2013 Legal Compliance for Nonprofits: Better Safe Than Sorry

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N.C. Center for Nonprofits
Overview of the Workshop

- Building blocks of corporate governance
- Federal tax laws and Form 990 reporting
- Charitable solicitation, acknowledgment of gifts, and fundraising rules
- State and local taxes
- Employment laws and human resources issues
- Board fiduciary duties
- And much more!
Some Basic Questions

- Nonprofit vs. not-for-profit
- Nonprofit vs. tax-exempt
- Tax-exempt vs. 501(c)(3)
Building Blocks of Corporate Governance
Hierarchy of Rules

- Internal Revenue Code
- N.C. Nonprofit Corporation Act
- Articles of Incorporation
- Bylaws
- Internal policies and procedures
N.C. Nonprofit Corporations

Articles of Incorporation

- Name – flexible
- Members vs. self-perpetuating board of directors
- Limitation of liability
N.C. Nonprofit Corporations

Articles of Incorporation

- 501(c)(3) restrictions:
  - Charitable purposes
  - No private inurement
  - Limited lobbying
  - No political activity
  - Dissolution clause
N.C. Nonprofit Corporations

Bylaws

- Size and composition of board of directors
- Term limits
- Quorum
- E-voting provisions
- Indemnification
N.C. Nonprofit Corporations

- Unusual provisions of N.C. law
  - Only one Board member required
  - No annual report
    - When do you report to Secretary of State?
N.C. Nonprofit Corporations

Nonprofit E-voting

- Nonprofit members can vote by email
- Directors can take action *by unanimous written consent* by email
- Notice to members and directors can be given by email
- Must document in bylaws
Recommended Policies

- Conflict of interest policy with annual disclosures
- Whistleblower policy
- Document retention and destruction policy
- Compensation review and approval process
- Policies on chapters and affiliates
- Joint venture policy
- Policy on making organizational information available to the public
- Process for review of Form 990
Federal Tax Law
Federal Tax Law

The IRS and Tax-Exempt Organizations

- Role of the IRS
- Federal tax-exempt status
  - 501(c)(3) organizations
  - Other types of tax-exempt organizations
Federal Tax Law

501(c)(3) Tax-Exempt Organizations

- Private foundations
  - Generally are grant-making organizations
  - Limits on deductibility of contributions
  - Restrictions on expenditures, investments, lobbying, and self-dealing

- Public charities
  - Generally carry on charitable, educational, religious, artistic, or scientific activities
  - Have broad public support
  - Highly scrutinized
Federal Tax Law

501(c)(3) Public Charity Rules

- Conformity to exempt purposes
- Must meet one of three public support tests
- Private benefit may only be insubstantial
- Private inurement is absolutely prohibited
- Influencing legislation must only be “insubstantial”
- No partisan political intervention
Avoiding private foundation status
- Exempt based on activities – church, school, etc.
- Exempt based on support – generally at least 1/3 of “support” is “public support”
- Contributions-based test
- Income-based test
Federal Tax Law

Public Support Tests

- Different definitions of “support”
  - Contributions-based test: “Support” – essentially all income except income earned from performing mission
  - Income-based test: “Support” = essentially all income
Federal Tax Law

Public Support Tests

- Different definitions of “public support”
  - Contributions-based test: “Public support” – all support except excess contributions
  - Income-based test: “Public support” – all support except:
    - Support from “disqualified persons” (DQPs)
    - Excess support from non-DQPs
What is Federal Tax Law?
Federal Tax Law is a body of laws and regulations that govern the taxation of individuals, businesses, and other entities. It includes provisions for income tax, wealth tax, estate and gift tax, and other types of taxation. The Federal Tax Law is administered by the Internal Revenue Service (IRS) and is enforced by the United States government.

What is the purpose of Federal Tax Law?
The purpose of Federal Tax Law is to raise revenue for the government, to provide for a fair and equitable distribution of the tax burden among individuals and businesses, and to encourage activities that benefit the public welfare. Federal Tax Law also aims to promote social and economic stability and growth by providing incentives for investment, innovation, and job creation.

What are some key provisions of Federal Tax Law?
Some key provisions of Federal Tax Law include:

1. Income Tax: The Federal Tax Law imposes income tax on individuals and businesses based on their income and taxable assets. The tax rate and structure vary depending on the taxpayer's filing status and income level.

2. Wealth Tax: The Federal Tax Law imposes a tax on the net worth of individuals and businesses. This tax is intended to discourage the accumulation of wealth.

3. Estate and Gift Tax: The Federal Tax Law imposes taxes on the transfer of property at death (estate tax) and the transfer of property during life (gift tax). These taxes are intended to prevent the accumulation of wealth beyond a certain threshold.

4. Federal Excise Taxes: The Federal Tax Law imposes excise taxes on certain goods and services, such as tobacco, alcohol, and gambling.

5. Federal Sales and Use Taxes: The Federal Tax Law also includes provisions for sales and use taxes, which are imposed on the sale of goods and services.

What are some common misconceptions about Federal Tax Law?
Some common misconceptions about Federal Tax Law include:

1. The Federal Tax Law is only concerned with income and wealth.
2. The Federal Tax Law is designed to tax the wealthy at higher rates.
3. The Federal Tax Law is designed to tax businesses at higher rates than individuals.

In reality, the Federal Tax Law is designed to provide a fair and equitable system of taxation that benefits all taxpayers. It is important for taxpayers to understand their obligations under Federal Tax Law and to comply with their tax obligations in order to avoid penalties and interest charges.

What resources are available to help taxpayers understand Federal Tax Law?
There are many resources available to help taxpayers understand Federal Tax Law, including:

1. IRS Publication 1, “Your Federal Tax Rights.”
2. IRS Publication 3, “Understanding Your Rights as a Taxpayer.”
3. IRS.gov, which provides a wealth of information about Federal Tax Law, including FAQs, tax forms, and guidance for taxpayers.
4. Tax professionals, such as accountants and tax lawyers, who can provide advice and assistance on Federal Tax Law.

What are the penalties for failing to comply with Federal Tax Law?
The penalties for failing to comply with Federal Tax Law include:

1. Tax Liens: The IRS may assert a lien on a taxpayer's property if they fail to pay their taxes.
2. Levies: The IRS may seize a taxpayer's property to satisfy their tax debt.
3. Substitution of Tax Liens: The IRS may assert a tax lien on a taxpayer's property if they fail to pay their taxes for a period of time.
4. Penalties and Interest: The IRS may impose penalties and interest charges on taxpayers who fail to pay their taxes on time.

In summary, Federal Tax Law is a complex system of laws and regulations that govern the taxation of individuals and businesses. It is important for taxpayers to understand their obligations under Federal Tax Law and to comply with their tax obligations in order to avoid penalties and interest charges.
Federal Tax Law

Public Support Tests

- 509(a)(2) test nuances
  - Additional test: no more than 1/3 of support may be investment income or UBI
  - Disqualified person includes
  - Substantial contributor
  - Exception: contributions from 509(a)(1)s don’t count
  - Foundation manager
Federal Tax Law

Public Support Tests

- Support tests – planning considerations
  - Calculate test even in first 5 years
  - When seeking large gifts, consider possibility of “tipping”
  - Objective is to raise income from diverse sources
### Federal Tax Law

**Private benefit and private inurement**

<table>
<thead>
<tr>
<th></th>
<th>Limited to 501(c)(3) and 501(c)(4)s?</th>
<th>Insiders Only?</th>
<th>Consequence?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private inurement</td>
<td>No</td>
<td>Yes</td>
<td>Revocation of org’s tax-exempt status; no de minimus standard</td>
</tr>
<tr>
<td>Private benefit</td>
<td>No</td>
<td>No</td>
<td>Revocation of org’s tax-exempt status if more than incidental</td>
</tr>
<tr>
<td>Excess benefit/intermediate sanctions</td>
<td>Yes</td>
<td>Yes</td>
<td>Excise taxes and penalties on insiders and foundation managers</td>
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- Different from self-dealing rules applicable to private foundations
Federal Tax Law

*Excess Benefit Transactions*

- Excess benefit – benefit provided to insider that exceeds consideration received
- Executive compensation
  - Approved in advance by independent persons
  - Relied on comparability data
  - Decision basis documented in minutes contemporaneously
- Intermediate sanctions – tax on EBTs
Unrelated business income

- Income from...
  - A trade or business
  - Regularly carried on
  - Not substantially related to the organization’s exempt purpose

... is generally subject to reporting on Form 990-T and to taxation
Exclusions from UBI

- Volunteer labor exception
- Convenience exception
- Contributed inventory exception
- Passive income, except debt-financed
Fragmentation

• An unrelated activity operated within a larger, related, activity is nonetheless subject to UBIT

• Examples:
  • Hospital pharmacy sales to public
  • Advertising sales in related publication
  • History museum gift shop sales of art books
  • Any nonprofit operating a mailing service, even for other nonprofits (unless this is within the first organization’s mission)
Recent IRS Report

- Colleges and Universities Compliance Project (CUCP) found problems with UBI reporting
  - Net operating losses – can usually be carried back 2 years or carried forward 20 years
  - Profit motive – claimed losses must be activities organization entered into for a profit motive
  - Grouping of activities for purpose of UBI determinations
Objectives in UBI Reporting

- Minimize income reportable as UBI
- Maximize expenses deductible from UBI
Allowable deductions from UBI

- Allocation of indirect costs
Advertising vs. Sponsorship

- **Advertising (UBI)** – expectation that the advertiser will receive promotional benefits
- **Sponsorship (contribution)** – no expectation that the sponsor will receive any substantial return benefit in exchange
Substantial return benefit

- Any benefit other than:
  - Use or acknowledgment of name or logo in connection with the exempt organization’s activities
  - Certain goods or services that have an insubstantial value
Website links

- Hyperlink to sponsor’s website on website of exempt organization qualifies as sponsorship
- If sponsor’s website says exempt organization endorses sponsor’s products, not a sponsorship
Royalties

- A royalty agreement exists where exempt organization’s name is exploited to promote payer’s products
Unrelated Business Income Tax

Examples:

- Listing sponsors on website
  Not taxable
- Active endorsement of commercial products
  Taxable
- Advertisements in publications or website
  Taxable
Unrelated Business Income Tax

Examples:

- Publishing and selling books
  Depends on content and pricing of books
- Selling membership lists
  Usually taxable
- Museum shop
  Certain items are taxable
Federal Reporting Requirements
Federal Tax Law

Filing Requirements

- Form 1023 – application for recognition of tax-exempt status
- Form 990 or Form 990-EZ – annual return
- Form 990-N (E-Postcard) – annual report for small nonprofits

Internal Revenue Service
United States Department of the Treasury
Form 990 Reporting

Public inspection requirements

- Forms 990 and 990-T filed with in the last 3 years
  - Donor names and addresses in Schedule B must be redacted for public inspection
- Form 1023 and all correspondence with IRS related to recognition of exemption
Form 990 Reporting

Public inspection requirements

- Two types of requests:
  - Provide paper copy or make “widely available by posting to website or by referring requester to Guidestar.org
  - Request for inspection and principal office – special rules if nonprofit has no principal office
Form 990 Reporting

*Filing thresholds and implementation schedule*

- Form 990 if: gross receipts > $200,000 or assets > $500,000
- Form 990-EZ if: gross receipts < $200,000 and assets < $500,000
- e-Postcard if: gross receipts < $50,000
Form 990-N (e-Postcard)

• Option for nonprofits with revenue normally under $50,000
• Simple annual filing – no financial information
• Penalty for failure to file for three years – revocation of tax-exempt status
• IRS information on e-Postcard - www.irs.gov/charities/article/0,,id=169250,00.html
E-Filing of 990s

- Required for:
  - Nonprofits filing Form 990-N
  - Large nonprofits filing 250 or more IRS forms per year with $10 million in assets
  - All private foundations filing 250 or more IRS returns
- Optional for other nonprofits
- Mandatory e-filing is possible in the near future
  - Better data for nonprofits, donors, regulators, and researchers
  - E-filing fees for nonprofits
Form 990 Reporting
Overview of redesign in 2007

- More information on form rather than attachments
- Emphasis on transparency, accountability, and clarity for nonprofits
- Emphasis on program service accomplishments
- Compensation reporting
Form 990 Reporting

*Highlights of the form*

- Filing required for all tax-exempt organizations other than churches and certain church-controlled organizations
- File Form 990 by the 15th day of the 5th month after your nonprofit’s accounting period ends
  - E.g. May 15 for calendar year filers
- Automatic 3-month extension (Form 8868)
- May be filed electronically; mandatory for large nonprofits
Form 990 Reporting

Highlights of the form

- All organizations complete Parts I through XII
- Also complete any schedules for which a “Yes” response is indicated in Part IV
Charitable Solicitation, Acknowledgment of Gifts, and Fundraising
Charitable Solicitation

Filing Requirements

- License required for nonprofits that receive $25,000 or more per year in grants and contributions and/or compensate officers, directors, or professional fundraisers
- Churches, schools, and hospitals are exempt
- File with N.C. Secretary of State
- Increased scrutiny of compliance and exemptions
  - Note: Let the Secretary of State know if you think your nonprofit is exempt
Charitable Solicitation

Filing Requirements for Individuals

- Fund-raising consultants
- Solicitors
- Contracts must be filed with Secretary of State
- Burden is on nonprofit to check that contractors are licensed
Charitable Solicitation

Does your nonprofit need to register in other states?

- Unified Registration Statement
- Charleston Principles
  - Recommend licensing when: (1) solicit contributions on website and regularly receive contributions from a particular state on a basis; or (2) send email solicitations to individuals residing within that state
Solicitation Disclosures

- Name of organization
- Address of organization
- Purposes for which contributions will be used
- Disclosures required on gift acknowledgments, website, and other solicitations
Solicitation Acknowledgement

- Acknowledgement *required* when:
  - for all gifts of $250+, and
  - receive gifts of $75+ for which you provide valuable goods or services

- Best practice to send contemporaneous written acknowledgment of each and every gift received
Solicitation Acknowledgement

- Lay groundwork for next gift with update on charitable activities and sincere expression of gratitude
Acknowledgment of Gifts of $250+

- Donor must receive acknowledgement on or before the donor’s tax filing deadline for the calendar year in which the contribution is made
- $250 threshold includes the deductible and nondeductible portions of the contribution
- Multiple gifts of less than $250 made in a single taxable year by the same donor are not aggregated for purposes of this rule (but best practice to acknowledge all gifts)
Acknowledgment of “Quid Pro Quo” Gifts of $75+

- Good faith estimate of the value of the goods or services provided to the donor by the organization
Incentive Compensation for Fundraising Professionals

- Intermediate sanctions – excise taxes and penalties on certain individuals who receive and/or approve excessive compensation
  - Disqualified persons
  - Organization managers

- AFP Code of Ethical Principals and Standards
  - No compensation or contract based on percentage of contributions or finder’s fees or contingent fees
  - Some performance-based contracts are permissible
Charitable Raffles

- Law revised in 2009
  - Two raffles per year per nonprofit
  - Cash or goods prizes up to $125,000/year
  - Total cash prizes no more than $10,000/year
  - Real estate prizes up to $500,000
  - Nonprofits with local affiliates may hold two raffles per year for each affiliate
Charitable Raffles

- Cost of raffle ticket not deductible by purchaser as charitable contribution – may be deductible as gambling loss
- Nonprofit must report on IRS Form W-2G any raffle prize where:
  - Value of prize, less amount paid for chance, is $600 or more
  - Payout is at least 300 times amount paid for chance
Charitable Raffles

- For a single prize of more than $5,000, nonprofit must withhold 25% federal income tax and report to IRS on Form W-2G and Form 945
- File by January 31 of the year following payment of the prize
- Nonprofit liable for failure to withhold tax
Charitable Raffles

- Tax withholding on non-cash prize must be collected from winner or paid by nonprofit and added to reported prize value
- Obtain completed IRS Form W-9, Request for Taxpayer Identification Number, from prize recipient before remittance
- For more information: IRS Publication 3079, Gaming Publication for Tax-Exempt Organizations
State and Local Taxes

N.C. Center for Nonprofits
Major Tax Law Changes

- Individual income tax rate reduced to 5.75% (5.8% in 2014) from current tiers of 6%, 7%, and 7.75%
- Corporate income tax rate is reduced from 6.9% to 6% in 2014, 5% in 2015, and possibly lower after that
- Sales tax rate remains unchanged, but base is slightly expanded
- Overall state revenue is projected to decline by $2.4 billion over the next five years
- More changes could be coming in the near future
N.C. Income Tax Exemptions

- For 501(c)(3) nonprofits - initial application for exemption from N.C. income and franchise taxes
- For other nonprofits – initial application and annual filing of Form 990 in N.C.
- No changes in new tax laws
  - Nonprofits still must pay state income tax on unrelated business income
  - Nonprofits are still exempt from state franchise tax, even if they have unrelated business income
N.C. Sales Tax – Collecting Tax

- Collecting sales tax on nonprofit sales
  - Applies to retail sales of items like books, videos, concessions, webinars, and electronic publications
  - Starting in 2014, also applies to admissions fees for entertainment activities
    - Limited nonprofit exemptions for two festivals or fundraising events per year and for youth athletic contests
    - Arts organizations are generally not exempt
    - State attractions are exempt
N.C. Sales Tax – Collecting Tax

- Nonprofit must charge 4.75% sales tax plus county rate (2% or 2.25% in most counties)
- County rate is based on sourcing principles – usually where the purchase takes place
- Files Form E-500 and pay the tax quarterly (under $100 per month) or monthly ($100 or more per month)
- File Form E-536 if you collect taxes in more than one county
N.C. Sales Tax Refunds

- Sales and use tax refunds – not true exemptions
- Most 501(c)(3) nonprofits are eligible for refunds
  - New $45 million cap on refunds per year starting in 2014
  - New rule: reimbursed purchases by staff are eligible for refunds
- Exception: nonprofits with three NTEE classifications:
  - Community improvement/capacity building
  - Public and societal benefit
  - Mutual and membership benefit
- Possible future changes
N.C. Property Tax Exemptions

- No changes in tax overhaul
- Buildings and land owned by nonprofits generally excluded
- Personal property is also generally excluded - equipment, for example
- Must be wholly and exclusively used for proper nonprofit purposes
- For vehicles, file DOR Form AV-10V when tags come up for renewal
Charitable Giving Incentives

- For individuals who itemize federal taxes, charitable contributions are fully deductible on N.C. taxes.
- In 2013, non-itemizers can get a 7% credit on N.C. taxes for contributions over 2% of federal AGI
  - This credit no longer applies in 2014.
- Corporations may only receive an annual deduction on state income taxes for charitable contributions up to 5% of net income
  - This is lower than federal deduction limit (10%) and can’t be carried forward.
IRA Charitable Rollover

- IRA charitable rollover – federal income tax exclusion for distributions from IRAs to nonprofits for individuals 70 ½ or older
- For state tax purposes in 2013:
  - IRA rollover is not an income tax exclusion
  - It can be claimed as either a tax deduction (itemizers) or a credit (non-itemizers)
Other Tax Changes in 2013

- Several provisions end after 2013
  - Credit for contributions or property for conservation or historic preservation purposes
  - Earned income tax credit
  - Deduction for contributions to 529 plans
  - Credit for disabled, education credit, child care credit, credit for adoption expenses, credit for premiums paid on long-term care insurance
  - Credit for construction of housing for handicapped
  - Sales tax exemption for food served in college and university dining halls
  - Estate tax
Lobbying and Civic Engagement

N.C. Center for Nonprofits
Basic Terminology

- Advocacy
- Lobbying
- Civic engagement
- Political activity
Federal Tax Law

Lobbying Limitations on Public Charities

- Nonprofits can’t engage in partisan political activities
- Public charity lobbying must be “insubstantial” part of activities
- 501(c)(4) and 501(c)(6) organizations may conduct unlimited lobbying
Federal Tax Law

501(h) election

- Lobbying means influencing legislation (at the federal, state, or local level)
- 501(h) election – IRS Form 5768
  - Direct lobbying limited based on expenditures
  - Grassroots lobbying limit is 25% of direct lobbying limit
- “Powerful, safe, and easy” (according to the National Council of Nonprofits
Nonprofit Political Activity

- 501(c)(3) nonprofits
  - Partisan political intervention is prohibited
  - *Citizens United* decision doesn’t change this
- 501(c)(4) organizations
  - Some partisan political activity is permissible
  - Under *Citizens United*, 501(c)(4) nonprofits have become a way to make anonymous contributions that influence campaigns
What Your Nonprofit *Can* Do!

- Nonpartisan voter education and registration
- Individual activity by nonprofit leaders
- Some candidate appearances
- Some business activity
- Some mention on websites
- See IRS Revenue Ruling 2007-41 or www.nonprofitvote.org
New NC Election Laws

- Why does this matter for nonprofits?
  - Nonprofits are expected to provide the information about these new laws to those they serve
  - Particularly those serving seniors, people with disabilities, students, and low-income families
  - People contacted by nonprofits about elections are much more likely to vote – 81% turnout vs. 69% overall turnout in NC in 2012 election

- Nonprofits must be nonpartisan in the voter education activities
New NC Election Laws

- Voter ID – required in 2016
- Free voter ID – beginning in 2014
- Shortened early voting – 2014
- Elimination of same-day registration – 2014
- Elimination of pre-registration – Sept. 1, 2013
- Voter registration changes – 2014
  - No compensation by number of voter registration forms submitted
  - No electronic signatures allowed
What constitutes lobbying?

- Attempts to influence legislation or executive action
- Communication with a “designated individual”
- Developing “goodwill” with designated individuals
N.C. Lobbying Law

- Differences from federal lobbying definition:
  (i) N.C. law covers executive action as well as legislative action – possible confusion among private foundations
  (ii) Goodwill lobbying is covered by N.C. law
  (iii) N.C. law applies only to lobbying with two branches of N.C. state government
N.C. Lobbying Law - Basics

- Who needs to register and report?
  - Principal – organization on whose behalf a lobbyist lobbies
  - Lobbyist – staff or contractor who lobbies
    - Staff – if you spend 5% of your time lobbying in any 30-day period or 5% of your time developing goodwill in any 30-day period
    - Contractors – must register
    - Volunteers – not required to register
  - Solicitor – organization that engages the public in lobbying activities – at least $3,000 in a 90-day period
N.C. Lobbying Law - Basics

• Registration
  • Annual registration
  • $250 fee per lobbyist AND principal in 2014
  • No fee waiver or reduction for nonprofits

• Reporting
  • Quarterly reports with basic information
  • Monthly reports if expenditures made during legislative session
  • Annual reports with lobbying and related expenses
  • Electronic filing required, starting October 1, 2013
Nonprofit Advocacy

For more:

- Nonprofit Town Halls – around the state in early 2014
- Webinar on advocacy from the Philanthropy Journal – October 16 at 2 p.m.
- More on nonpartisan voter education – coming soon from the Center
Asset Management
Asset Management

- Gift agreements
- Investment policies
- Affiliated entities
  - Limited liability companies
  - Foundations
  - Chapters
  - Affiliations/partnerships
UPMIFA (effective March 19, 2009)

- “Prudence” in investing and spending
- Eliminates HDV concept
- Applies to “endowments” (i.e., funds that are not wholly expendable on a current basis)
- Governing board determination pursuant to investment policy
- Diversification generally required
- Pooling expressly permitted
Question of Donor Intent

- Donor intent trumps UPMIFA
- Forensics often necessary
- Gift instrument
  - Gift agreement
  - Pledge card
  - Response to institutional solicitation?
“Prudence” in Spending

- Generally, must consider funds “uses, benefits, purposes and duration” in accumulating and spending
- “Good faith” and “care an ordinarily person in a like position under similar circumstances”
- Donor limitations must be “specifically stated”
- Permanent duration assumed
- 7% rebuttable presumption of imprudence not adopted in NC
“Prudence” in Spending (cont.)

- Seven specific factors:
  - Duration and preservation of the fund
  - Purposes of the nonprofit and the fund
  - General economic conditions
  - Possible effect of inflation or deflation
  - Expected total return from investing
  - Other resources of the nonprofit
  - Nonprofit’s investment policy
“Prudence” in Investing

- Generally, must consider purposes of nonprofit and the fund
- “Good faith” and “care an ordinarily person in a like position under similar circumstances”
“Prudence” in Investing (cont.)

Eight specific factors:

- General economic conditions
- Possible effect of inflation or deflation
- Expected total return from investing
- Other resources of the nonprofit
- Expected tax consequences of investment decisions
- Role of each asset within overall investment portfolio
- Needs of the nonprofit and the fund to make distributions and to preserve capital
- An asset’s special relationship or value to the nonprofit
Caution - Private Foundations

- UPMIFA does **not** trump federal tax rules applicable to private foundations
  - Mandatory minimum distribution requirement
  - Self dealing
  - Jeopardizing investments
- Federal tax law is generally more restrictive
Donor or Court-Approved Release or Modification

- Unlawful, impracticable, impossible to achieve, wasteful
- Living donor may consent to modification/release
- Cy pres – notice to AG and opportunity to intervene; donor’s probable intention considered
Cy Pres Exception

- Applicable to old, small funds
  - 10+ years old
  - $100,000 or less

- Nonprofit may release or modify donor restriction without donor or court approval

- But, 60 days’ notice to AG required
Delegation Permitted

Investment and management functions may be delegated if:

- Use prudence in selecting agent
- Establish scope of engagement
- Monitor performance
Higher Standard of Care for “Experts”

- Persons with (i) special skills or expertise, or (ii) selected in reliance on person’s representations
- Duty to use skills/expertise in investing
- N/A to volunteers (no compensation beyond reimbursement of expenses)
Alternative Structures to 501(c)(3) Nonprofits
Fiscal Sponsorship

What is fiscal sponsorship?
- Arrangement between 501(c)(3) and a program
- Provides “fiscal home” for program
- Usually temporary arrangement
Fiscal Sponsorship

Advantages of fiscal sponsorship

For sponsor:
- Income from administering program
- Cost savings from sharing resources

For sponsored program:
- Management expertise
- Incubation for startup organization
- Qualifying as a 501(c)(3) public charity
Fiscal Sponsorship

- How does fiscal sponsorship work?
  - Fiduciary responsibility
  - Mission
  - Written agreement
  - Staff and volunteers
  - Ownership
Fiscal Sponsorship

- Financial considerations in fiscal sponsorships
  - Contributions are restricted for sponsored program
  - Earned income is unrestricted
  - Expenses should ideally not exceed revenue
  - Administrative fees
  - Accounting issues
501(c)(4) “Social Welfare” Affiliates

- Activities must be commensurate with “common good and general welfare”
- Doesn’t include activities that primarily constitute carrying on a business with the general public in a manner similar to for profit orgs
- Can’t be a social club for benefit, pleasure or recreation, although social functions are ok if they aren’t the primary activity
- Must be for benefit of community, not just members
501(c)(4) “Social Welfare” Affiliates

- Political activity cannot be primary activity of social welfare org
- Some political activity permissible so long as primary activity directed towards proper social welfare purpose
501(c)(4) “Social Welfare” Affiliates

- 501(c)(3) can control a 501(c)(4) affiliate
  - Two entities must be separate legally
  - Control often ensured by a governance structure that gives the (c)(3) parent authority to appoint all or a majority of sub’s board of directors
  - Orgs can operate in same office is they keep separate books, avoid commingling funds, and have provision that (c)(3)’s assets go to another (c)(3) on dissolution
  - Boards can overlap
  - (c)(3) must be reimbursed by (c)(4) for any expenditures on its behalf and (c)(4)’s share of overhead
Single Member LLC

- U.S. charity “parent” as sole member
- Asset protection / risk management
- No IRS determination letter issued
- No annual meeting of the member
- Annual report to NC SOS required
- Recent IRS guidance re: deductibility of charitable gifts
  - But risk of confusion if donor is audited by IRS
  - Clarify in gift acknowledgement and encourage donor to retain
What is an L3C?

- Hybrid entity – formed for both a charitable purpose and business purpose
- *Not* a non-profit
- Type of LLC
- “Low-profit” is a misnomer
- North Carolina LLC statute no longer specifically provides for L3Cs, but they can be created as regular LLCs
Why use an L3C?

- Attract capital
  - Private foundations: Program Related Investment (“PRI”)
  - Private investment
    - Market returns
    - Socially conscious investors
- Branding
- Builds social purpose into corporate DNA
Program Related Investment ("PRI")

- Investment by private foundations
- L3C statute tracks IRC requirements for PRI
- Private foundation investor tax considerations
  - Foundation’s exempt purposes
  - Mandatory minimum distributions
  - Expenditure responsibility
Do investments in L3Cs qualify as PRI?

- Private letter rulings
  - PLR 200610020
- Federal legislation proposed
- Do foundations need a private letter ruling?
Benefit Corporations

- For-profit corporations with socially beneficial purposes
- Legislation failed in North Carolina in 2012 and 2013
  - Would have provided legal recognition of accredited benefit corporations in North Carolina
  - Would have provided protection against shareholder derivative suits
- Legislation passed in South Carolina in 2012
Employment Laws
1. Make Informed Hiring Decisions
Hiring Process

- Avoiding discrimination
  - Job postings
  - Interviews – don’t ask questions about impermissible factors (age, sex, race, color, religion, national origin, health, disability)

- Screening employees
  - Background check and reference checks – get written permission

- “At will” employment – can be limited by contracts or promise of employment for duration of time
2. Avoid the Embarrassing Question: “Do You Work Here?”

N.C. Center for Nonprofits
Employment taxes for nonprofits

- Federal Insurance Contributions Act (FICA)
  - Social security tax – 6.2%
  - Medicare tax – 1.45%
- Nonprofits pay FICA for employees, but not for independent contractors
Consequences of Misclassification

- Tax penalties
  - Organization
  - Board members (if willful)

- Liability for overtime wage payments
Classifying Employees and Independent Contractors

- IRS factors:
  - Behavioral control
  - Financial control
  - Relationship of parties
Classifying Employees and Independent Contractors

- Employer’s right to direct and control the workers
- Training provided to worker by employer
- All business expenses are reimbursed by employer
- Use of employer’s facilities and supplies
- Single employer, no other clients
- No profit or loss for worker
- Benefits provided to worker by employer
- Worker’s services are key to business
3. Know Who Qualifies for Overtime Pay
Fair Labor Standards Act

- Minimum wage is $7.25/hour as of July 24, 2009
- Overtime pay for non-exempt employees
  - Exempt employees include executives, professionals and even certain administrative staff
  - Compensatory time must be taken in same work week
- Equal pay for equal work (differences in pay may be justified by seniority and special skills or training)
Fair Labor Standards Act

- Special situations
  - Comp time – generally not permitted, except within the same work week
  - Travel time and commuting time
  - Salaried employees who don’t meet an exception
Volunteers and Interns

- Employees as volunteers – can lead to confusion and liability
- Interns
  - Position description
  - Paid employees vs. unpaid volunteers
  - Stipends
4. Know What’s In Your Personnel Manual
Personnel Manuals

- Are they contracts?
  - N.C. courts aren’t clear
  - Include disclaimers
  - Follow policies and allow discretion
- Why use them?
  - Communication of policies
  - Consistency and clarity
Personnel Manuals

- If you have one, do:
  - Be consistent with your bylaws and policies
  - Provide current copies to all employees
  - Get employees to sign acknowledging receipt
  - Act in accordance with your policies

- If you have one, don’t:
  - Promise employment for a duration of time
  - Promise progressive discipline
  - Have policies that are legally prohibited
5. Don’t Discriminate
Title VII of Civil Rights Act of 1964

- Applies if 15+ employees
- No discrimination based on race, color, religion, sex or national origin:
  - hiring, promotion, compensation, etc.
  - some facially-neutral personnel practices forbidden
Americans with Disabilities Act

- Applies if 15+ employees
- Requirements:
  - reasonable accommodations
  - physical accessibility
- Avoid health-related questions during interview
6. Keep Good Records

N.C. Center for Nonprofits
Personnel Files

- Contents for personnel files
  - Job application
  - Correspondence with employee
  - Performance reviews and warnings
  - Termination information

- Health Insurance Portability and Accountability Act (HIPAA)
  - Maintaining separate (more secure) file for medical records
  - Also may want to keep I-9 and W-4 forms in this secure file
Personnel Files

- N.C. Identity Theft Protection Act
  - Social security numbers – keep these in a secure file
  - Confidential and personal information – have a written policy for record destruction
  - Security breaches – notify individuals in writing
- Applies to personnel files and also to other records maintained by nonprofits
Performance Reviews

- Clear standards as basis for review
  - Job description
  - List of goals
- Common practices
  - Discussion of any problems and concerns
  - Reminder about basic personnel policies
  - Salary changes
- Document the review in writing
  - This can be informal and does not need to be signed by the employee
7. Know Your Requirements and Options for Unemployment Insurance
Unemployment Insurance

- Administered by Division of Employment Security (www.ncesc.com)
- Two options for nonprofits
  - Paying taxes – quarterly tax that businesses pay, which is based on experience rating
  - Reimbursement method – maintain funds with DES of 1% of nonprofit’s payroll – Note: surety bond of letter of credit is no longer an option
- Not required for nonprofits with fewer than four employees who work 20 weeks in a year
Unemployment Insurance

- Employees eligible for unemployment
  - Discharged through no fault of their own
  - Nonprofit employer is responsible for benefits

- Employees ineligible for unemployment
  - Discharged for fault – may be partially eligible, depending upon culpability
  - Employees may dispute their ineligibility, so it’s important to document the reason for termination
8. Make Informed Decisions About Health Coverage
Health Insurance Coverage

- Nonprofits aren’t required to provide health-related benefits to employees . . .
- . . . But if they do, then
  - Anti-discrimination laws apply to provision of health coverage
  - Employee Retirement Income Security Act (ERISA) applies
    - Disclosure of plan summary and annual report
    - Timely and fair process for benefit claims
    - Continuation of coverage (20+ employees)
    - Certificate of health insurance
Affordable Care Act

- Employer notice – by October 1, 2013
- Employer mandate – 50 or more full-time employees
- Payroll tax credit for small nonprofit employers (2010)
  - Nonprofits with 25 or fewer FTE and average wages under $50,000 qualify
  - Credit can be up to 25% of health coverage amounts in 2013 and 35% in 2014
  - May be reduced due to sequestration
Affordable Care Act

- Health exchanges (2014)
  - North Carolina will use the federal exchange through the U.S. Department of Health and Human Services
  - Nonprofits with fewer than 50 employees can use Small Business Health Options Program to find more affordable health insurance options

- Changes to health savings accounts
  - Over-the-counter, non-prescription drugs (2011)
  - $2,500 cap on annual election (2013)
9. Make the Best of a Bad Situation
Terminating an Employee

**Good practices**

- Let employee know the full reasons
- Meet in private room with two representatives of the nonprofit present
- Have a plan for dealing with the individual’s keys, passwords, nonprofit possessions, and personal possessions
- Consider a waiver and release of claims agreement
Terminating an Employee

Before terminating an employee, carefully consider:

- Other possible remedies
- Possible claims of discrimination/wrongful termination
- Termination vs. resignation
- Documentation
Terminating an Employee

Separation agreement

- Have consideration (and be clear it’s something employee isn’t otherwise entitled to receive)
- Age Discrimination in Employment Act (age 40+)
  - Right to independent legal counsel
  - 21 days to consider agreement (45 days in group layoff)
  - 7 days to revoke agreement
Terminating an Employee

Separation agreement

- Other important provisions:
  - Waiver and release of claims
  - Non-disparagement clause
  - Return of property
  - Non-competition and non-solicitation
  - References
  - Confidentiality
10. Know That There Are Many Other Laws That Affect Nonprofit Employers
State-Specific Employment Laws

- **Wage Payment Act:**
  - Notice of wages (including when paid), vacation, sick leave, and related policies; keep on record; notice of proposed changes
  - If separated by termination or resignation, must be paid by next scheduled payday
  - If vacation, bonuses, or commissions are forfeited upon separation, prior notice is required
State-Specific Employment Laws

- Occupational Safety and Health: workplace free of recognized hazards
  - Poster
  - Log of injuries and illnesses

- Retaliatory Employment Discrimination
  - Whistleblower protection for employees who file complaints internally or with N.C. Department of Labor
  - Employers have burden of proving that same action would have been taken if employee hadn’t filed a complaint
State-Specific Employment Laws

- Youth employment certificate
  - For persons under 18 years of age – apply through county department of social services
  - Nonprofit volunteers are exempt
- Juror protection – one year statute of limitations
- Leave for parental involvement in school – four hours per calendar year
- Employment Law Posters – N.C. Department of Labor
- Worker’s compensation insurance – required with 3 or more employees or officers
NLRB Poster Requirement

- Must post a notice about employee rights under the National Labor Relations Act
  - Originally applicable April 30, 2012 for private employers (not just those with union employees)
  - But federal court has temporarily stopped enforcement of this rule
  - Would apply to nonprofits with budgets over $250,000

Poster available at: www.nlrb.gov/poster
Immigration Compliance

- Verification that new workers are authorized to work in the U.S.
  - File Form I-9 with U.S. Citizenship and Immigration Services
  - E-Verify system – N.C. law requires nonprofits with 25+ employees to use this, starting July 1, 2013
Winding Down a Nonprofit
Nonprofit Mergers

- Is there a fit?
  - Programmatic
  - Funding sources
  - Cultural
- Due diligence is KEY
- Documentation
  - Letter of intent
  - Merger agreement
- Employment matters
Nonprofit Mergers

- Notice filings
  - State filings
  - IRS disclosure
- Post-closing protections
  - Indemnification/release of merged entity’s directors and officers
  - Board representation on surviving entity’s board
- Consider transfer of assets and dissolution as alternative to merger
  - But fraudulent conveyance concerns
Dissolution

- Board approval
- Member approval
- Articles and plan of dissolution
- Notice filings
- Final Form 990

The End!
Bankruptcy

- Creditor protection available to nonprofits
- Assumes assets to protect
- Defining scope of bankruptcy estate
- Restructure debt and finances
- Public relations!
Audits
## N.C. Nonprofits – State Funding

**Office of State Budget and Management**

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<th>Form</th>
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Audits

- Why do we need an audit?
- Who is the user of the audit report?
Audits

• Audit provides CPA opinion on whether the financial statements fairly represent organization as a whole
• Generally Accepted Accounting Principles (GAAP) reporting standard
• Not designed to uncover fraud
• Current OMB proposal to increase “Single Audit” threshold from $500,000 to $750,000 for federal awards spent
Alternatives to Audits

- **Review** – CPA not aware of material modifications needed to make financial statements conform to GAAP
  - Analytical procedures and management inquiries
  - Limited assurance
- **Compilation** – CPA prepares financial statements from management information
  - No assurance
Alternatives to Audits

- Agreed upon procedures – CPA performs limited audit-type procedures but doesn’t express opinion on findings
  - Need to get user “buy in”
- Form 990
- Biennial audit
- Balance sheet only audit
Board Governance and Fiduciary Duties

N.C. Center for Nonprofits
Board Governance

- Training
- Fiduciary duties
- Conflict of interest
- Private inurement vs. private benefit
- Size of board
- Role of chair
- Executive committee
- Board’s role vs. staff’s role
Minimizing Exposure to Personal Liability

- Legal entity
- Statutory immunity
- Limitation of liability
- Indemnification
- Directors and officers insurance
- General liability insurance
Board Fiduciary Duties

- Basic fiduciary duties of nonprofit board members:
  - Duty of Care
  - Duty of Loyalty
  - Duty of Obedience
Duty of Care

Directors must use care of reasonably prudent person

- Inform yourself before making decisions
- Attend meetings
- Monitor management
- Evaluate the nonprofit’s mission
- Monitor finances and activities
- Be active decision makers
  (Not merely a rubber stamp)
Duty of Care

- Free exchange of thought is essential to board’s success
- Fostering culture where constructive self-criticism of board and board members is welcomed
Duty of Loyalty

- Manage conflicts of interest
- No personal profit from board service
- Refrain from appropriating “corporate opportunities”
- Disclose conflicts of interest and recuse yourself from discussion where appropriate
- Keep matters confidential
- Don’t accept improper benefits from board service
- Be a positive advocate for the organization
Duty of Obedience

- Compliance with:
  - Articles of incorporation
  - Bylaws
  - Policies and procedures
  - State and federal nonprofit and tax law
  - Other state and federal laws
- Key question for all board members: What is the organization’s mission?
Board Fiduciary Duties

- Conflict of interest policy
  - Annual disclosure of potential conflicts
  - Recusal (discussion and voting)
- For more information: Nonprofit Board Guidebook
Questions and Answers
For More Information

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- Dennis Walsh, CPA (nonprofitcpa365@gmail.com)
  The Micah Project