members and City representatives would be perceived as an arm of the City. Including members of the private sector would likely increase the monetary, experiential, and networking resources available to the Foundation.

Whether a Board with this structure is subject to the Brown Act will depend on whether the City provides the Board with funding and/or in-kind donations.

- (a) If the foundation does not receive any funding from the City and does not receive in-kind donations from the City, including free City staff support or free meeting space on public property (other than space which is generally free to the public), then the Brown Act will not apply.
- (b) However, if the foundation does receive funding or in-kind support from the City, the Brown Act will apply.

Under Government Code subdivision 54952(c)(1)(B), legislative bodies subject to the Brown Act include a private corporation that “receives funds from a local agency and the membership of whose governing body includes a member of the legislative body of the local agency appointed to that governing body as a full voting member by the legislative body of the local agency.”

C. Option 3: No City Council Members Serve On Board

A Board with this structure would be made up solely of non-City Council members. The City’s control over the Board would depend on the size of the Board, the amount of City representatives on the Board (other than City Council members), and the amount of Board members appointed by the City Council. A Foundation of this type would more likely be viewed as non-political, which could encourage more donations.

A Foundation with this Board structure will not be subject to the Brown Act.

**Fiscal Impact:**

Formation of the nonprofit corporation does not come without cost. The corporation must be formed and filed with the Secretary of State before applying for the nonprofit status and enjoying the cost savings that follow. Currently the filing fee for the Secretary of State nonprofit corporate filing is \$30.00. The more substantial cost however, is the IRS Form 1023 filing fee of \$850.00. In addition, an employer’s identification number<sup>1</sup> must be obtained from the state; filing on the Registry of Charitable Trusts through the Attorney General is required (\$25.00 fee due to the Department of Justice); as well as other local registrations. Staff time will also be required to prepare all the initial paperwork. However, once the corporation is formed and nonprofit status obtained, all future expenses will be paid by the nonprofit corporation itself, unless the City Council directs the Board to include City staff members, then there will be staff costs associated.

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<sup>1</sup> An employer identification number is required even when there are no employees.

**Conclusion:**

A nonprofit corporation may be a useful tool for raising funds to support civic projects currently outside the scope of the City's budget. The process, while it does have some costs attached, is not terribly complicated and can be accomplished without the use of a consultant. Once the nonprofit corporation is established, it will be self-supporting and no future expenditures will be required from the City, unless the City Council directs staff to support or serve on the board.

Respectfully submitted,

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Jim Throop, City Manager