New to Nonprofit / On a Nonprofit Board: Nonprofit Law Overview

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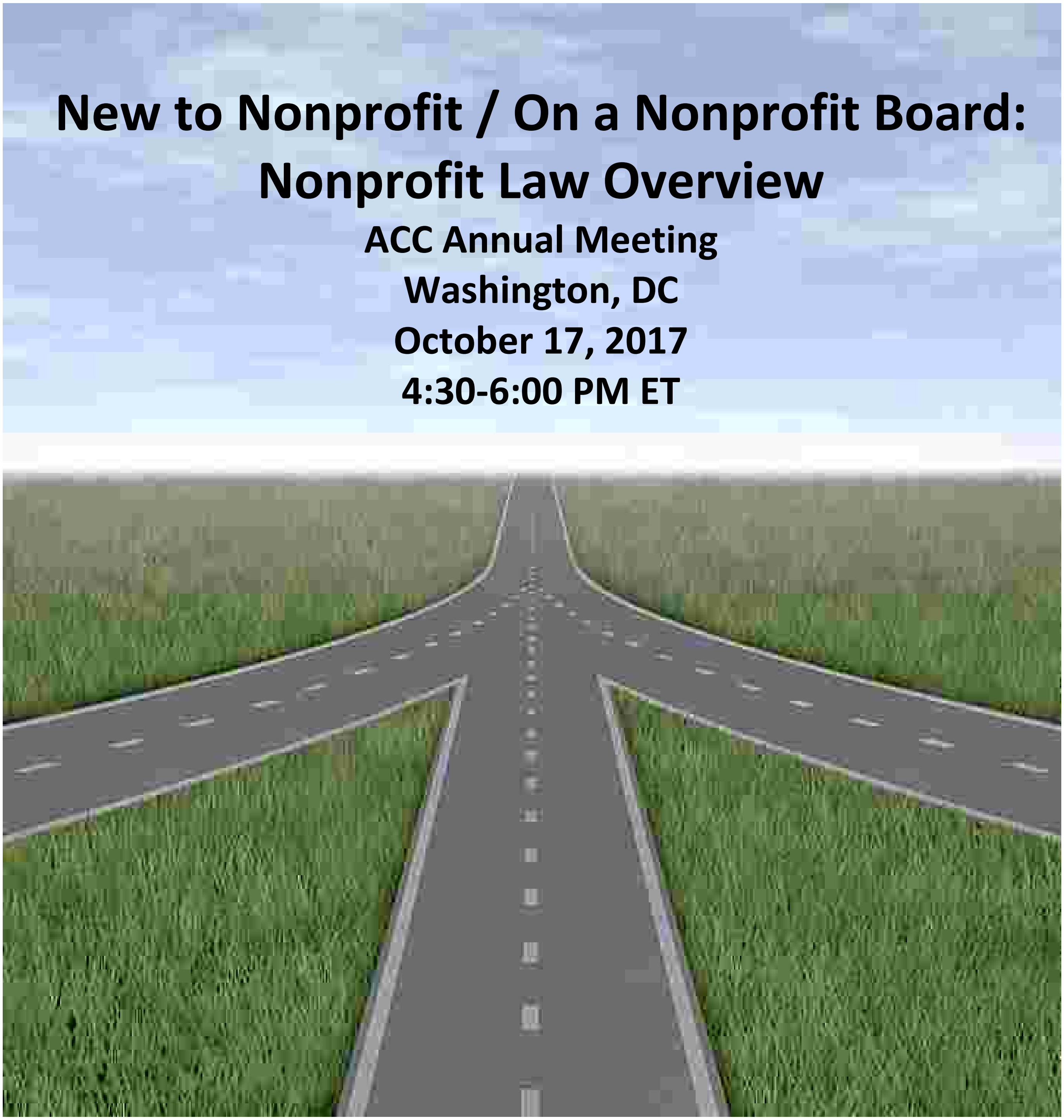

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OUTLINE

OVERVIEW
- Nonprofits: 501(c)(3) Organizations (Public Charities or Private Foundations), and 501(c)(4), 501(c)(5), and 501(c)(6) Organizations

KEY PRINCIPLES AND DIFFERENCES BETWEEN A FOR-PROFIT AND A NONPROFIT
- Public Trust
- Government Oversight
- Transparency
- Mission Integrity
- Donors Are Not Shareholders
- Use of Donor Dollars
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- Charitable Tax Deductibility and Substantiation
- Lobbying and Political Activities
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  - Lobbying Tests
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- Differences between For-Profit and Non-Profit Boards

REGULATORY WEB
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- Ten Nonprofit Policies and Documentation Procedures Identified on the IRS Form 990
- Executive Compensation
- Conflicts of Interest
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- Seven Hidden/Potential IRS Form 990 Pitfalls

<u>State Regulators</u>
- Areas Regulated/Consumer Protection
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- Types of Filings

<u>Local Regulators</u>
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<u>Charity Watchdog Groups</u>
- 20 Council of Better Business Bureaus Wise Giving Alliance Standards

- Charity Watchdog Groups (e.g., BBB Wise Giving Alliance, Charity Navigator, GuideStar, and CharityWatch)

MARKETING/BRAND PROTECTION

- Brand Is a Major Asset
- Protecting and Policing Nonprofit Brands

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WHAT IS A NONPROFIT, TAX-EXEMPT ORGANIATION?

Nonprofit Corporation

A nonprofit corporation is a state entity that does not automatically come with a federal tax exemption. A nonprofit corporation that has been recognized under Internal Revenue Code (IRC) Section 501(c)(3) by the IRS is not only exempt from paying federal corporate income tax, but it also allows donors to receive charitable tax deductions for their donations.

501(c)(3) Tax-Exempt Organization

An organization must be organized and operated exclusively for exempt purposes set forth in section 501(c)(3), and none of its earnings may inure to any private shareholder or individual.

- **Organized** – Charter state entity is organized for a charitable purpose.
- **Operated** – Organization must actually operate for a charitable purpose.
- **Exempt purpose** – Can be religious, charitable, or scientific; includes testing for public safety, literary, or educational purposes; fostering national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment); or the prevention of cruelty to children or animals.
- **Inurement** – The funds must be used for nonprofit purposes, and even if the nonprofit dissolves, the remaining funds must be spent on the charitable mission or donated to another charity or governmental entity. No private inurement or individual/corporate gain. Charities may not distribute their net earnings to or for the benefit of private interests. This means that charities cannot share their earnings with board members, founders, or others associated with their organization. However, charities are permitted to pay reasonable compensation to their employees, contractors and other who provide services to or on behalf of the organization. There is no explicit prohibition against paying board members for their service, though most charities do not do so.

An organization that qualifies for tax-exempt status under section 501(c)(3) of the IRC is further sub-classified as either a public charity or a private foundation. Being a public charity is preferable, as more prohibitions and limitations are imposed on private foundations, and there are more limits on the charitable deductibility of donations for private foundations. The primary distinction between the two – from a qualification perspective – is from where do they get their funding.

https://www.irs.gov/charities-non-profits/charitable-organizations/exemption-requirements-section-501c3-organizations

Public Charity

- **Tests to determine whether a nonprofit is a public charity:**
  - **1/3 Support Test:** 33.3% or more of organization's support over the past five years comes from the public, as defined by IRS regulations.
  - **10% of Support Requirement – Facts and Circumstances Test.** The facts and circumstances test is for organizations failing to meet the one-third support test. If

your organization fails to meet the one-third support test, it may still be treated as a publicly supported organization if it normally receives a substantial part of its support from government units, from direct or indirect contributions from the general public, or from a combination of these sources. To qualify, an organization must meet the ten-percent-of-support requirement (10% of total support from past five years is from government or public support) and the attraction of public support requirement (maintains a continuous and bona fide program for solicitation of funds from the general public, community, or membership group involved, or if it carries on activities designed to attract support from government units or other charitable organizations described in IRC Section 509(a)(1)). These requirements establish, under all the facts and circumstances, that an organization normally receives a substantial part of its support from government units or from direct or indirect contributions from the general public. The organization also must be in the nature of a publicly supported organization, taking into account five different factors:

    - Percentage of financial support
    - Sources of support
    - Representative governing body
    - Availability of public facilities or services
    - Additional factors pertinent to membership organizations. (A supporting organization is one whose funds are used to support a 501(c)(3). For example, the Memorial Healthcare System Foundation supports Memorial Hospital and its affiliates, not other outside charitable organizations.)

- Note that the public charity test is an ongoing requirement.
- If an organization cannot pass the public support test for two consecutive years, it will lose its public charity status. The penalty for not reaching this level of public support could be a reclassification as a private foundation. This reclassification would likely hurt a nonprofit's fundraising prospects among certain donors.
- "Supporting Organizations" are another way to qualify as a public charity; this generally can be arrived at by being controlled or operated for the benefit of another 501(c)(3), (c)(4), (c)(5), or (c)(6) organization that itself meets one of the public support tests outlined above.

https://www.irs.gov/pub/irs-tege/eotopicj93.pdf

Private Foundation

- The distinction between public charities and private foundations is public support. Public charities generally get their support from multiple different sources (or qualify as "supporting organizations," while private foundations generally get their support from one or a very small number of financial supporters/donors (be it individuals, corporations or families).

What Is a 501(c)(4), 501(c)(5) and 501(c)(6) Organization?

- **501(c)(4): Social Welfare Organizations**
- **501(c)(5): Labor Unions**
- **501(c)(6): Trade or Professional Associations or Chambers of Commerce**

Note that while these other common types of tax-exempt organizations are exempt from paying federal corporate income tax on their net income, contributions to them are not eligible for charitable tax deductibility, However, their operations and activities are not as limited as those of 501(c)(3) organizations.

TAKEAWAYS: *Nonprofit organizations organized under state law must meet ongoing requirements to qualify as a 501(c)(3) organization, which provides tax benefits to donors.*

Public charity requirements are enforced – follow them.

See additional lobbying and political campaign activity limitations on 501(c)(3) organizations in the next section.

KEY PRINCIPLES AND DISTINCTIONS

Public Trust

- Nonprofits need public trust for legitimacy, for effectiveness, and for non-financial as well as financial support.
  - Soliciting and receiving charitable contributions
  - Exercising custody over assets for the benefit of society
  - Employing the organization's social capital for the public's benefit
  - Mission commitment and adherence

Government Oversight

- The federal government exempts nonprofits from federal corporate income tax. The IRS, the federal government taxing authority, requires nonprofits to provide certain information each year to qualify for nonprofit tax-exempt status.
- Nonprofits receive certain benefits under the law, including exemption from tax and tax deductibility of donations (to 501(c)(3) organizations) to incentivize donations. To ensure this benefit is not abused, the government exercises its oversight powers in a variety of ways at the federal, state and local levels.
- Governments regulate and require licenses and permits for certain nonprofit and nonprofit-related activities and require reports with financial information, contracts and fees paid to professional fundraisers.
- Additional information in Regulatory section.

Transparency

- Both the IRS and certain state governments require that charities make the IRS Form 990 and other summary financials publicly available.
- Regulatory filings to government entities are public records and are open to the public. They inform the public of registered charity activities, financial information and program service expenses.
- Certain activities require disclosures to the public. All activities should follow the "front-page" rule: If you don't want your grandmother to read about it on the front page of your local paper, don't do it.

Mission Integrity

- Nonprofits must work in furtherance of the mission for which they have been formed.
- Organization planning is a critical process that defines a nonprofit's overall direction and activities to be employed to fulfill its mission. Nonprofits are obligated to understand their role in providing public benefits, and conduct their activities with integrity and accountability.
- Not following the nonprofit mission may result in a revocation of status, a return of donations, or a loss of public trust.

Donor Intent and Use of Donor Dollars

- Donors are different from shareholders. They are donating money, not purchasing an equity interest. However, in return for the donation, the charitable organization must use their funds for the purpose for which they are donated.
- The language used to solicit the donations can form a quasi-contract that expresses donative intent for how the funds are used, which must be followed by the charity.

- Donative intent refers to the conscious desire to make a gift. The issue of donative intent is an issue of fact. The law presumes a donative intent when the grantee is the natural object of the grantor's bounty; however, this presumption is rebuttable. Deviations from donor intent do not have to be dramatic. For example, donor intent can be compromised by a lack of clarity about the purpose of the donated assets.
- To avoid issues involving gift restrictions and donor intent: (1) educate donors, (2) get donations and intentions of the donation in writing, (3) account for the donation via an effective accounting system, (4) carefully consider changes in use and explain this possibility to the donor, and (5) review current gift agreements.
- Example**:** In a well-publicized case, country music superstar Garth Brooks was awarded $1 million in 2012 by an Oklahoma jury that found a hospital had defaulted on an oral agreement to construct and name a women's center after the singer-songwriter's late mother. Brooks claimed that the hospital's president suggested the gift be used to construct a women's center and that he made the donation for the sole purpose of constructing such a center to honor his mother. Even though the agreement was never made in writing, the jury eventually found in favor of Brooks—awarding him punitive damages of $500,000 in addition to the return of the $500,000 donation.

Charitable Tax Deductibility and Substantiation

- A donor must have a bank record or written communication from a charity for any monetary contribution before the donor claims a charitable contribution on his/her federal tax returns.
- The organization must acknowledge gifts of $250 or more. A donor cannot claim a tax deduction for any single contribution of $250 or more unless the donor obtains a contemporaneous, written acknowledgment of the contribution from the recipient organization stating: (1) the name of the organization, (2) the amount of cash contribution, (3) a description (but not the value) of any non-cash contribution, (4) a statement that no goods or services were provided by the organization in return for the contribution, if applicable, (5) a description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution, (6) a statement that goods or services, if any, that an organization provided in return for the contribution consisted entirely of intangible religious benefits.
- Charitable organizations are required to provide a written disclosure to a donor who receives goods or services in exchange for a single payment in excess of $75.00.
- Acknowledgments are not required for:
  (a) Tokens: Goods and services considered insubstantial if the payment occurs in the context of a fundraising campaign in which a charitable organization informs the donor of the amount of the contribution that is a deductible contribution, and
    a. The fair market value of the benefits received does not exceed the lesser of 2 percent of the payment or $106, or
    b. The payment is at least $53, the only items provided bear the organization's name or logo (ex: calendars, mugs, or posters), and the cost of these items is within the limit for "low-cost articles," which is $10.60.

  (b) Membership Benefits Exception: An annual membership benefit is insubstantial if it is provided in exchange for an annual payment of $75 and consists of annual recurring rights or privileges.

  (c) Intangible religious benefits: Benefits provided by a tax-exempt organization operated exclusively for religious purposes, that are not usually sold in commercial transactions outside a donative (gift) context (ex: admission to a religious ceremony, wine used in a religious ceremony).

https://www.irs.gov/charities-non-profits/charitable-organizations/charitable-contributions-written-acknowledgments

TAKEAWAYS: *Nonprofits are public trusts. Government entities provide nonprofits with exemptions from taxes and certain requirements but regulate a variety of nonprofit activities at the federal, state and local levels. As charities are the recipients of donor dollars, charities must be transparent, showing that donor dollars are used for the purpose(s) for which they were given. Donors expect efficient expense management and that charities will wisely use the dollars they are given. Donors are not buying a product; they are giving money for a purpose – the organization's mission. Donor trust is incredibly important.*

NONPROFITS AND POLITICAL ACTIVITIES

Political Campaign Activities vs. Lobbying Activities

- **No Participation in Political Campaigns:** Under the Internal Revenue Code, all section 501(c)(3) organizations are absolutely prohibited from directly or indirectly participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for elective public office. Contributions to political campaign funds or public statements of position (verbal or written) made on behalf of the organization in favor of or in opposition to any candidate for public office clearly violate the prohibition against political campaign activity. Violating this prohibition may result in denial or revocation of tax-exempt status and the imposition of certain excise taxes. But limited lobbying is allowed (more to follow in political activity section).

- **But Limited Lobbying Allowed:** There are limits on the amount of lobbying a charity can do. According to the IRS, organizations that qualify for 501(c)(3) status cannot substantially participate in lobbying: "A 501(c)(3) organization may engage in some lobbying, but too much lobbying activity risks loss of tax-exempt status." An organization will be regarded as attempting to influence legislation if it contacts, or urges the public to contact, members or employees of a legislative body for the purpose of proposing, supporting, or opposing legislation, or if the organization advocates the adoption or rejection of legislation. However, nonprofit organizations have the ability to advocate to advance their policies and interests.

How Much Lobbying Is Allowed?

- **Substantial Part Test:** Whether an organization's attempts to influence legislation (i.e., lobbying) constitute a substantial part of its overall activities is determined on the basis of all the pertinent facts and circumstances in each case. The IRS considers a variety of factors, including the time devoted (by both compensated and volunteer workers) and the expenditures devoted by the organization to the activity.
- **Expenditure Test:** Organizations other than churches and private foundations may elect the expenditure test under section 501(h) as an alternative method for measuring lobbying activity. Organizations should pass on this if expenditures related to such activity do not normally exceed an amount specified in section 4911. This limit is generally based upon the size of the organization and may not exceed $1,000,000 annually.

Is all advocacy work considered lobbying? Organizations may, however, involve themselves in issues of public policy without the activity being considered lobbying. For example, organizations may conduct educational meetings, prepare and distribute educational materials, or otherwise consider public policy issues in an educational manner without jeopardizing their tax-exempt status or incurring penalties.

Some **examples of (non-lobbying) advocacy** by a nonprofit:

- An organization writes to its Congress member requesting that he or she contact an administrative agency regarding a proposed regulation. The communication to the

Congress member is not lobbying because administrative rules are not "legislation" as defined by the IRS lobbying regulations.
- An organization paper on a particular state's environmental problems. The paper does not reflect a view on any specific pending legislation or on any specific legislative proposal that Z supports or opposes. Z's paper is not a lobbying communication, even if it is sent to a legislator.

Some **examples of lobbying** by a nonprofit:
- A pamphlet distributed by an organization states that a particular legislative plan should be passed and encourages readers to "write or call your senators and representatives and tell them to vote for the plan." Since the pamphlet refers to, reflects a view on, and encourages readers to take action with respect to specific legislation, the pamphlet is considered a grassroots lobbying communication.
- An organization places an advertisement that specifically identifies and opposes a bill that T asserts would harm the economy. The ad is not a mass media communication described in the special rules for certain mass media advertisements, but it does state that Senator Y favors the bill. Because it refers to and reflects a view on specific legislation, and encourages readers to take action by specifically identifying a legislator who opposes T's views on the bill, the advertisement is considered a grassroots lobbying communication.

Different Rules for 501(c)(4), (c)(5) and (c)(6) Organizations for Lobbying and Political Campaign Activity
- Organizations described in IRC 501(c)(4), (c)(5), and (c)(6) may engage in an unlimited amount of lobbying, provided that the lobbying is related to the organization's exempt purpose.
- IRC 501(c)(4), (c)(5), and (c)(6) organizations may engage in political campaigns on behalf of or in opposition to candidates for public office, provided that such intervention does not constitute the organization's primary activity (more than 50%).

https://www.irs.gov/charities-non-profits/charitable-organizations/political-and-lobbying-activities

NONPROFIT BOARDS – SIMILARITIES AND DIFFERENCES

Fiduciary Duties of Board Members
- Duty of Loyalty: Board members should act in good faith and in a manner that is reasonably believed to be in the interests of the organization and consistent with its purposes rather than their own interests or the interests of another person or organization.
- Duty of Care: Board members should carry out their responsibilities in good faith and with that degree of diligence, care, and skill that ordinarily prudent persons would reasonably exercise under similar circumstances in like positions. A board member must act in a manner that he or she reasonably believes to be in the best interests of the organization.
- Duty of Obedience: Board members must abide by the organization's governing documents (e.g., articles of incorporation, bylaws, policies) to carry out the organization's mission and to ensure that funds are used for lawful purposes.
- Duty to Document: Like their for-profit counterparts, nonprofit organizations need to maintain appropriate records about their operations. For example, financial records, significant contracts, real estate and other major transactions, employment files, and fundraising obligations should be retained according to guidelines established by the organization.

<u>Differences between For-Profit and Nonprofit Boards</u>

- Board members for nonprofits are usually not compensated for their service (but there is generally no legal prohibition on doing so).
    - Note that a board member could receive compensation in another capacity, such as an author or a researcher, but there are disclosure requirements.
- Board members often have fundraising expectations for the nonprofits, and grants often ask what percentage of nonprofit board members are donating to the nonprofit.
- For-profit board members are responsible to shareholders, to maximize shareholder value. Nonprofit directors are responsible for ensuring the nonprofit follows its mission and uses donor dollars in an appropriate and responsible manner. Activities that might be acceptable to a for-profit may not be to a nonprofit.
- Boards for nonprofits are typically larger than for-profit boards.
- Nonprofits rarely have a CEO who is also the president/chairman of the board. Therefore, the roles are more distinct. The board's role is oversight, strategic direction, and governance. The CEO's role is management and execution of the strategic plan.
- No SOX requirements, except that two sections apply to nonprofits:
    - The federal Sarbanes-Oxley Act (SOX) provides new protections for whistleblowers and criminal penalties for actions taken in retaliation against whistleblowers. The Act protects whistleblowers who put themselves at risk by reporting suspected illegal activities in the organization. It is illegal for a corporate entity—for-profit and nonprofit alike—to punish the whistleblower in any manner.
    - The federal Sarbanes-Oxley Act addresses destruction of documents or information that may be relevant to federal investigation, enforcement action, or lawsuit. The law makes it a crime to alter, cover up, falsify, or destroy any document (or persuade someone else to do it) to prevent its use in an official federal proceeding (e.g., federal investigation or bankruptcy proceedings). The Act turns automatic document destruction into a process that must be monitored, justified, and carefully administered.

<u>IRS Form 990 History</u>

- 1894-1969: Legislation enacted to develop the structure of tax exemption for the charitable sector outlined in the federal Tax Code.
- Congress established the basic principles and requirements of tax exemption, identified business activities of tax-exempt organizations that are subject to taxation, and defined and regulated private foundations.
- IRS – The federal government entity that collects taxes regulates nonprofits that generally do not pay taxes through its tax filing process.
- Federal Revenue Act of 1943 – Required first IRS Forms 990 to be filed.

The Form 990 is a public document that is made available by filing organizations, the IRS, and others. It is the key transparency tool relied on by the public, state regulators, the media, researchers, and policymakers to obtain information about the tax-exempt sector and individual organizations.

<u>Three versions of the Form 990</u>

- <u>Form 990-N</u>: If your gross receipts were less than or equal to $50,000, then this form is yours. Different from most forms, this one is filed as an e-postcard.
- <u>Form 990 EZ</u>: If your gross receipts for the fiscal year were less than $200,000, and your total assets were less than $500,000, then this is the form for you.
- <u>Form 990</u>: If your gross receipts were greater than or equal to $200,000, and your total assets were greater than or equal to $500,000, then choose this form. (This discussion focuses on the Form 990.)

Form 990 Overhaul
In 2008, the IRS completed an overhaul of the Form 990. For 30 years, the IRS made modest annual changes to Form 990, but in 2008 it made significant changes to Form 990. The revised Form 990 reflects the IRS's intention to enhance the transparency of tax-exempt organizations' financial affairs and governance practices.

1) The "Core" Form 990 consists of the following new or significantly revised parts (new or revised as of 2008):

   a) **New Sections:**
      i) Part I, Summary, provides certain important information regarding the organization's mission, activities and governance, and current and prior years' financial results: revenue, expenses and net assets.
      ii) Part IV, Checklist of Required Schedules: The 2008 Form has added 16 new schedules for reporting additional information not asked in the Core Form.
         (1) Schedule A Public Charity Status and Public Support
         (2) Schedule B Schedule of Contributors (instructions included in schedule)
         (3) Schedule C Political Campaign and Lobbying Activities
         (4) Schedule D Supplemental Financial Statements
         (5) Schedule E Schools (instructions included in schedule)
         (6) Schedule F Statement of Activities Outside the United States
         (7) Schedule G Supplemental Information Regarding Fundraising or Gaming Activities
         (8) Schedule H Hospitals
         (9) Schedule I Supplemental Information on Grants and Other Assistance to Organizations, Governments, and Individuals in the United States (instructions included in schedule)
         (10) Schedule J Compensation Information
         (11) Schedule K Supplemental Information on Tax-Exempt Bonds
         (12) Schedule L Transactions with Interested Persons
         (13) Schedule M Non-Cash Contributions (instructions included in schedule)
         (14) Schedule N Liquidation, Termination, Dissolution, or Significant Disposition of Assets (instructions included in schedule)
         (15) Schedule O Supplemental Information to Form 990 (instructions included in schedule).
         (16) Schedule R Related Organizations and Unrelated Partnerships

With these changes, the IRS is capturing more information in the Form 990, some of which may have been captured outside of the Form 990 and some of which they had not previously captured. For example, prior to the changes, the re-determination process, where a tax-exempt organization has made significant changes to its purpose or programs and would request a formal IRS "re-determination" and took place outside of the Form 990, has essentially been replaced by Schedule O.

      iii) Part IV of the Core Form provides a checklist for the organization to determine which schedules should be completed and attached to the Core Form. The 38 questions in Part IV flow in alphabetical order based on the related Schedules (i.e., schedule A, Schedule B, and so on).
      iv) Part VI, Governance, Management, and Disclosure, asks 20 nonfinancial questions related to the organization's governing body and management, policies, and disclosure practices; many of the questions ask for submission of explanations on Schedule O.
         (a) Section A generally asks questions regarding how the organization is governed, and by whom.

(i) Number of voting board members
(ii) Number of independent voting board members
(iii) Related business transactions
(iv) Delegation of control over management duties to a management company
(v) Whether the organization made any significant changes to the organization's governing documents during the past year, and if so, to briefly describe the changes
(vi) Diversion of assets
(vii) Does the organization have members or stockholders; can those members or stockholders appoint members of the governing body?
(viii) Did the organization document meetings of the governing body and its committees?
(ix) Are any officers, directors or trustees not reachable at the organization's mailing address?

(b) Section B asks whether the organization has questions on the existence of chapters/branches, board review process of the 990, written conflicts of interest, whistleblower, and document retention and destruction policies, joint venture investments and asks what process it uses to determine the compensation of its top management official and other officers or key employees.

(c) Section C asks questions regarding the public disclosure of certain documents subject to public disclosure requirements (Form 1023, Form 990) and documents not subject to public disclosure requirements (governing documents, conflict of interest policy, and financial statements).

v) Part XII, Financial Statements and Reporting: This is a new part as of the 2008 Form 990, which requests information as to the organization's method of accounting; whether the organization's financial statements were compiled, reviewed, or audited by an independent accountant; and whether the organization has an audit or similar committee.

b) **Substantial Changes:**

i) Part VII, Compensation of Officers, Directors, Trustees, Key Employees, Highest Compensated Employees, and Independent Contractors. Part VII requires reporting of two types of compensation: 1) reportable compensation (amounts reportable on a person's Form W-2 (box 5) or Form 1099 (box 7)) and 2) other compensation. Special rules apply to determine which types and amounts of compensation must be reported as "other compensation." Compensation is reported in Part VII on a calendar-year basis for all Form 990 filers, regardless of their fiscal tax year.

(1) Section A of Part VII requires a listing of the organization's current officers, director, and trustees, regardless of whether they are compensated. This schedule should include only voting directors or trustees.
(2) Non-voting members of the board should no longer be reported.
(3) Top 20 highest-paid "key employees" who receive over $150,000, and
(4) Top 5 other highest-compensated employees who receive over $100,000 (as opposed to the $50,000 threshold for 2007). NOTE: The top 5 highest-paid employees are in addition to the individuals listed under other categories – if your officers listed are also the 5 highest-paid individuals, as the organization you must list the next 5 highest-paid individuals.

ii) Section B of Part VII requires the listing and reporting of compensation of the organization's top 5 highest-paid independent contractors that receive more than $100,000 from the organization (the 2007 threshold was $50,000).

<u>Governance Policies that Nonprofits Are Expected to Have</u>

The Form 990 asks whether the organization has adopted a number of policies and procedures. Although, as noted already, these policies are not mandated by the IRC, the implication appears to be that a well-run nonprofit would have them. If an organization answers that they do not, this may or may not be a red flag for further IRS scrutiny of their return. Below are descriptions of common board-approved policies maintained by tax-exempt organizations; the ones with asterisks (*) next to them are the ones specifically asked about on the Form 990. The IRS generally does not provide sample policies, but some samples can be found online.

1) ***Conflict of Interest Policy*.***
   a) Conflict of interest policies have long been a good governance standard. IRS Form 1023, Application for Recognition of Exemption Under § 501(c)(3), has, for several years, strongly suggested that applicants adopt a conflict of interest policy. Some state law also requires that directors act in a manner that is in the best interests of the organization. The 990 considers conflicts to consist solely of financial conflicts and does not address conflicts of loyalty that may arise for directors who serve on several boards. The 990 also expects the policy to apply to key employees as well as officers and directors and requires disclosure of how the policy is implemented.
   b) Purpose: To define conflict of interest, identify the classes of individuals covered by the policy, facilitate disclosure of information to identify conflicts of interest, and specify procedures to manage conflicts of interest.
   c) A conflict of interest policy prohibits officers and directors of nonprofits from receiving more favorable financial benefits than they would in an open market and prohibits an officer or director from enjoying priority over open market competitors without the approval of the board.
   d) Form 990: Must disclose implementation of your policy.
   e) Be sure that your nonprofit's conflict of interest policy covers not just financial conflict, but situational conflicts as well (such as serving in a leadership role of a competing nonprofit), and that it has an appropriate procedure for "managing" conflicts. The sample IRS-provided conflict of interest policy (on its website) is actually far from an ideal policy.
   f) SAMPLES:
      i) http://www.publiccounsel.org/tools/assets/files/CIPolicy.doc
      ii) http://www.mtnonprofit.org/uploadedFiles/Files/About/Conflict_of_Interest_Policy_and_Statement.pdf

2) ***Whistleblower Protection Policy*.***
   a) SOX imposes penalties—including severe criminal penalties—against all organizations (including nonprofits) that retaliate against whistleblowers. Although it is a good idea to have a written policy on whistleblowers, there is nothing in the law that requires exempt organizations to have one. An effective whistleblower policy specifies the process to be used for reporting confidentially on any potential wrongdoing, so that the organization can investigate and, if necessary, correct any problems, while eliminating, as much as possible, the chance of retaliation against the whistleblower.
   b) Whistleblower Policy: Protects an employee, volunteer or other person associated with a nonprofit from retaliation for exposing the wrongdoing of the organization or its employees.
   c) SAMPLE:
      i) https://www.councilofnonprofits.org/sites/default/files/Sample%20WhistleblowerPolicy%202.2010.pdf

3) ***Record Retention and Destruction Policy*.***
   a) SOX also extends its record retention and destruction requirements to all entities, including nonprofits. Form 990 asks whether the organization has a written document retention and destruction policy. As with the whistleblower issue, the law does not require a written policy, but it is certainly a good idea for the organization to have one. A

written policy should cover not only document retention and destruction, but also standards for document integrity, such as guidelines for handling electronic files, backup procedures, archiving of documents, and regular checks to determine the reliability of the system.

b) Potentially worse than not having a written policy is having such a policy and not following it, so be careful about implementation. In case of a dispute, unfavorable inferences can readily come to mind when an organization destroys records in violation of its own policy.

c) Document Retention and Destruction Policy: The policy should identify the types of paper documents and electronic files the nonprofit generates, lists how long the organization will retain them, and requires monitoring of progress with compliance in written form.

d) SAMPLE:

   i) http://www.lawhelpny.org/files/B23B29BF-0DED-F7B9-2149-1DB14E1A7DE5/attachments/620D9708-9136-0E43-BBA5-E1C88F13EFA2/497691Document%20Retention%20Policy.pdf

   ii) http://www.publiccounsel.org/tools/assets/files/DocPolicy.doc

4) ***Executive Compensation Policy*.***

   a) Executive compensation has been a significant issue for exempt organizations, especially since the introduction of the intermediate sanctions law for excess benefits transactions, adopted by Congress in response to a number of high-profile nonprofit scandals involving excess compensation issues (26 U.S.C. § 4958) (See www.runquist.com/article_intermedsancts.htm). Form 990 requires the organization to describe the process used in setting compensation in narrative. State law also may impose requirements concerning executive compensation.

   b) Executive Compensation Approval Process: Ensures that the board has approved reasonable, not excessive, compensation for the executive director or CEO of a nonprofit organization.

   c) *SAMPLE:* https://www.councilofnonprofits.org/sites/default/files/documents/Sample%20Policy%20for%20Bd%20Approval%20of%20Compensation_0.doc

5) ***Joint Venture Policy*.***

   a) If the organization engages in joint ventures or similar arrangements, such as partnerships, whether with nonprofit or for-profit partners, it must state whether it has in place a written joint venture policy. The instructions define such a policy as one that safeguards the organization's tax-exempt status during its participation in the endeavor. Again, there is no legal requirement for the organization to adopt such a policy, or that it be in writing.

   b) Joint Venture Policy: Requires the board of a nonprofit organization to evaluate specific kinds of transactions under current tax law and focus on safeguarding the exempt status of the nonprofit with respect to those transactions.

   c) SAMPLES:

      i) http://www.publiccounsel.org/tools/assets/files/JVPolicy.doc

      ii) http://www.reacpa.com/wp-content/uploads/2017/03/Sample-policies_Joint-Venture.pdf

6) ***Disclosure Policy for Form 990 and Governance Documents*.***

   a) Another question asks how the organization disseminates its Form 990. This is not inappropriate since, as noted previously, Congress has required Form 990 to be made available for public inspection. This same question also asks how the organization makes its Form 1023 or 1024 (the exemption application forms for 501(c)(3) and other

501(c) organizations, respectively) available. Form 990s are readily available for inspection online, but there is not a similar method by which Forms 1023 and 1024 are made available.

b) The organization also must disclose how it makes its governing documents, conflict of interest policy, and financial statements available to the public. Unlike Forms 990 and 1023, there is no federal law requiring such disclosure (limited disclosure may be required by some states); therefore, the organization needs to determine whether, and the extent to which, such disclosure is appropriate.

c) While a written, board-approved policy is not necessary to answer these questions favorably, it has become a best practice to maintain such a policy.

7) ***Chapter Relations Policies*.**

a) Form 990 asks whether multi-level nonprofit organizations have policies and procedures to ensure mission consistency throughout the organization, including chapters, affiliates, and branches. This question appears to encourage such nonprofits to adopt stronger central oversight, which may or may not be consistent with the structure of the particular organization.

8) ***Nondiscrimination Policy*.**

a) This policy typically provides that nonprofit organizations will treat employees and job applicants fairly, and without regard to at least several federally protected classes, such as disability, race, creed, color, national origin, or sex. States and localities may require that other classes be protected as well.

9) ***Donor Privacy Policy*.**

a) This policy ensures that donors' personal and donation information will be kept confidential and will not be shared with anyone outside the nonprofit organization, unless the donor approves.

10) ***Gift Acceptance Policy*.**

a) A gift acceptance policy describes the types of gifts a nonprofit organization will and will not accept from donors and which staff or board members will make those decisions. The policy may also enumerate when the organization must seek outside legal counsel.

11) ***Review Process of Form 990*.**

a) The Form 990 Review Process should allow board members, or a board subcommittee, adequate time to conduct a meaningful review of the nonprofit's Form 990 before it is submitted to the IRS. This process should also allow for feedback and revisions based on input.

b) SAMPLE:

i) http://www.reacpa.com/wp-content/uploads/2017/03/Sample-policies_990-Review.pdf

12) ***Meeting Minutes Documentation Procedure*.**

a) This process ensures that boards take minutes of their meetings while the meetings occur, not afterward, and retain them safely for the long term

https://www.irs.gov/pub/irs-pdf/p4221pc.pdf

Board Involvement Approval of Form 990

- Part VI of IRS Form 990, Section A, Question 10, asks, "Was a copy of the Form 990 provided to the organization's governing body before it was filed? All organizations must describe in Schedule O the process, if any, the organization uses to review the Form 990." There is no existing legal requirement to provide board members with IRS Form 990. This question relates to how an organization's governing body reviews the 990.

- Schedule O should be used to describe
    - The process by which the organization's officers, directors, trustees, board committee members, or management reviewed the prepared IRS Form 990;
    - Whether the review occurred before or after it was filed with the IRS; and
    - The specifics regarding who conducted the review, when it was conducted, and the extent of such a review.
- Boards should consider adopting an IRS Form 990 review policy that provides adequate time for meaningful review by at least a subcommittee of the board and a method for allowing feedback and revisions based on board input.
- A copy of the Form 990 should be provided to the board prior to filing (hard copy or electronic).
- The review of the Form 990 by the board and/or committees of the board should be documented in meeting minutes.

Executive Compensation

- Section 4958 of the IRC imposes a penalty excise tax directly on certain persons who receive excessive compensation (and other "excess benefit transactions") from certain tax-exempt organizations. If a nonprofit executive violates Section 4958, the nonprofit executive is personally liable to pay one or more penalty excise taxes. In some cases, managers of a nonprofit who approve excessive compensation arrangements, such as members of the board of directors, may also have to pay an excise tax.
- An excess benefit transaction is any transaction in which an economic benefit is provided by an applicable tax-exempt organization directly or indirectly to or for the use of any disqualified person, and the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) received for providing the benefit.
    - Unreported compensation is considered by IRS to be an automatic excess benefit. Upon examination, IRS agents will review all expense reimbursements to determine the nature of the reimbursement. There must be a business connection to all reimbursed expenses, or they will be considered compensation. Reimbursed expense reports must verify the date, time, place, amount, and the business purpose of the expenses, and receipts are required. It is also important to note that any unreported income negates any rebuttable presumption efforts performed by the organization.
- A disqualified person is anyone in a position to exercise substantial influence over the affairs of a tax-exempt organization, such as a board member/trustee or officer, president/CEO, COO, CFO/treasurer, or other senior executives, as well as certain family members of disqualified persons.
- If the "Rebuttable Presumption of Reasonableness" is established by the nonprofit, then the burden of proof to establish and prove the excess benefit transaction shifts to the IRS. There are three steps to establishing the Rebuttable Presumption of Reasonableness:
    - Approval by an authorized independent body;
        - governing body or authorized committee, without a conflict of interest for the transaction (those with a conflict must recuse themselves)
    - Use of appropriate comparability data; and
        - compensation paid by similarly situated for-profit and nonprofit organizations for comparable positions, whether or not there is a ready supply of people to perform similar services in the geographic area where the nonprofit is located; current compensation surveys compiled by

independent firms; and actual written offers from similar institutions competing for the services of the disqualified person.
  - o Contemporaneous documentation of the same.
    - ▪ the terms of the transaction and the date it was approved; the members of the authorized body who were present when the transaction was debated; the comparability data obtained and relied on by the authorized body and how the data was obtained; and any actions taken by a regular member of the authorized body who had a conflict of interest with respect to the transaction (e.g., recusal).
- Penalties
  - o The penalty requires the return of the excessive benefit to the organization AND a tax of either 25% of the value of the excessive benefit if the benefit is returned to the organization before the issuance of a notice of deficiency by the IRS, or 200% of the value of the excessive benefit if the benefit is returned after the IRS issues the notice of deficiency.
  - o A tax equal to 10% of the amount of the excessive compensation received by a disqualified person is imposed, jointly and severally, on any "organization manager" who knowingly approves excessive compensation.
  - o Therefore, the payment of excessive compensation to an organization's managers, or the provision of substantial benefits in addition to compensation, presents significant risks to an organization's exempt status, even when the provision of such benefits is isolated and small in amount.

https://www.pbpatl.org/wp-content/uploads/2011/12/ExecutiveCompensationAlert1.pdf

Conflict of Interest

A conflict of interest arises when a person in a position of authority over an organization, such as an officer, director, or manager, can benefit financially from a decision he or she could make in such capacity, including indirect benefits, such as to family members or businesses with which the person is closely associated. For this purpose, a conflict of interest does not include questions involving a person's competing or respective duties to the organization and to another organization, such as by serving on the boards of both organizations, that do not involve a material financial interest of, or benefit to, such person. Note that not all conflicts of interest are necessarily bad for the organization; it all depends on whether and how the conflict is disclosed, and then how the conflict is managed by the organization.

Form 990 Questions Regarding Conflict of Interest:
- Does the organization have a written conflict of interest policy?
- Were officers, directors, or trustees, and key employees required to disclose annually interests that could give rise to conflicts?
- Did the organization regularly and consistently monitor and enforce compliance with the policy?
- Schedule L requires the disclosure of information with respect to business transactions of interested persons.

An actual conflict does not preclude taking action.

Ensure you have reasonable and effective information-gathering procedures:
- Organization must make a reasonable effort to obtain the information needed.
- Distributing a questionnaire is sufficient.
- Recommended: Annual disclosure questionnaires, as well as a requirement to disclose actual or potential conflicts as they may arise during the year.

Independent Directors

Form 990 requires the number of **independent** board members

Question for board and officers to determine interest:

- Whether they or any of their family members ***engaged in any business transactions*** with the organization;
- Whether entities of which they or their families owned *more than 35 percent* ***engaged in any business transactions*** with the organization;
- Whether they ***do business***, other than as a member of the general public, with another board member, officer, or key employee, or with an entity of which another board member, officer, or key employee is a director, officer, or more than 35 percent owner;
- Whether they ***have a family relationship*** with any other director, officer, or key employee of the organization; and
- Whether they are a director, officer, or greater than 10 percent owner *of an entity* of which *another* of the organization's directors, officers, or key employees is a director, officer, or greater than 10 percent owner.

Steps to take once a conflict is identified:

1) The person with the potential conflict with respect to a transaction should disclose such potential conflict.
2) The person should not participate in or be present at any meeting during which the discussion of the possible conflict of interest takes place.
3) The chair of the board should, if appropriate, appoint a committee of the board made up of disinterested directors to investigate alternatives to the proposed transaction.
4) If a more advantageous transaction is not reasonably available, the governing board or committee should determine, by a majority vote of the disinterested directors, whether the transaction is in the organization's best interest and is fair and reasonable.
5) The organization should also document, through well-kept minutes, any decisions related to transactions involving an actual or possible conflict of interest.
6) Disclosure on Form 990 and other state reports
7) Finally, the organization must be diligent in taking appropriate disciplinary and corrective action if a person who is covered by the conflict-of-interest policy fails to disclose an actual or possible conflict of interest.

Part VI of the Form 990 asks: "Does the organization regularly and consistently monitor and enforce compliance with the policy?" The organization should describe its practices for monitoring proposed or ongoing transactions for conflicts of interest and dealing with potential or actual conflicts, whether discovered before or after the transaction has occurred. In addition, the organization should include an explanation of the class of people – such as officers, directors, and the CEO – are covered under the policy, the level at which determinations of whether a conflict exists are made, and the level at which actual conflicts are reviewed. The organization should also discuss its commitment to following the procedures set out in the conflict of interest policy, and include and explain any restrictions imposed on persons with a conflict, such as prohibiting them from participating in the governing body's deliberations and decision in the transaction.

http://www.lawhelp.org/files/7C92C43F-9283-A7E0-5931-E57134E903FB/attachments/BFD5CF9D-227B-4836-8667-E9A6A3274C2E/dc-bar-alert-conflict-of-interest-disclosure-january-2017-update.pdf

Seven Hidden/Potential Pitfalls

1) **Gross income and net losses from activities that are not substantially related to your mission (Part I, Questions 7a and 7b).** Ensure proper allocation for unrelated business

income.

2) **Significant alternative investments (Part X, Question 12 and Schedule D, Part VII).** If you have investments such as managed futures, hedge funds, commodities, or derivatives contracts, you may be exposed to unrelated business income, foreign filing, and state filing obligations. The rules in each of these areas are very complex and can lead to steep penalties for noncompliance.

3) **Employees with salaries greater than $150,000 receive fringe benefits and expense reimbursements without a written policy, or participate in a nonqualified retirement plan (Schedule J).** To reduce your risk, you may consider establishing an accountable reimbursement plan and using an independent compensation consultant or commissioning a compensation survey or study to support your organization's compensation decisions.

4) **Significant amount of inventory sales (Part VIII, Question 10).** Ensure you comply with sales tax obligations, which nonprofits are not necessarily exempt from.

5) **Foreign Activities: Subsidiaries, offices, employees, and/or independent contractors in a foreign country or financial interest over a foreign account (Part V, Question 4) (Schedule F).** If you are engaged in foreign activity or have signature authority over a foreign bank account or other type of foreign financial account (exceeding certain thresholds), then you may need to file Form 114, Report of Foreign Bank and Financial Accounts (FBAR). The rules relating to this filing are very complex, and the penalties for noncompliance are steep. A U.S. income tax exemption does not necessarily mean that you are exempt from income tax in foreign countries. Many countries assess a value-added tax (VAT) that your organization must comply with. Employees in foreign countries may also trigger employment tax reporting and withholding requirements, not only in the U.S. but also in the foreign country.

6) **You have a taxable, related organization in which you do business (Schedule R).** There are special tax rules for exempt organizations that have taxable subsidiaries. Income from the taxable subsidiary to the parent exempt organization that would otherwise not be taxable may become taxable. You need to take precautions to maintain separation, so that the taxable subsidiary does not threaten your tax exemption with significant unrelated business activities through an agency relationship. Your organization should also have a transfer pricing study to substantiate any charges and reduce your exposure to penalties.

7) **Engaging in Lobbying and Political Activity.**

https://www.bdo.com/blogs/nonprofit-standard/april-2016/11-risks-hidden-in-your-form-990

TAKEAWAYS:

*1) **Tell your story, and tell it consistently:** The Form 990 discloses an organization's mission and program accomplishments for the year. This information should be cross-checked with other collateral materials published by the organization, including annual reports, brochures, solicitation mailing, and content on the organization's website. Just as importantly, it should be viewed as an opportunity to tout your organization's accomplishments, and to provide a detailed story about how the mission is accomplished. The program accomplishments listed should be in support of the overarching mission and provide concrete examples of how the organization is conducting its programmatic activities.*

*2) **Properly allocate revenue and expenses:** Nonprofits must be especially careful to distinguish the different types of revenue reported on Form 990, e.g.., program-related* *revenue, unrelated business revenue that is subject to tax, and related revenue that is excluded from tax. They also should ensure that contribution revenue is properly reflected, since this will directly impact nonprofits' public support tests. To ensure that their exempt statuses are not jeopardized, organizations should always take a step back to compare program revenue and unrelated business revenue to the total revenue. Last, when organizations are segregating fundraising, program-related expenses, and management/general expenses, they should ensure that the allocation methodology is consistent and accurate. Functional expense ratios are one of the benchmarks used by charity watchdogs to determine ratings and should therefore always be top of mind.*

3) ***Obtain a thorough understanding of your organization's business operations and governance procedures:*** *To properly advise the organization on how to complete the 990, it is helpful, if not essential, that you are aware of the fundraising activities and the governance to be able to determine the appropriate answers to the questions.*

4) ***Complete compensation disclosures:*** *Form 990 requires that organizations disclose the total compensation for officers, directors, trustees, key employees, and any other of the highest-compensated individuals who were on the board or employed at any time during the tax year. Compensation includes not only an individual's salary, but also his/her taxable and nontaxable fringe benefits, including insurance, allowances, and deferred compensation. Deferred compensation includes any salary accrual, such as a bonus, that is not paid within two and a half months after an organization's fiscal year end.*

5) ***Ensure transparent governance, policies, procedures, and transactions with interested persons:*** *Form 990 requires disclosure of an organization's policies and procedures, including its conflict of interest policy and compensation policy. As such, nonprofits should take the time to make sure these policies are active and accomplish their intended goals, and the disclosure should accurately reflect the implementation of these policies. Transactions with interested persons should be clearly disclosed on Schedule L and indicate whether the organization entered into the transactions in accordance with a conflict of interest policy and at fair market value.*

6) ***Conduct a final review:*** *Once Form 990 is prepared, organizations should undergo a thorough review of the document prior to submission to the IRS. The reviewers should include an internal team consisting not only of the finance department, but also of human resources, legal, program directors, and development groups. Last but not least, as is considered a best practice and is disclosed on Form 990, the document should be made available to the organization's board prior to submission to the IRS.*

https://www.bdo.com/blogs/nonprofit-standard/february-2015/reviewing-the-irs-form-990-five-tips-and-best-pra

TAKEAWAY: *The IRS Form 990 is NOT just a tax filing.*

STATE AND LOCAL LAWS AND REGULATIONS GOVERNING CHARITABLE SOLICITATION

Currently approximately 40 states, the District of Columbia, and certain cities require most charities (principally 501(c)(3) organizations) to register before soliciting charitable contributions from their residents. A number of states have very sophisticated and helpful charity divisions that assist and regulate charities. Unfortunately, there is no single source to go to for state regulatory information, and national nonprofits often devote significant time to ensuring that they are complying with each state's and local regulations related to their activities and meet the various state deadlines for filing and renewing registrations.

Web of Regulations:

- No single state law. Regulations can be found in various code sections.
- No single department of government. Regulation of charities can be implemented in attorney general offices, secretaries of state, gaming offices, and other departments.
- No single registration form. Although state regulators are making ongoing efforts to create a single portal, lack of funds for such a project have slowed implementation.
- No consistent due dates. Each state has its own due dates.

When?

- Prior to solicitation, definition varies by state, but a charitable solicitation is generally broadly defined to include any direct or indirect request of any kind for a charitable contribution.
    - o in-person or telephone solicitation
    - o distribution of a newsletter or brochure that solicits a gift
    - o soliciting grants from foundations
- Solicitation is the request for a contribution, *whether or not a contribution is actually received*.

Online Solicitations — Charleston Principles (Guidelines – not the law)
For online solicitation, registration is required when:

1. Charitable organization is domiciled in state
2. Charitable organization is not domiciled in state, but:
    a. Offline activities would be enough to assert jurisdiction (e.g., send letter or make phone calls into state)
    b. Solicits donations on internet and:
        i. Specifically targets those within that state OR
        ii. Receives contributions from the state on a repeated and ongoing basis or a substantial basis through its website

While most states are broad and only exempt a select group of organizations, some make the requirements narrow: e.g., Texas: Registration required for organizations that solicit for law enforcement, public safety, or veterans' causes

Examples of State Registration Exemptions:

- Religious organizations
- Small organizations if fundraising is done by volunteers / only to members
- Hospitals
- Fundraising for a named individual

What is required to register or renew?

- Foreign qualification
- Disclosures when soliciting (e.g., identification of state office where financial reports are filed)
- Annual financial reporting; 990 and audited financials (depending on size)
- Notification of professional fundraiser, professional fundraising consultant, or commercial co-venture relationships
- Governance – Board and officer list; Interested director transactions; officer compensation

Many states also have strict requirements for disclosure language:

- Example: Pennsylvania requires the following statement: The official registration and financial information of (insert the legal name of the charity as registered with the department) may be obtained from the Pennsylvania Department of State by calling toll-free within Pennsylvania to (800) 732-0999.

<u>LOCAL REGISTRATIONS</u>

Sometimes cities and counties have separate registration requirements

- Example: LOS ANGELES:
    - o Prior to Solicitations: The Charitable Services Section regulates charitable solicitation activities in the City of Los Angeles. This regulatory program consists of receiving and investigating Notice of Intentions to ensure compliance with the City's Charitable Solicitation Ordinance, issuing Information Cards, copies of which must be available to all potential donors, and reviewing Reports of Results of solicitation campaigns. At least 15 days before the start of a fundraising campaign or special event, a “Notice of Intention” must be filed with the Los Angeles Police Commission, Charitable Services Section. No solicitation shall be started until an Information Card has been issued.
    - o During Solicitations: Each solicitor must possess and display upon request a copy of the Information Card to all persons solicited.
    - o After Solicitations: A report of results of activity showing receipts, expenditures, and distribution of net proceeds must be filed within 30 days of the termination of the fundraising campaign or within 30 days after the special event.

<u>LOCAL PERMITS</u>

TAKEAWAYS*: While the state charity regulator offices and websites can provide significant helpful information to nonprofits (e.g., the New York State Attorney General’s Charities Bureau), some states are very stringent in their registration requirements and deadlines, such as the State of Mississippi. Watch and adhere to deadlines. Some state charity regulator offices are more active than others (e.g., the aforementioned New York State Charities Bureau is arguably the most active in the nation currently). The public day of the annual conference of the National Association of Attorneys General / National Association of State Charity Officials, generally held each October in Washington, DC, is a great opportunity to learn more and meet state regulators.*

<u>PROFESSIONAL SOLICITOR / PROFESSIONAL FUNDRAISING CONSULTANT</u>

State laws generally regulate for-profit entities acting at the behest of charities. About 41 states require registration and have other requirements.

- Professional Solicitor or Fundraiser – For a fee or other compensation, solicits on behalf of a charity OR has custody and control of funds.
- Examples of Professional Solicitors include Third-Party Call Centers; Door-to-Door and Street Canvassers.
- Professional Fundraising Counsel – Manages, advises, plans, produces, or designs a solicitation, but does not directly solicit or hold funds.
- Examples of Professional Fundraising Counsel include individuals or entities that provide fundraising strategy and design fundraising campaigns and collateral.

Examples of requirements:

- Registration
- Bond

- Filing of contracts
- Disclosures
- Approval of script, solicitation language, and mail pieces by the state
- List of contracts on the charity's annual registration
- Annual report of amount paid to professional solicitor or fundraising and amount retained by the nonprofit. These reports can be quite extensive.

Often mandatory contractual provisions:
- Charity right to rescind
- Gross collections delivered to charity
- Donor list is intellectual property of charity
- Listing of fee calculation
- Signature of two charity officials
- Minimum amount to charity

Commissions – may not be allowable.

Also listed on the Form 990. Generate lots of attention by state regulators.

Takeaways: *It is not always easy to identify professional fundraisers – carefully analyze relationships with third parties to ensure you are paying them to "assist" with fundraising and wording of your contracts. Often consultants overstate their services in their proposals and use words that imply they are a professional fundraiser when they are not.*

A few states post all professional fundraiser registrations on their websites, which are a useful resource for determining whether an entity has considered itself to be a professional fundraiser in the past.

But remember, employees are not professional fundraisers.

Make sure that your professional fundraisers listed on your Form 990 and state filings are consistent, but know that some states have different thresholds for reporting than the IRS.

<u>COMMERCIAL CO-VENTURES (CCV)</u>

What is a CCV? A CCV is an arrangement between a charity and a commercial entity under which the commercial entity advertises in a sales or marketing campaign that the purchase or use of its goods or services will benefit a charity or charitable purpose.

What are the benefits of a CCV? Studies show that consumers are more willing to buy goods or services when their purchase benefits a good cause. In order to protect consumers' expectations of where and how their money is being used, state regulators have created laws to prevent nonprofits from being taken advantage of by for-profit organizations using a CCV.

Are CCVs regulated? Several states, approximately 26, have laws that specifically regulate CCVs. The requirements vary, but may include campaign registration, filing of the contract, post-campaign reporting, bond requirements, etc. Laws regulating CCVs impact <u>both</u> the charity and the for-profit company.

Registration States
- Alabama
- California

- Illinois
- Massachusetts
- South Carolina

Notification States and the Party Responsible

- Arkansas (charity)
- Connecticut (charity)
- Hawaii (CCV)
- Mississippi (CCV)
- New Hampshire (charity)
- New Jersey (charity)
- Utah (charity)

Sample State Contract Requirements

(1) legal name and alias name, address, and registration number, if any, of the professional solicitor, professional fundraising counsel, or commercial co-venturer;
(2) legal name, address, and registration number of the charitable organization;
(3) name and residence address of each person directing or supervising the contract solicitation services;
(4) description of the event or campaign;
(5) date the solicitation or campaign will commence;
(6) date the solicitation or campaign will terminate;
(7) statement of the amount or guaranteed minimum percentage of gross receipts to be remitted or retained by the charitable organization, excluding the amount that the charitable organization must pay for fundraising costs;
(8) statement of the amount or percentage of gross receipts with which the professional solicitor, professional fundraising counsel, or commercial co-venturer is compensated, including the amount the professional solicitor, professional fundraising counsel, or commercial co-venturer must be reimbursed as payment for fundraising costs; and
(9) if applicable, the maximum dollar amount that will benefit the charitable organization.

What public disclosure Is required for a CCV? The required disclosure must provide a "clear and conspicuous disclosure of the amount of the solicited funds to be paid to the nonprofit beneficiary." Be sure to always specify contribution caps/limits, as well as time limits on the campaign. And never be – or allow the for-profit CCV partner to be – deceptive or misleading at all in public statements about the campaign.

An example of required disclosures for a CCV showing the time frame, the amount per sale, and the maximum payment:

> "Every time you buy a bottle of ECO between June 1 and December 31, 2016, 5 cents will be given to the Earth Foundation, up to a maximum of $25,000."

Takeaways:

1. *<u>Transparency</u> – Be upfront with the public. Clearly and conspicuously describe the promotion, as well as how much will be donated. If there is a maximum donation and/or time limit on the campaign, that information must be disclosed.*
2. *<u>Avoid Vague Donations</u> – A donation such as "all net profits" does not inform the consumer about exactly how much money is going to charity.*
3. *<u>Avoid Payments from Charities</u> – Avoid being paid if possible. Separate, more stringent requirements are required for paid fundraising solicitors.*
4. *<u>Let the Public Know How Much Was Raised</u> – Once the promotion is over, the company should tell the public how much money was raised and given to the charity.*

5. *Register – If the promotion will be conducted in a state that requires registration, make sure to register your promotion.*
6. *Full Disclosure – Make a full disclosure of the charity's name, its tax-exempt status, and other information so that consumers can obtain more information if they desire.*

Example:

20 Council of Better Business Bureau Wise Giving Alliance Standards

- The Council of Better Business Bureaus (BBBs) Wise Giving Alliance developed 20 Standards for Charity Accountability that create public confidence in organizations and promote ethical conduct by those seeking to meet the standard.
- The standards apply to 501(c)(3)s and organizations who conduct charitable solicitations.
- The 20 standards cover a range of aspects and require a variety of documentation from organizations. The Standards for Charity Accountability look to see how organizations are governed, the ways they spend their money, the truthfulness of their representations, and their willingness to disclose basic information to the public.
- Purpose: The overall purpose of the Standards for Charity Accountability is to provide full disclosure to current and potential donors of organizations. The BBB Wise Giving Alliance promotes transparency between nonprofits and donors. The standards particularly focus on organizations' finances, effectiveness, and fundraising. A nonprofit that is able to meet the standards laid out by the BBB benefits from the transparency they provide.

What Are the Wise Giving Standards?

- **Standards 1 – 5: Governance and Oversight:** The governing board has the ultimate oversight authority for any charitable organization. This section of the standard seeks to ensure that the volunteer board is active, independent, and free of self-dealing. To meet these standards, the organization shall have:
  1. **Board Oversight** – A board of directors that provides adequate oversight of the charity's operations and its staff. Indication of adequate oversight includes, but is not limited to, regularly scheduled appraisals of the CEO's performance, evidence of disbursement controls, such as board approval of the budget, fundraising practices, establishment of a conflict of interest policy, and establishment of accounting procedures sufficient to safeguard charity finances.
  2. **Board Size** – A board of directors with a minimum of five voting members.
  3. **Board Meetings** – A minimum of three evenly spaced meetings per year of the full governing body with a majority in attendance, with face-to-face participation. A conference call of the full board can substitute for one of the three meetings of the governing body. For all meetings, alternative modes of participation are acceptable for those with physical disabilities.

4. **Board Compensation** – Not more than one or 10% (whichever is greater) directly or indirectly compensated person(s) serving as voting member(s) of the board. Compensated members shall not serve as the board's chair or treasurer.
5. **Conflict of Interest** – No transaction(s) in which any board or staff members have material conflicting interests with the charity resulting from any relationship or business affiliation. Factors that will be considered when concluding whether a related party transaction constitutes a conflict of interest and whether such a conflict is material, include, but are not limited to: any arm's-length procedures established by the charity; the size of the transaction relative to like expenses of the charity; whether the interested party participated in the board vote on the transaction; whether competitive bids were sought; and whether the transaction is one-time, recurring, or ongoing.

- **Standards 6 – 7: MEASURING EFFECTIVENESS:** An organization should regularly assess its effectiveness in achieving its mission. This section seeks to ensure that an organization has defined, measurable goals and objectives in place and a defined process in place to evaluate the success and impact of its program(s) in fulfilling the goals and objectives of the organization and that identifies ways to address any deficiencies. To meet these standards, a charitable organization shall:

6. **Effectiveness Policy** – Have a board policy of assessing, no less frequently than every two years, the organization's performance and effectiveness and of determining future actions required to achieve its mission.
7. **Effectiveness Report** – Submit to the organization's governing body, for its approval, a written report that outlines the results of the aforementioned performance and effectiveness assessment and recommendations for future actions.

- **Standards 8 – 14: FINANCES:** This section of the standards seeks to ensure that the charity spends its funds honestly, prudently, and in accordance with statements made in fundraising appeals. To meet these standards, the charitable organization shall:

8. **Program Expenses** – Spend at least 65% of its total expenses on program activities.
9. **Fundraising Expenses** – Spend no more than 35% of related contributions on fundraising. Related contributions include donations, legacies, and other gifts received as a result of fundraising efforts.
10. **Accumulating Funds** – Avoid accumulating funds that could be used for current program activities. To meet this standard, the charity's unrestricted net assets available for use should not be more than three times the size of the past year's expenses or three times the size of the current year's budget, whichever is higher.
11. **Audit Report** – Make available to all, on request, complete annual financial statements prepared in accordance with generally accepted accounting principles. When total annual gross income exceeds $500,000, these statements should be audited in accordance with generally accepted auditing standards. For charities whose annual gross income is less than $500,000, a review by a certified public accountant is sufficient to meet this standard. For charities whose annual gross income is less than $250,000, an internally produced, complete financial statement is sufficient to meet this standard.
12. **Detailed Expense Breakdown** – Include in the financial statements a breakdown of expenses (e.g., salaries, travel, postage) that shows what portion of these expenses was allocated to program, fundraising, and administrative activities. If the charity has more than one major program category, the schedule should provide a breakdown for each category.
13. **Accurate Expense Reporting** – Accurately report the charity's expenses, including any joint cost allocations, in its financial statements. For example, audited or unaudited statements that inaccurately claim zero fundraising

expenses or otherwise understate the amount a charity spends on fundraising, and/or overstate the amount it spends on programs will not meet this standard.

14. **Budget Plan** – Have a board-approved annual budget for its current fiscal year, outlining projected expenses for major program activities, fundraising, and administration.

- **Standards 15 – 20: FUNDRAISING AND INFORMATIONAL MATERIALS:** A fundraising appeal is often the only contact a donor has with a charity and may be the sole impetus for giving. This section of the standards seeks to ensure that a charity's representations to the public are accurate, complete, and respectful. To meet these standards, the charitable organization shall:
    15. **Accurate Materials** – Have solicitations and informational materials, distributed by any means, that are accurate, truthful, and not misleading, both in whole and in part. Appeals that omit a clear description of program(s) for which contributions are sought will not meet this standard. A charity should also be able to substantiate that the timing and nature of its expenditures are in accordance with what is stated, expressed, or implied in the charity's solicitations.
    16. **Annual Report** – Have an annual report available to all, on request, that includes: a) the organization's mission statement, b) a summary of the past year's program service accomplishments, c) a roster of the officers and members of the board of directors, and d) financial information that includes (i) total income in the past fiscal year, (ii) expenses in the same program, fundraising, and administrative categories as in the financial statements, and (iii) ending net assets.
    17. **Website Disclosures** – Include on any charity websites that solicit contributions the same information that is recommended for annual reports, as well as the mailing address of the charity and electronic access to its most recent IRS Form 990.
    18. **Donor Privacy** – Address privacy concerns of donors by: a) providing in written appeals, at least annually, a means (e.g., such as a check-off box) for both new and continuing donors to inform the charity if they do not want their name and address shared outside the organization, and b) providing a clear, prominent, and easily accessible privacy policy on any of its websites that tells visitors (i) what information, if any, is being collected about them by the charity and how this information will be used, (ii) how to contact the charity to review personal information collected and request corrections, (iii) how to inform the charity (e.g., a check-off box) that the visitor does not wish his/her personal information to be shared outside the organization, and (iv) what security measures the charity has in place to protect personal information.
    19. **Cause Marketing Disclosures** – Clearly disclose how the charity benefits from the sale of products or services (i.e., cause-related marketing). Such promotions should disclose, at the point of solicitation: a) the actual or anticipated portion of the purchase price that will benefit the charity (e.g., 5 cents will be contributed to ABC charity for every XYZ company product sold), b) the duration of the campaign (e.g., the month of October), and c) any maximum or guaranteed minimum contribution amount (e.g., up to a maximum of $200,000).
    20. **Complaints** – Respond promptly to and act on complaints brought to its attention by the BBB Wise Giving Alliance and/or BBBs about fundraising practices, privacy policy violations, and/or other issues.

https://www.bbb.org/us/storage/0/Shared%20Documents/Standards%20for%20Charity%20Accountability.pdf

Charity Watchdog Groups

- Charity watchdog groups have achieved increasing visibility and influence in recent years. These organizations – themselves generally nonprofit 501(c)(3) organizations – collect, analyze and provide to the public a wide array of information, metrics, performance reviews, and ratings for nonprofit organizations. Examples include the BBB Wise Giving Alliance, Charity Navigator, GuideStar, and CharityWatch. Due to their increased influence on everything from consumer donation decisions to media coverage to governmental enforcement actions, their role cannot be ignored.
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Brand Is a Major Asset

- Charities must take the necessary steps for their brand:
  - Establish brand
  - Strengthen brand
  - Protect the brand
- A nonprofits value is closely interwoven with its brand
- Trademarks
  - Establish, register, police use
    - Use and renew
    - Work with marketing department and others to ensure proper trademark use
  - Train staff/volunteers who may be unfamiliar with trademarks to not infringe upon other organizations' trademarks
- Partner organizations:
  - Contract with partners to establish brand/trademark use requirements

Takeaways: *Your brand is your most valuable asset. If you lose your goodwill, you lose your ability to maximize donations and carry out your mission effectively.*

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