

RUNNING A NONPROFIT: AVOIDING COMMON PITFALLS

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Session Objectives

- To gain an understanding of how a charitable organization can further the educational and charitable work of those in the legal profession
- To understand the legal and tax differences between a charitable organization and a professional association
- Discussion of the organizational, operational and compliance aspects of a charitable nonprofit, including governance, tax and reporting requirements
- Identification of ways that good corporate practices can lead to success

Agenda

- Introduction
- Differences between professional associations and charitable organizations
- Organizational and operational requirements of charitable organizations
- Governance and compliance issues
- Best practices

Professional Associations

- Nonprofit, cooperative, voluntarily-joined organization of business competitors designed to assist its members and its industry in dealing with mutual business problems
- Tax-exempt under IRC section 501(c)(6)
 - Not organized for profit
 - No inurement to benefit private individuals

Professional Associations

- Political activities
 - No prohibition or limitation provided not primary activity
 - Dues not deductible by members to the extent association participates in or intervenes in any political campaign on behalf of (or in opposition to) any candidate for public office

Professional Associations

- Legislative Activities
 - Direct and grass roots lobbying
 - No deduction permitted
 - Notify members of reasonable estimate of portion of dues for lobbying expenses or pay proxy tax

Charitable Organizations

- Entity structure
 - Corporation, community chest, fund, foundation or unincorporated association
- Tax status
 - Tax-exempt under IRC section 501(c)(3) or non-exempt
- Exempt purpose(s)
 - Organized and operated exclusively for one or more of the following purposes: religious, charitable, scientific, testing for public safety, literary, educational, fostering national or international amateur sports competition, the prevention of cruelty to children or animals

Organizational Requirements

- Exempt Purposes
- Articles of organization must limit the organization's purposes to one or more of those described and must not expressly empower it to engage, other than as an insubstantial part of its activities, in activities that do not further one or more of those purposes
- Requirements not satisfied if the limit is contained only in the bylaws or other entity rules or regulations
- Assets must be permanently dedicated to an exempt purpose, i.e., should the organization dissolve, its assets must be distributed for an exempt purpose

Operational Requirements

- Must be operated exclusively for one or more tax-exempt purposes
- Met if organization engages primarily in activities that accomplish one or more of its exempt purposes
- Not met if more than an insubstantial part of activities are not in furtherance of exempt purpose
- Net earnings may not inure in whole or in part to the benefit of private individuals
- May operate a trade or business as a primary purpose if it accomplishes or furthers exempt purpose (may have unrelated business taxable income)

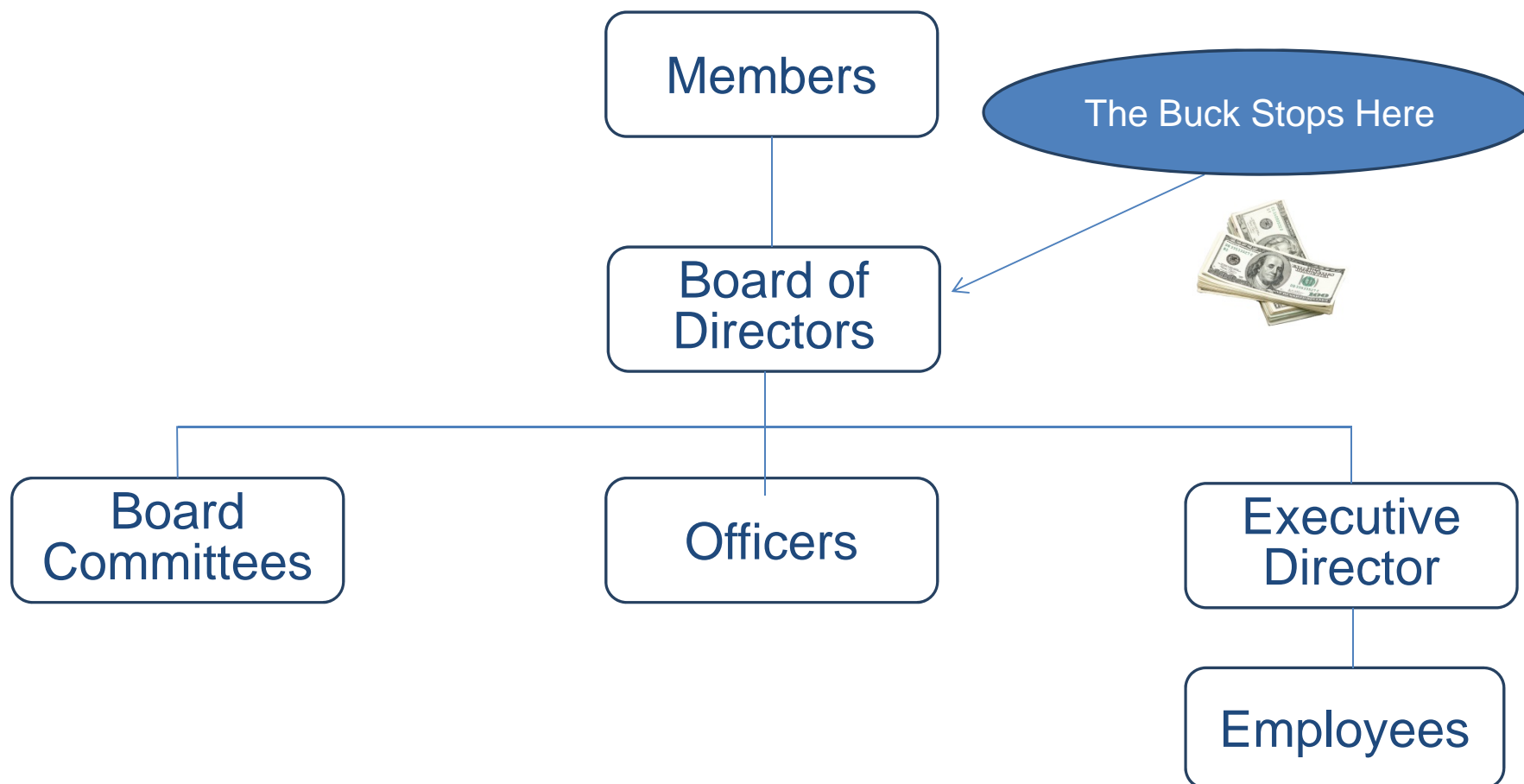
Operational Requirements

- Focus is on the purpose the activity is designed to accomplish rather than the type of activity conducted (distinguish between furthering an exempt purpose versus the primary purpose being an “unrelated trade or business”)

Corporate Structure Considerations

- Board size and composition
- Term limits
- Role of officers
- Members
 - No members
 - Voting or non-voting members

Sample Organizational Structure



Corporate Governance

- Board of Directors' Role
- Officers' Roles
- Laws Governing the Board
- Board's Fiduciary Duty
- Attorney General's Role



Financial Matters and Recordkeeping

- Financial reports and records
- Corporate records
- Record retention
- Tax returns
- Governmental filings
(e.g., Secretary of State, Attorney General)



Tax-Exemption Issues

- Federal and state exemption
- Federal information returns and state tax returns
- Private benefit and inurement
- Political campaign intervention
- Legislative activities
- Unrelated business taxable income

Other Tax Issues

- Exempt purpose(s)
- Substantial non-exempt activities
- Recordkeeping and public inspection
- Acknowledgment of contributions

Private Benefit and Inurement

- Private Benefit
 - Private use of assets by non-insider
 - Incidental benefit OK
- Private Inurement
 - Private use of assets by insider
 - Reasonableness standard
 - Incidental benefit not OK

Private Inurement

- Excess Benefit Transactions
 - Any transaction in which an economic benefit is provided directly or indirectly to or for the use of a “disqualified person” where the value of the economic benefit exceeds the value of the consideration received by the organization
 - “Disqualified person” includes those in a position is exercise substantial influence (5-year look-back), a family member of those persons or an entity where they own more than 35%
 - Excise tax imposed on DP, including second tier tax unless corrected
 - Participating organization manager excise tax unless not willful and reasonable care used
 - Documentation critical

Lobbying

- Defined as influencing legislation
- Distinguish from educational activities
- Grass roots versus direct lobbying
- Extent of activity permitted
- IRS section 501(h) election

Campaign Activity

- Must not participate in or intervene in any political campaign on behalf of or opposition to any candidate for public office
- Federal, state and local levels
- Candidates may be invited to speak at events
 - Give others equal opportunity
 - Do not indicate support or opposition
 - No fundraising

Unrelated Business Income

- An exempt organization is not taxed on its income from activity substantially related to the charitable, educational or other purposes that is the basis for the organization's exemption. Such income is exempt even if the activity is a trade or business.
- However, if an exempt organization regularly carries on a trade or business not substantially related to its exempt purpose, except that it provides funds to carry out that purposes, the organization is subject to tax on its income from that unrelated trade or business. (IRS Publication 598)

Unrelated Business Income

- Defined as income from a trade or business regularly carried on, that is not substantially related to the charitable, educational or other purpose that is the basis of the organization's exemption.
 - Trade or business includes any activity conducted for the production of income from selling goods or performing services
- Regularly conducted if shows a frequency and continuity and is pursued in a manner similar to comparable commercial activities of nonexempt organizations

Unrelated Business Income

- Not substantially related to an organization's exempt purpose if it does not contribute importantly to accomplishing that purpose (other than through the production of funds)
- Taxed
- Must be less than a substantial portion of an organization's overall activities, otherwise exempt status may be revoked by the IRS
- No specific percentage limitation (instead based on facts and circumstances)
- Evaluation can include time and resources devoted to activity

Additional Compliance Issues

- Filing tax returns
- Recordkeeping and public inspection
- Substantiation of contributions
- Financial records
- Fundraising, including raffles and auctions

Policies

- Conflict of Interest Policy
- Document Retention Policy
- Investment Policy
- Whistle-blower Policy
- Statement of Value and Code of Ethics

Liability and Insurance Issues

- Some states have statutes protecting volunteer directors and executive officers from third-party liability under certain circumstances
- Review bylaws or state statutes regarding indemnification of agents
- Statutory insurance
- Contractual insurance
- Optional insurance

Best Practices

- Board building, training and engagement
- Essential governance duties
- Collaborative thinking and execution of priorities
- Accountability and transparency
- Communication and inquiry

Recap

- Must be operated primarily for exempt purposes
- Important to engage in good governance practices
 - Board must be engaged
 - Financial reporting and recordkeeping must be done
- Beware private benefit and private inurement
 - Private inurement involves insiders receiving excess benefits

Recap

- Limited lobbying OK; campaign activity not OK
- Be familiar with fundraising rules and acknowledgment of donations
- Strive to engage in best practices
 - Board, bar association members, community

Helpful Resources

- IRS website for charities and nonprofits:
<http://www.irs.gov/Charities-&-Non-Profits>
 - Publication 557 – Tax-exempt Status for Your Organization
 - Publication 4221-PC – Compliance Guide for 501(c)(3) Public Charities
 - Publication 1771 - Charitable Contributions - Substantiation and Disclosure Requirements
- State Secretary of State website
- State taxing agency website
- State Attorney General website
- BoardSource: <https://www.boardsource.org>

Questions?

Thank You



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