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CONTENTS

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The editorial staff of the *Michigan Business Law Journal* welcomes suggested topics of general interest to the Section members, which may be the subject of future articles. Proposed topics may be submitted through the Publications Director, D. Richard McDonald, The Michigan Business Law Journal, 39577 Woodward Ave., Ste. 300, Bloomfield Hills, Michigan 48304, (248) 203-0859, drmcdonald@dykema.com, or through Daniel D. Kopka, Senior Publications Attorney, the Institute of Continuing Legal Education, 1020 Greene Street, Ann Arbor, Michigan, 48109-1444, (734) 936-3432, dan@icle.org.

Each issue of the Michigan Business Law Journal has a different primary theme focused on articles related to one of the standing committees of the Business Law Section, although we welcome articles concerning any business law related topic for any issue. The primary theme of upcoming issues of the Michigan Business Law Journal and the related deadlines for submitting articles are as follows:

Issue	Primary Theme/Committee	Article Deadline
Spring 2013	Debtor/Creditors Rights Committee	November 30, 2012
Summer 2013	Unincorporated Enterprise Committee	March 31, 2013
Fall 2013	Financial Institutions Committee	July 31, 2013
Spring 2014	Regulations of Securities Committee	November 30, 2013

ADVERTISING

All advertising is on a pre-paid basis and is subject to editorial approval. The rates for camera-ready digital files are $400 for full-page, $200 for half-page, and $100 for quarter page. Requested positions are dependent upon space availability and cannot be guaranteed. All communications relating to advertising should be directed to Publications Director, D. Richard McDonald, the *Michigan Business Law Journal*, 39577 Woodward Ave., Ste. 300, Bloomfield Hills, MI 48304, (248)203-0859.

MISSION STATEMENT

The mission of the Business Law Section is to foster the highest quality of professionalism and practice in business law and enhance the legislative and regulatory environment for conducting business in Michigan.

To fulfill this mission, the Section shall: (1) expand the resources of business lawyers by providing educational, networking, and mentoring opportunities; (2) review and promote improvements to Michigan's business legislation and regulations; and (3) provide a forum to facilitate service and commitment and to promote ethical conduct and collegiality within the practice.

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Volume XXII, Issue 1, and subsequent issues of the *Journal* are also available online by accessing http://www.michbar.org/business/bizlawjournal.cfm

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From the Desk of the Chairperson

By Edwin J. Lukas

While it is difficult to believe that the time is passing so quickly, I am serving in my final few months as chairperson of the Business Law Section. As I reflect on the past year, I am very pleased with the Section's achievements during this time. I have had the opportunity to work closely with our Council, committees, and directorships on a wide variety of issues. The Section has led initiatives related to business courts in Michigan, renewed our focus on diversifying our membership, and worked diligently at enhancing the statewide legislative and regulatory environment. Also, as a result of our concerted efforts, Michigan business lawyers working in an in-house capacity are expressing renewed enthusiasm for the Section. Most importantly, the scope, breadth, and depth of the Section's seminars, programs, and events over the last year have been unparalleled.

All of these achievements have required considerable time and energy given by numerous individuals. The Section's extended leadership team worked diligently on our initiatives while managing their respective practices. I am especially appreciative of the hard work conducted by Marguerite Donahue (Vice Chairperson), Jeff Van Winkle (Treasurer), James Carey (Secretary), and Terri Shoop (Section Administrator). It has been a pleasure working with such capable, accommodating individuals. Thank you for being generous with your time, patience, and expertise.

From time to time, we discuss the state of Michigan's economy and explore ways to improve the business environment here. An important part of Michigan's economic recovery involves stabilizing—and, in some cases, rebuilding—the communities in which we live. Creating meaningful opportunities for Michigan's citizens that ultimately result in economic growth requires a collaborative effort by a host of market participants. Fostering innovative ideas, and enabling individuals throughout the state to capitalize on them, truly depends on contributions from all parts of the economy.

The nonprofit community is an often overlooked segment that drives economic results. Throughout Michigan, nonprofit organizations invest significant financial and enterprise resources that are key to our recovery. When we hear the term "nonprofit," many of us restrict our thinking to the good work conducted by public and private charities, including health and human service providers, advocacy organizations, certain hospitals, private schools, and religious organizations. Similarly, social welfare organizations provide public benefits that are difficult to measure but certainly improve our society.

Consider, though, how our nonprofit professional and trade associations promote the business interests of our communities, industries, and professions. Through innumerable chambers of commerce, business leagues, and other groups, these organizations serve as advocates for their members and provide education and assistance focused on improving the manner in which their members achieve performance goals and profitability.

The real giant of Michigan's nonprofit sector, however, may be the foundation community. Foundations, which are established by individuals, families, businesses, and communities, make strategic investments that advance their mission. They deploy capital through a combination of philanthropic grants, equity investments, and loans that further the charitable purposes of the recipients. Capital is frequently provided by foundations at below-market rates in underserved communities. Foundations also fund important research and development projects that ultimately lead to improvements in, among other things, education, technology, and health care, all of which drive our economy.

In this latest issue of the *Michigan Business Law Journal*, we offer you a host of articles on nonprofit organizations. Jennifer M. Oertel provides practical guidance designed to assist nonprofits and their counsel in identifying potential pitfalls and adopting best practices from a governance and compliance perspective. In addition to offering sage advice that should be followed by all nonprofits, Ms. Oertel presents numerous tips for consideration by foundations and public charities.

In a very timely piece offered during this election year, Mary Catherine Wilcox reviews the complex regulatory schemes that govern a nonprofit's political activities. Ms. Wilcox also discusses permissible political activities and compliance requirements that are imposed on nonprofits.

Deanna M. Deldin explores the benefits associated with the Model Protection of Charitable Assets Act (MPOCAA). Ms. Deldin acknowledges that, while adoption of MPOCAA may do little to change the oversight of and processes for overseeing charitable assets that already exist in Michigan, its adoption could consolidate existing regulations and promote better governance.

With the summer camp season in full swing, Daryl L. Barton and Howard Bunsis encourage business lawyers to undertake a risk assessment with their nonprofit clients that operate youth camp programs. The article examines the different avenues of potential liability, the potential ramifications of caselaw holding that pre-injury waivers signed by parents or legal guardians on behalf of minor children are unenforceable, and the steps that should be taken to minimize exposure.

Outside the realm of nonprofits, Douglas Toering assesses the manner in which business lawyers contribute to economic development. Mr. Toering asserts that attorneys not only facilitate commerce but also make a direct economic impact through employment, business relationships, and pursuit of justice on behalf of clients.

Please consider attending the Business Law Section's Annual Meeting. The meeting is scheduled for Thursday, September 20 at 4:00 p.m. in Novi. Details regarding the meeting are available on the Section's webpage. One of the highlights of the meeting will be the presentation of the 2012 Stephen H. Schulman Outstanding Business Lawyer Award. It is my privilege to announce that this year's recipient is Jeffrey S. Ammon of Miller Johnson. For numerous years, Jeff has been a leader in the Section, in his practice, and in the Grand Rapids community. He is a keen lawyer and trusted colleague whose cheerful and good-natured sense of humor is always welcome. Please join us to celebrate Jeff's noteworthy career as a business lawyer. We hope to see you there.

Thank you for the opportunity to serve the Section over the past several years. I have enjoyed contributing and engaging in what has proven to be an incredibly rewarding experience on both a professional and personal level.

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Michigan Corporate Income Tax and Conversions

The new Michigan corporate income tax modifies the corporate tax structure in the state. This tax applies only to C corporations, and pass-through tax entities avoid the six percent corporate income tax rate.

At first glance it appears that converting or electing to become a pass-though tax entity, such as a limited liability company, rather than operating as a C corporation, would be beneficial. Conversion of a corporation to an LLC is permitted under the Business Corporation Act and the Michigan Limited Liability Company Act.

However, there are several tax and non-tax issues that should be taken into account when determining choice of entity. To assist businesses that might be considering converting to an LLC, LARA Director Steven Hilfinger requested we put together a "toolkit" regarding the new corporate income tax and conversion to an LLC.

Daniel Minkus, Chair of the Business Law Section's Unincorporated Enterprises Committee, agreed to assist us by putting together and chairing an Ad Hoc Committee of members of the legal and accounting professions. The Ad Hoc Committee discussed the tax and non-tax issues that may arise in choice of entity determinations or in a conversion and developed "Issues to Consider Before Electing to Convert From a C Corporation to a Limited Liability Company or Before Electing S Corporation Status."

Under Non-Tax Issues, the document identifies issues to consider and actions that may be required. The Tax Issues portion identifies consequences and advantages of converting to an LLC or S corporation. The last two pages of the document includes a decision tree that may be useful in determining the impact of converting to a pass-through entity on a particular C corporation.

The goal is to make the document widely available. Daniel Minkus included the document in the materials for the Business Law Institute. The final version of the document, dated May 1, 2012, is available on the Bureau of Commercial Services website: http://www.michigan.gov/lara/0,4601,7-154-35299_61343_35413---,00.html. The document may be accessed from News and Announcements; Forms and Publications; and the Limited Liability Company page. Director Hilfinger has shared the document with the Michigan Department of Treasury and the Michigan Economic Development Corporation. Attorneys, accountants, and other business advisors are encouraged to share this information with their clients.

Limitation on Successor Corporation Asbestos-Related Liability

Generally, a surviving corporation is liable for any civil actions filed against the non-surviving constituent corporations of a merger. The general rule is modified by House Bill 4601,[1] which adds Chapter 30 entitled,"Limitation of Successor Asbestos-Related Liability" to the Revised Judicature Act (MCL 600.3001). Chapter 30 limits the asbestos-related liability of a survivor corporation that merged with a corporation that engaged in asbestos-related activities if the corporation "became a successor before January 1, 1972 or that is a successor of such a corporation." Governor Snyder signed the bill on April 10, 2012, and it became Public Act 84 of 2012, effective April 11, 2012.

MCL 600.3001(1)(b) defines corporation as "a corporation organized for profit, whether organized under the laws of this state, another state, or a foreign nation." According to the legislative bill analysis, the legislative intent of the bill is to limit a successor corporation's liability related to an asbestos claim, which it assumed or incurred as the result of or in connection with a merger or consolidation before January 1, 1972. Section 3001(4) of the bill limits the successor corporation's cumulative asbestos-related liability to the fair market value of the transferring corporation's total gross assets determined at the time of the merger or consolidation, subject to an increase for each subsequent year as provided in MCL 600.3001(9).

MCL 600.3001(3) excludes from the limitation a workers' compensation claim, a claim against a corporation that was not a successor asbestos-related liability, or an obligation under the National Labor Relations Act or a collective bargaining agreement. In addition, MCL 600.3001(3)(d) provides that the limitation does not apply to a successor that continued in the asbestos business after the merger or consolidation.

MCL 600.3001(13) provides "[a] court shall, to the fullest extent permissible, liberally apply the limitation in liability under this section in an action that includes successor asbestos-related liability. A court shall apply procedural provisions of this section retroactively. However, if the application of a provision of this section would unconstitutionally affect a vested right, the provision shall only be applied prospectively." MCL 600.3001(14) provides that this section applies to "an action that includes an asbestos claim" if either "[t]he action is filed on or after the effective date of the amendatory act that added this section" or "[t]he action is pending but trial on the action has not commenced as of the effective date of the amendatory act that added this section."

Property Tax Liability of Shareholders of Summer Resort Association

House Bill 4468[2] amends Public Act 230 of 1897 to provide if a corporation subject to the act has real property platted under section 20, MCL 455.20, and the lots have been leased to stockholders under section 21, MCL 455.21, the taxable and assessed values of the corporation's real property within the plat "shall be allocated to the stockholder lessees." Each stockholder lessee will be assessed for "[t]he real property each stockholder lessee leases from the corporation" and for "[a]ny of the corporation's real property improvements that are within the

plat and are available for the common and exclusive use of the corporation's stockholder lessees, including guests of the stockholder lessee." Governor Snyder signed the bill, and it became Public Act 46 of 2012 on March 13, 2012, and has immediate effect.

Section 21 of the act, MCL 455.21, provides lots assigned, allotted or confirmed to stockholders "shall be deemed and considered as appurtenant and attached to a certain share or shares of capital stock in such corporation…." In addition, section 21 prohibits a stockholder from selling, assigning, transferring or disposing "of any right, title, claim or interest he may have or acquire in any lot or lots assigned, allotted or confirmed…separated or detached the share or shares of capital stock to which it shall be appurtenant or attached." Section 21 is silent regarding leasing of a lot or lots to stockholders.

Section 14 of the act, MCL 455.14, provides, "The stock of every such corporation shall be deemed personal property, and may be transferred as shall be prescribed by this act and the by-laws of the corporation…." The Michigan Court of Appeals in *Slatterly v Madiol,* 257 Mich App 242, 668 NW2d 154 (2003) reviewed stockholders rights under 1897 PA 230. The court concluded, "Pursuant to the act, individuals acquire the right to use a lot by purchasing shares in the corporation" and that "the act does not create a present real property interest." In addition, the court pointed out, "Had the Legislature intended a present real-property interest, it could have used statutory language effectuating this intent rather than the language it actually used."

Section 123 of the Business Corporation Act (BCA), MCL 450.1123(1), provides that the BCA applies to summer resort associations. Section 314(4) of the BCA, MCL 450.1314(4), provides, "When the corporation receives the consideration for which the board authorized the issuance of shares, the shares issued are fully paid and nonassessable and the subscriber has all the rights and privileges of a holder of the shares." Section 315 of the Nonprofit Corporation Act, MCL 450.2315(4), provides, "Unless the articles of incorporation otherwise provide, shares which are fully paid shall be nonassessable."

There are differences in each of the summer resort association statutes regarding property and property tax assessments. Attorneys representing summer resort associations should review 2012 PA 46 and 1897 PA 230 to determine what impact, if any, the legislation has on their clients or the shareholders of the incorporated summer resort association. A summer resort association is also subject to either the Business Corporation Act or Nonprofit Corporation Act.[3] An attorney representing a summer resort association formed under 1897 PA 230 may also wish to review the recent amendment, other provisions of 1897 PA 230, and provisions of the Business Corporation Act and Nonprofit Corporation Act to determine what impact the legislation has on a summer resort association formed under 1897 PA 230.

NOTES

1. http://legislature.mi.gov/doc.aspx?2011-HB-4601.

2. http://legislature.mi.gov/doc.aspx?2011-HB-4668.

3. For discussion of the applicability of the Business Corporation Act to summer resort associations, see the Michigan Court of Appeals unpublished decision in *Andreozzi v Stony Point Peninsula Association* http://coa.courts.mi.gov/DOCUMENTS/OPINIONS/FINAL/COA/20090604_C281113_37_281113.OPN.PDF. .

G. Ann Baker is Deputy Director of the Bureau of Commercial Services, Department of Licensing and Regulatory Affairs. Ms. Baker routinely works with the department, legislature, and State Bar of Michigan's Business Law Section to review legislation. She is a past chair of Business Law Section and is the 2008 recipient of the Stephen H. Schulman Outstanding Business Lawyer Award.

By Paul L.B. McKenney

Michigan Zaps Zappers – Cash Business Owners Beware!

Overview

The proverbial "second set of books" cat and mouse game with taxing authorities now reflects the fact that most point-of-sale, or POS, bookkeeping is done electronically. Michigan recently joined numerous other jurisdictions by enacting tax enforcement-spawned legislation making the sale, purchase, installation, transfer, or mere possession of any "zapper" software subject to a felony. Zappers are also known as automated sales suppression devices. Michigan's statute contains a mandatory minimum of one year incarceration and severe monetary sanctions.[1] The statute defines a zapper as a software program, however accessed or possessed, that "falsifies the electronics records of electronic cash registers and other point-of-sale systems, including, but not limited to transaction data and transaction reports."[2] In essence it creates a second set of books, albeit electronic. While the sole purpose of zappers is tax evasion, the prosecution does not have to prove intent, merely use, sale, or possession. The zapper software is typically run off a USB thumb drive rather than residing on the computer's hard drive to avoid leaving evidence of its use. However, as noted below, there is a readily identifiable electronic trail. Zappers have been quietly marketed by freelancing IT types and certain cash register sales people.

A not uncommon example illustrates what a zapper does. Assume a restaurant or other cash receipts business grosses $250,000 per month and is highly profitable. A zapper software "entrepreneur" visits the restaurant early in the month and is told precisely what recorded cash bank deposits are as well as credit card charges totals by day. Alternately, the peddler may sell a USB drive and also provide needed technical support. Assume reported sales total $200,000 and there is $50,000 of unreported cash, or "skim." The zapper software will quickly and accurately modify the sales records a) by transaction, b) by day, c) to the penny resulting in the credit card charges and cash deposits equaling what is reported on the books. Thus a traditional audit will find that everything appears to be in order, at least until someone finds evidence of the zapper.

Zappers represent significant lost sales tax and other tax dollars to states. For example, three years ago, California estimated zappers at restaurants cost that state $2.8 billion in receipts, and the corresponding New York estimate was $1.7 billion.[3] In an era of record state fiscal problems, this is real money.

The recent Michigan legislation is effective as of August 29, 2012. It is patterned after another enforcement problem the Michigan Department of Treasury encountered, and overcame, with false cigarette tax stamps. The Michigan Treasury was hemorrhaging cash because of cigarettes that were brought in from out of state, and counterfeit Michigan stamps were purchased on a flourishing underground market. The Department of Treasury urged the legislature to adopt legislation that the mere possession of cigarettes with counterfeit stamps required a minimum prison term. Legislation followed, the minimum mandatory jail time virtually ended the fake stamp problem overnight, and Treasury receipts from cigarette taxes swelled.

Economic Sanctions Too

The zapper legislation has teeth. In addition to the one-year minimum mandatory term, there is a fine of up to $100,000.[4] However, from a monetary perspective, there is another more costly provision that requires disgorgement of "all profits associated with the sale or use of ..." a zapper.[5] In the above example, if the skim is $50,000 a month, then $600,000 a year is subject to forfeiture. The offending party is also responsible for all Michigan sales, withholding and other taxes, penalties, and interest. These other levies include the corporate income tax and individual income tax. Typically cash businesses that use zappers, such as restaurants and retailers selling small dollar amount items, also pay employees all or some of their wages in cash "under the table" and/or purchase food or inventory.

Zapper programs originated in Europe and migrated first to Quebec in North America. They came from jurisdictions where there were value-added taxes. The Internal Revenue Service (IRS) has taken certain steps to target businesses that might employ zappers, and the state of Michigan has taken notice. It should be pointed out that Michigan's vigorous criminal and civil penalty regime is separate and distinct from the Internal Revenue Service, which is also free to pursue the same individual and business. There is an exchange of information agreement between the Internal Revenue Service and the Michigan Department of Treasury.

Zapper's Electronic Fingerprints and Enforcement

Those selling zappers to business owners tout that it leaves no electronic fingerprints, and thus is invisible to the IRS and other law enforcement agencies. That dog don't hunt. The reality is that zappers leave telltale electronic fingerprints, and the IRS and other agencies have sophisticated criminal techies who can readily check a computer system and flag evidence of a zapper.

How have the IRS and Michigan uncovered businesses running zappers? A secret ceases to be secret when two or more people know about it. When the owner, the manager of a restaurant or store, the zapper software peddler and others, such as the controller or bookkeeper, key employees at the restaurant, at least one or more people at each location, etc. know about the zapper, only one needs to talk. Somebody may have reason to talk, such as a problem

with the DEA, IRS, FBI or other law enforcement agency and will readily give up the business owner in exchange for no prosecution or a reduction in charges or sentencing. For example, a metro Detroit freelance IT salesman peddling zappers to bars and restaurants was discovered when a party with law enforcement issues named him. That salesman, in exchange for an extremely lenient sentence, in turn identified and cooperated with federal law enforcement in prosecuting numerous customers for tax evasion. Some of his customers went to jail. The IRS and other federal and state agencies are seasoned veterans of how to play that game most effectively.

Consequences of Getting Caught

Those who raid businesses with search warrants typically take away computers, hard drives, USB thumb drives, and other hardware for inspection by highly sophisticated technicians. What does a cash business owner face if his or her business is raided by the Michigan State Police or other tax or law enforcement personnel, and evidence that a zapper has been applied to the electronic books is uncovered? A plethora of problems. A short, non-inclusive list includes:

1. The new Michigan legislation and its mandatory jail time and economic sanctions;
2. Michigan criminal sanctions for various false returns as well as associated civil tax liabilities, fraud penalties, and other penalties and interest;
3. IRS criminal issues including, a five-year evasion felony per year and a three-year max for false statements on a tax return;
4. Myriad IRS civil liabilities for income tax and payroll taxes and associated penalties as well as interest, compounded daily, and;
5. If there is fraud, then there is no civil statute of limitations in tax—the IRS and Michigan can and do go back many, many years.

Passive Business Owners & Entities With Multiple Locations

Owners are not the only ones who might want to skim and use a zapper to hide it. A absentee owner as well as owners of multiple locations have two problems if managers or key employees use zappers to hide embezzlement. In addition to being the victim of the skim, the larcenous employee will tell the IRS and Michigan Treasury that the owner must have done it, and the owner has criminal and civil exposure. Such owners can protect themselves by unannounced electronic audits to determine if any zappers have been used. A telltale sign is that servers, per managers, need to be replaced with unusual frequency. That can well be an attempt to hide evidence of electronic tampering.

What To Tell Clients

Smaller business clients that have zappers are not going to boast about it to their counsel. You might pass along a proverbial word to the wise to cash business owners. This new zapper law is out there, it has teeth, and those who ignore it do so at their peril to both personal liberty and treasure. Also, as noted just above, beware of skimming employees as well.

NOTES

1. See MCL 750.411w.
2. MCL 750.411w(4)(a).
3. See "State governments target tax-cheating software," *Bloomberg Businessweek*, April 3, 2012.
4. MCL 750.411w(2).
5. MCL 750.411w(3).

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By Michael S. Khoury

SEC Issues Guidance on Cybersecurity Risks and Disclosure

On October 13, 2011, the Securities and Exchange Commission (SEC), Division of Corporation Finance, issued without much fanfare CF Disclosure Cybersecurity Guidance: Topic No. 2,[1] "Regarding Disclosure Obligations Related to Cybersecurity Risks and Cyber Incidents" (the "Cybersecurity Guidance"). The SEC noted the increasing reliance and dependence of companies on digital technologies and the importance of information to businesses. Companies should disclose both the risks of cyber attacks and incidents involving data breach, data theft, and other business disruption caused or potentially caused by cyber attacks as a risk factor consistent with Regulation S-K Item 503(c).[2]

Interestingly, the Cybersecurity Guidance also included specific "appropriate disclosures" as follows:

- Discussion of aspects of the registrant's business or operations that give rise to material cybersecurity risks and the potential costs and consequences;
- To the extent the registrant outsources functions that have material cybersecurity risks, description of those functions and how the registrant addresses those risks;
- Description of cyber incidents experienced by the registrant that are individually, or in the aggregate, material, including a description of the costs and other consequences;
- Risks related to cyber incidents that may remain undetected for an extended period; and
- Description of relevant insurance coverage.[3]

The Cybersecurity Guidance indicates that registrants should be addressing these issues in the MD&A section of SEC filings, as well as required interim disclosures related to a specific cyber incident. Finally, "[r]egistrants are required to disclose conclusions on the effectiveness of disclosure controls and procedures."[4]

While the Cybersecurity Guidance was quietly issued, the cybersecurity community certainly noted its importance. Failure to follow the Cybersecurity Guidance by registrant companies could lead to liability.

In reviewing the Cybersecurity Guidance, it is clear that there are several duties under the SEC rules and applicable laws. Risk factors under SEC Regulation S-K and obligations to disclose information in the MD&A section of the registrant filings were discussed above. Additionally, the registrant should consider the knowledge of a cyber event on the overall business, and whether an actual or prospective event could impact the company's business or products. There may also be legal proceedings that require disclosure, as well as the impact on the financial statements of the company.

Risks of Disclosure?

The SEC recognized the risks of disclosure in the Cybersecurity Guidance. One important issue that must be considered is whether disclosure of these risks could provide a roadmap for the cyber thieves to attack a company that discloses weakness in its systems. In a recent article in the American Bar Association Business Law Section's *Business Law Today*,[5] the authors express five concerns from cybersecurity specialists about the Cybersecurity Guidance:

- Registrant disclosures may be cautious and minimal, and of little use to potential investors.
- Minimal and vague disclosures are likely to help competitors and hackers before they are useful for investors.
- Detailed disclosures could undermine cybersecurity by giving a road map for cyber thieves to penetrate systems.
- The potential for a shareholders' derivative action if the disclosure leads to a cyber attack.
- The Cybersecurity Guidance marks only the beginning of increased disclosure requirements for registrants in the area of cybersecurity.

Recent reports about the nature of cyber attacks detail that some of the attacks are for political purposes, while others are for commercial and industrial espionage and theft of financial information. The Cybersecurity Guidance is layered on top of the registrant's related state law obligations, which are different in each state.

Disclosure Experience and Governance of Risks

The early experience with disclosures of cyber incidents by reporting companies leaves open the question of real compliance with the guidelines. In the first few months after guidelines were issued, one review indicated that several companies (including defense contractors) with known cyber incidents failed to disclose actual and attempted breaches in their filings with the SEC. [6]

Of greater concern to those in the cybersecurity industry is the seeming lack of attention by corporate management to risks associated with cyber incidents. In its third report on enterprise security, CyLab and Carnegie Melon University surveyed board members and senior executive members from the Forbes Global 2,000 companies, including a significant number of respondents from critical infrastructure companies. The following excerpt from the Executive Summary is troubling.

> For the third time, the survey revealed that boards are not actively addressing cyber risk management. While placing high importance on risk management generally, there

management generally, there is still a gap in understanding the linkage between information technology (IT) risks and enterprise risk management. Although there have been some measureable improvements since the 2008 and 2010 surveys, boards still are not undertaking key oversight activities related to cyber risks, such as reviewing budgets, security program assessments, and top-level policies; assigning roles and responsibilities for privacy and security; and receiving regular reports on breaches and IT risks. Involvement in these areas would help them manage reputational and financial risks associated with the theft of confidential and proprietary data and security breaches of personal information.[7]

Whether reporting companies begin to take the issues seriously prior to a significant set of damages to these companies from cyber incidents is unclear, but the trends should be clear to directors and senior executives.

Your Takeaway

Business lawyers involved in this area should become acquainted with the nuances of cybersecurity to ensure that the disclosures consistent with the SEC Cybersecurity Guidance are accurate and do not provide too much information as to put the company at risk. This will be the first stage of many ongoing developments as the risks of the information age become more important, and the lack of cybersecurity efforts across industry and government become more apparent.

NOTES

1. http://www.sec.gov/divisions/corpfin/guidance/cfguidance-topic2.htm.

2. *Supra*, (Summary).

3. *Supra*, (Risk Factors).

4. *Supra*, (Disclosure Controls and Procedures).

5. Trope and Hughes, *The SEC Staff's "Cybersecurity Disclosure" Guidance: Will It Help Investors or Cyber-thieves More?*, *Business Law Today*, December 2011.

6. Menn, *Exclusive: Hacked Companies Still Not Telling Investors,* Reuters (February 2, 2012). The article can be found at: http://www.reuters.com/article/2012/02/02/us-hacking-disclosures-idUSTRE8110YW20120202.

7. Governance of Enterprise Security: CyLab 2012 Report, *How Boards & Senior Executives Are Managing Cyber Risks*, Published by Carnegie Mellon University & Carnegie Mellon CyLab (May 16, 2012) at Page 5. The full report can be found at: http://www.rsa.com/innovation/docs/CMU-GOVERNANCE-RPT-2012-FINAL.pdf.

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Avoiding Pitfalls in Nonprofit Practice: Do THIS – Not THAT

By Jennifer Miller Oertel*

Introduction

Whether you are a seasoned nonprofit practitioner or someone who dabbles in nonprofit law, there are several traps for the unwary in this often misunderstood specialty area. Below we offer some practical guidance to assist you in steering clients around these pitfalls in order to avoid the often draconian penalties for noncompliance.

In General

DON'T confuse terminology. Not every "nonprofit" is a tax-exempt entity, and 501(c)(3) status can imply a public charity or a private foundation, which are very different animals. **DO** be sure to clarify what your client means. This article will generically refer to a 501(c)(3) tax-exempt entity as a "nonprofit" unless a public charity or private foundation is specified.

DON'T assume all 501(c)(3)s are created equal. What is permissible for a public charity could be forbidden in a private foundation. Further, special rules apply to certain public charities categorized as supporting organizations. Practitioners have drafted conflict of interest policies for private foundations that are intended for public charities. **DO** draft conflict of interest policies tailored to the law of private foundations so that clients don't accidentally run afoul of the law and expose their organizations to excise taxes or even loss of tax-exempt status.

DON'T form a nonprofit for a client without fully explaining the responsibilities and potential liability involved in running a tax-exempt entity. **DO** provide clients with memoranda or IRS publications (there are several good ones available on the IRS Web site,[1] although in reality they are so complex that most clients will not read them) describing their annual compliance requirements, fiduciary duties, and the activities to avoid in order to stay tax-exempt. Prepare a presentation to the board on these matters and encourage annual follow-up training, as well as training for new directors that are added to the board and executive officers.

DON'T assume that one can easily migrate a nonprofit to a new state by merging the old nonprofit into a shell nonprofit in the new state. **DO** be aware that the tax-exempt status does not automatically transfer to the surviving entity and so a new Form 1023, Application for Tax Exemption, would need to be filed.

DON'T draft bylaws that are too specific. Actions taken contrary to a nonprofit corporation's bylaws could be held to be invalid. Countless nonprofit bylaws state that meetings shall be conducted in accordance with Robert's Rules of Order. However, in reality most nonprofits utilize an abbreviated form of parliamentary procedure. **DO**, however, assure that the bylaws will be specific enough so as to assist the nonprofit in complying with applicable law. For example, Section 404 of the Michigan Nonprofit Corporation Act[2] (the "Act") requires that, if a shareholder or member is permitted to participate in and vote at a meeting by remote communication, the notice of meeting must include a description of the means of remote communication by which such person may participate. If an attorney is not involved in each meeting (which is often the case due to lack of funds or an unwillingness to pay legal fees for "something so ministerial"), then the client may not know how to adhere to the law unless such procedures are spelled out clearly in the bylaws.

DO observe the corporate formalities for nonprofit board meetings just as one

The author would like to acknowledge the expert advice of her partners William Sider, Deborah Baughman, and Amy Nowlan.

would in the for-profit context. Ensure that there is proper legal notice of meetings, in accordance with the nonprofit's bylaws and applicable law, that board actions are properly approved and recorded, and that minutes of meetings are kept. **DON'T** assume that because it is a nonprofit, there is no need to observe good corporate governance. Lawsuits against nonprofits are on the rise, especially employment-related lawsuits. Also, state attorneys general are becoming more active in their oversight roles over charitable assets. In fact, the Internal Revenue Service ("IRS") has issued proposed regulations permitting it to disclose information about charities and other exempt organizations to state officials.[3]

DO take careful minutes of board and committee meetings (or provide a template and train nonprofit staff how to do so). The purpose of minutes is to lay a foundation to show proper director exercise of fiduciary duties. Minutes should reflect the general discussion, the names of the directors making and seconding motions, and exactly what actions were taken at the meeting. Ideally, formal resolutions should be distributed to the directors (along with any supporting materials) for review and consideration in advance of the meeting. Some "experts" recommend that no names be mentioned in minutes, yet in the for-profit context, courts have commented that proper detail in meeting minutes is necessary to demonstrate whether fiduciary duties have been fulfilled. It is especially important that abstentions be reflected. **DON'T** use minutes as a way to transcribe each word stated at the meeting. This is not only cumbersome, but it is not the intent of minutes, and it may prove detrimental.

DO adopt policies and procedures. At a minimum, a nonprofit should adopt (and follow) those policies and procedures about which the IRS Form 990 asks.[4] Further, directors should annually update their conflict of interest questionnaires to disclose interests that may be in conflict with the nonprofit upon whose board they serve. **DON'T** forget that the whistleblower and records retention requirements of the Sarbanes Oxley Act apply to nonprofits.

DO be aware that the IRS is increasingly focused on governance and has recently denied exempt status in several private letter rulings based on governance matters (mainly, lack of an independent board of directors that the IRS presumed would result in private inurement).[5] In fact, IRS agents now use a governance checklist in their examinations of nonprofits. The checklist includes questions such as the frequency of board meetings (and whether that frequency met the organization's bylaws requirements, if any), whether the directors *and the public* have been given copies of the organization's articles and bylaws, what comparability data is used in making compensation determinations, the total number of business and family relationships between board members, whether the nonprofit has a written mission statement and whether it is complying with it, whether the nonprofit has a conflict of interest policy (and whether it addresses recusals and annual written disclosures of potential conflicts of interest), how the nonprofit exercises financial oversight, and whether it has adopted a document retention and destruction policy.

DO encourage nonprofits to secure director and officer indemnification insurance, which is often a pre-requisite to service for savvy board members. It is also prudent to institute individual indemnification agreements with directors and officers. **DON'T** assume that insurance is a substitute for poor governance. Neither the IRS nor the laws of most states will permit indemnification of directors or officers if they acted willfully and without reasonable cause with respect to the act or failure to act which led to liability or if they received an improper personal benefit.

DO maintain attorney-client privilege of board meetings, especially when sensitive issues are discussed. **DON'T** permit

Not every "nonprofit" is a tax-exempt entity, and 501(c)(3) status can imply a public charity or a private foundation, which are very different animals.

third parties to be present at board meetings except when attending for a particular purpose, in which case they should be excused from the meeting when that purpose is fulfilled. Note that the presence of a nonprofit consultant would negate the attorney-client privilege. **DO** assure that clients understand that there is no such thing as an accountant-client privilege.

DO encourage nonprofit directors and officers to take advantage of ongoing training opportunities. The IRS offers online courses[6] as well as regional seminars, and there are several national and local resources.

DO be aware that the IRS is increasingly focused on Web sites and blogs. Examiners will routinely conduct an Internet search of a tax-exempt applicant's name and make specific inquiries as to how the information in cyberspace differs from what the applicant provided on its application for tax exemption.

DON'T forget the debt-financed income rules under the Internal Revenue Code of 1986, as amended (the "Code") Section 514.[7] Although income from real property is usually exempt from unrelated business income tax ("UBIT"), if it is debt-financed, it must fit within one of the enumerated exceptions in order to be free of UBIT. For example, the IRS recently ruled that land purchased by an exempt church that can reasonably be expected to be used for exempt purposes within fifteen years of its acquisition would be exempt from UBIT for five years from the date of acquisition by reason of the neighborhood land rule exception to the debt-financed property rules.[8] However, securities purchased on margin for a supporting organization were held to constitute debt-financed property, with the income derived therefrom held subject to UBIT.[9]

DON'T run afoul of IRC 409A, which governs unfunded, nonqualified deferred compensation arrangements (e.g., a plan meeting the requirements of IRC 457(f)). IRC 409A imposes complicated requirements on deferred compensation arrangements by restricting the timing of elections and payment of benefits. With few exceptions, a plan provides for the deferral of compensation if it provides that an employee (director or consultant) has a legally binding right during a taxable year to compensation that, pursuant to its terms, is or may be payable to the employee in a later taxable year. The definition of "plan" under IRC 409A is so broad it covers almost any compensation arrangement. If a plan violates IRC 409A in writing or in operation, compensation deferred under the plan is subject to immediate taxation (possibly before receipt of the compensation), plus an additional tax equal to 20 percent of the amount included in income and an additional interest-based tax. In addition to these taxes and penalties imposed on the employee, the employer could be subject to reporting, withholding, and deposit penalties for the failure to properly report, withhold, and deposit federal income taxes. **DO** watch for the much-anticipated IRC 457(f) regulations, although that may be a long wait since, as reported in the *Pension and Benefits Daily*, the U.S. Treasury Department has indicated that healthcare and pension funding relief regulations have a higher priority.[10]

The definition of "plan" under IRC 409A is so broad it covers almost any compensation arragnement.

Private Foundations

DON'T base a client's estate plan around funding a private foundation mainly with stock in a privately held company and insufficient cash. The stock will increase the foundation's 5 percent distribution requirement yet there will be insufficient liquidity to meet that payout. The IRS' Chief Counsel's Office has expressed no sympathy toward private foundations that have this issue, stating that advisors should have been aware of the distribution requirements at the time of planning. There could also be an excess business holdings issue. **DO** consider alternatives such as including put rights of the foundation in the private company's charter, mandatory liquidity provisions, or a separate class of dividend-paying stock.

DO avoid any potential self-dealing issue by entering into an engagement agreement directly with the foundation, rather than the individual client, so that it is clear that the foundation, and not the client, is paying the legal costs of its own formation. There is limited IRS guidance on the ability of an individual to deduct the expenses of forming a foundation. However, the individual may take a contribution for donations to the foundation (within the 30 percent adjusted gross income limitation), and the foundation may use those funds to pay its own formation costs. **DON'T** forget to have the foundation substantiate the gift if over $250.

DON'T state in the Form 1023 or governing documents that the private foundation will "only make grants to other U.S. 501(c)(3) public charities." Although there are additional requirements involved, and it may subject the private foundation to scrutiny (and in some cases require public disclosure), private foundations are permitted to make grants to international organizations, individuals, and even other private foundations. **DO** instruct clients to notify you before they make any such grants, and assure them that you understand the rules so that you can properly advise them. Given the history of abuses in the private foundation arena, the penalties for noncompliance are often draconian.

DO encourage private foundations to take advantage of the rebuttable presumption test when determining whether compensation is reasonable.[11] Under this test, compensation payments are presumed to be reasonable if they are approved in advance by an authorized body composed entirely of individuals who do not have a conflict of interest with respect to the arrangement, such authorized body obtained and relied upon appropriate data as to comparability prior to making its determination, and it adequately documented the basis for its determination concurrently with making the determination. Executive compensation continues to be a focus point in IRS audits.

DO be aware of withholding obligations relating to international grants. **DON'T** run afoul of the anti-terrorist financing guidelines. **DO** advise clients to have their private foundation substantiate any contributions, including that of the founder of the foundation. The IRS has denied a deduction for a charitable contribution (of over $250) by a founder to such founder's family foundation based upon the lack of written acknowledgement from the foundation for such contribution.[12]

DO advise private foundations that they cannot purchase tickets for charitable fundraisers for directors and officers (or anyone else) unless such people attend the charitable event on official foundation business. Otherwise, this is private inurement and subject to excise taxes.[13]

DON'T assume that there is a minimum start-up period for a private foundation's required 5 percent distribution. This is a common misconception. These rules are only applicable to certain set-aside projects. **DO** advise clients to consult with advisors knowledgeable in private foundation law in order to properly calculate the amount that must be distributed each year. Penalties for failure to distribute the appropriate amount are severe.

DON'T take a potential grantee's word that it is a tax-exempt public charity. The IRS determination letter is also not enough to prove that such status has not been revoked. **DO** verify the status of all potential grantees with the new IRS Exempt Organizations Select Check,[14] an online search tool that consolidates three former search sites (including Publication 78) into one. Also, secure appropriate due diligence materials and representations and warranties from all grantees.

DON'T assume that what a client asks for is what they need. Some experts opine that a private foundation is not worth the work and liability exposure unless assets will be at least $1 million,

Given the history of abuses in the private foundation arena, the penalties for noncompliance are often draconian.

although a relatively recent survey of family foundations by The Foundation Center reported that 64 percent had assets of less than that.[15] **DO** advise clients of the work and risk involved and counsel them about alternatives such as kitchen table philanthropy or a donor-advised fund so that they may make an informed decisions. **DO** also advise clients about the increased gift tax exemption of $5.12 million that is set to expire at the end of 2012.

DO keep an eye on Senate Bill 593,[16] which proposes to amend the Code to: (1) reduce from 2 percent to 1.39 percent the excise tax rate on the net investment income of private foundations, and (2) repeal the 1 percent reduction in such tax rate for private foundations that meet certain higher distribution requirements.

DON'T assume that the L3C form is a panacea for program-related investments ("PRI"). Neither Congress nor the IRS has conferred categorical approval on PRI's that involve an L3C, and so careful foundation managers must still seek a private letter ruling or an appropriate legal opinion in order to avoid having their investment classified as a jeopardizing investment. Interestingly, the proposed PRI regulations issued by the IRS in May are silent as to L3Cs. **DO**, however, consider advising the making of a PRI if it significantly furthers the private foundation's mission. Remember that an approved PRI will count as a qualifying distribution and may lower the tax on investment income (at least, until Senate Bill 593 is passed, if ever).

Remember that an approved PRI will count as a qualifying distribution and may lower the tax on investment income (at least, until Senate Bill 593 is passed, if ever).

Public Charities

DO advise clients to be clear when they are speaking publicly about political issues whether or not they are representing their charity. This is especially important when politicians serve in leadership roles or establish their own charities. The IRS examined over 250 exempt organizations based on allegations of political activity in the 2004, 2006, and 2008 federal election years, substantiated the allegations in over half of the examinations, and revoked the tax-exempt status of seven non-compliant organizations (the remainder were given a warning to comply with the ban on political activities).[17]

DON'T run afoul of the lobbying rules. No more than an "insubstantial part" of a charity's activities may be attempting to influence legislation. In most cases, charities should elect the expenditure test as opposed to the substantial part test. The penalty for going beyond the permitted expenditures is a tax (although revocation of exemption is possible in extreme cases), while the penalty for breaching the somewhat ambiguous substantial part test is more likely to be loss of tax exemption. **DO** be aware of the differences between grassroots lobbying and direct lobbying. **DO** also be aware of legislation regulating lobbying and lobbyists.

DON'T overlook the various state charitable solicitation laws. While most states don't provide for severe penalties, some do, and it's never a good idea to advise clients to disregard the laws due to burdensome compliance. **DO** consult the Charleston Principles,[18] which, although not binding law, are one of the best guides, especially with respect to solicitations via Web sites. Note that when a nonprofit mails a letter or directs an email to a recipient requesting a contribution, that is definitely a solicitation, and so one must review whether the applicable state has a *de minimis* exception to its charitable solicitation registration requirement. **DO** be aware of state and federal regulations governing commercial co-venturing, professional fundraising, and fundraising counsel.

DO advise clients to proceed with extreme caution when considering a joint venture with a for-profit entity. **DO** require that the nonprofit retain voting control, actual control over important matters such as budgeting, hiring, and daily operations, and that the charitable purposes of the nonprofit are the primary focus of all activities of the joint venture. The vehicle of choice for a joint venture is the limited liability company ("LLC"), in

which case the activities of the LLC will generally be attributed to the nonprofit member, thereby potentially threatening tax-exempt status. **DON'T** proceed without proposing that the nonprofit adopt a policy with respect to joint ventures, and **DON'T** forget about UBIT issues.

DO encourage any nonprofit with employees to adopt a code of conduct and ethics policy. This not only sets a "tone from the top" as to the values of the organization but also can prove useful when it is necessary to terminate an employee for cause. **DON'T** forget to advise clients about the potential to take advantage of the Small Business Health Care Tax Credit,[19] which is designed to assist small tax-exempt organizations (as well as small businesses) to provide health insurance coverage to their employees. **DO** also advise about the Work Opportunity Tax Credit ("WOTC") that was expanded by The VOW to Hire Heroes Act of 2011,[20] which added two new categories to the existing qualified veteran targeted group and made the WOTC available to certain tax-exempt employers as a credit against the employer's share of social security tax.

DO advise clients of the various employment laws and tax reporting and withholding obligations related to their employees. **DON'T** advise clients to simply "hire" workers as independent consultants without reviewing the IRS' three factor test. **DO** counsel them that nonprofits are eligible to take part in the IRS' Voluntary Classification Settlement Program,[21] providing them the opportunity to reclassify their workers as employees for employment tax purposes for future tax periods with partial relief from federal employment taxes, if they have misclassified employees as contractors and failed to pay the required employment taxes.

DO encourage that the terms of executive employment be set forth in an employment agreement, covering such things as salary and benefits, responsibilities and authority, reporting structure, term of employment, outside activities, non-competition and non-solicitation provisions, confidentiality provisions, and dispute resolution. The board, or an independent committee thereof, should review and approve the compensation and benefits arrangement after consultation with an attorney or compensation benchmarking organization.

DON'T disregard state and federal laws applicable to gaming. In Michigan, even an apparently innocuous "50-50" or a "drawing for a door prize" qualifies as a raffle and must be licensed. **DO** analyze UBIT ramifications and the potential effect on tax-exempt status in advance. Although gaming may generate funds that will be used by the nonprofit for exempt purposes, the gaming itself does not further the exempt purposes of most nonprofits. The IRS recently concluded a project by which it cross-referenced information from seventeen state gaming regulatory tax agencies with its own Form 990 database to identify UBIT returns that should have been filed. The nonprofits filed with their state regulators to be able to continue to conduct the gaming but failed to pay federal taxes.

DON'T forget about UBIT implications. The volunteer worker exception to UBIT will not apply if workers are permitted to accept tips (that are not donations to the nonprofit). **DO** be aware of the UBIT implications of permitted sponsorship contributions versus revenues from advertising.

DO advise clients that good governance is their best defense!

NOTES

1. http://www.irs.gov.
2. Michigan Nonprofit Corporation Act, MCL 450.2101 – 450.3192 (effective January 1, 1983).
3. Notice of Proposed Rulemaking: Disclosure of Information to State Officials Regarding Tax-Exempt Organizations: REG-140108-08 (2011-13 I.R.B.)(March 28, 2011).
4. 2011 Form 990, http://www.irs.gov/charities/article/0,,id=233830,00.html.
5. See, for example, IRS Private Letter Rulings 200736037, 200737044, 200830028, and 200845053.
6. http:// www.StayExempt.irs.gov.
7. Internal Revenue Code of 1986, as amended, United States Code Title 26, Subchapter F, Part III, §514.

8. Private Letter Ruling 201020022.

9. *Henry E. and Nancy Horton Bartels Trust for the Benefit of Cornell University v. United States*, 2009 US Claims LEXIS 236, 2009-2 U.S. Tax Cas (CCH) P 50475 (2009), *aff'd,* 617 F3d 1357 (Fed Cir 2010).

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11. IRC 4958.

12. *Stussy v. Commissioner*, T.C. Memo 2003-232.

13. Private Letter Ruling 9021066.

14. http://www.irs.gov/charities/article/0,,id=249767,00.html.

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17. Internal Revenue Service Fiscal Year 2011 Workplan (http://www.irs.gov/pub/irs-tege/epwrkpln_11.pdf).

18. http://www.nasconet.org/Charleston%20Principles%2C%20Final.pdf.

19. IRS Notice 2010-44.

20. IR-2012-17, Feb. 9, 2012.

21. IRS Announcement 2011-64.

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How Nonprofits Can Engage in Political Activity During This Election Cycle

By Mary Catherine Wilcox

Introduction

The excitement of a presidential election will entice many nonprofits to make themselves heard this election season. But nonprofits should be aware of the complex regulatory schemes that govern their political activity, including federal tax law and state and federal campaign finance laws. The Michigan Nonprofit Corporation Act, MCL 450.2101 *et seq.*, provides for the incorporation of nonprofit organizations in Michigan and governs their corporate activities. Nonprofit corporations may be considered tax-exempt under federal tax law, which applies restrictions on nonprofit political activity depending on the type of tax exempt organization. State or federal campaign finance laws may also apply to a nonprofit that is attempting to influence an election. This article will provide a basic overview of these laws and generally discuss permissible political activities and compliance requirements.

Tax Exempt Organizations Governed by the Internal Revenue Service

Permissible Political Activity

In General

The level of political activity that a nonprofit can engage in depends on the section of the Internal Revenue Code (IRC) under which it qualifies for tax exemption. Nonprofit corporations are commonly recognized as tax exempt under IRC 501(c)(3), (c)(4), (c)(5), (c)(6), and 527. The tax law restrictions on the political activities of these organizations are generally discussed below.

Charitable Organizations Under Section 501(c)(3)[1]

Overview

Sections 501(c)(3) organizations are the most limited in terms of permissible political activity because they must be organized and operated *exclusively* for one of the exempt purposes set out in section 501(c)(3).[2] The Internal Revenue Code prohibits charities from participating or intervening in a political campaign on behalf of (or in opposition to) any candidate for public office.[3]

Organizations that engage in political campaign activity are considered "action" organizations.[4] The income tax regulations state that action organizations are not operated exclusively for exempt purposes, and thus, are not considered to be tax exempt under section 501(c)(3).[5] Charities who do not follow these regulations risk being subject to certain excise taxes under IRC 4911, 4912, and 4955 and losing their tax exempt status.[6]

Prohibited campaign activity includes providing or soliciting financial support for candidates or political organizations, or establishing a political action committee ("PAC").[7] Charities also cannot make or distribute written (including those prepared by others) or oral statements supporting or opposing candidates.[8] This includes endorsing candidates in writing or verbally, rating candidates (even on a non-partisan basis), and distributing partisan campaign literature.[9]

Permissible vs. Prohibited Political Activity

This does not mean that charities are prohibited from participating in *all* political activity. Although political campaign activity is absolutely prohibited, some legislative lobbying is permissible.[10] A facts and circumstances test is applied to determine whether an activity is political campaign activity or permissible political activity.[11] The following paragraphs demonstrate the application of this test to distinguish permissible from prohibited political activities.

Issue Advocacy

General advocacy, which includes influencing public opinion on issues, influencing non-legislative governing bodies (the executive branch and regulators), and encouraging voter participation, is permitted as an educational activity.[12] If a charity chooses to engage in "issue advocacy," it should be careful that it does not become participation

or intervention in a political campaign by including a message that favors or opposes a candidate.[13] The fundamental test for determining whether an issue advertisement is political campaign activity is "whether support for or opposition to a candidate is mentioned or indicated by a particular label used as a stand-in for a candidate" (i.e., whether the organization is actually commenting on a candidate rather than speaking about an issue).[14] The IRS considers a number of factors in making this determination.[15]

Voter Education

Certain voter education activities, including preparing and distributing voter guides, presenting public forms, and voter registration and "get-out-the-vote" drives are permissible if conducted in a *nonpartisan* manner.[16] If they show a bias against or preference for the views of a particular candidate, however, they constitute prohibited participation or intervention.[17]

Individual Leaders' Activity/Candidate Appearances

It is important to note that leaders of organizations may engage in partisan political activities in their individual capacities.[18] They are prohibited, however, from making partisan comments in official organization publications or at official functions of the organization.[19] Candidate appearances at official functions of the organization must also be analyzed to ensure compliance with tax laws.[20] Candidates may also appear or speak at organization events in a non-candidate capacity.[21]

Business Activity/Websites

Some business activity, such as selling mailing lists or renting office space, is permissible if certain guidelines are met.[22] Charities must also be mindful of what they post on their websites. Postings that favor or oppose a candidate for public office are prohibited, including links to other sites, even if the charity does not have control over the content of the linked site.[23]

Other 501(c) Organizations

Social Welfare Organizations—501(c)(4)

Social welfare organizations must be organized as nonprofit organizations and be operated *exclusively* for the promotion of social welfare, which includes promoting the common good and the general welfare of the people in a particular community.[24] This is accomplished by bringing about civic betterment and social improvements.[25]

Lobbying for legislation related to the organization's programs is a permissible social welfare purpose. Thus, a social welfare organization may further its exempt purposes through lobbying as its primary activity without jeopardizing its exempt status. If an organization that collects dues from members engages in lobbying, however, it may be required to either provide notice to its members regarding the percentage of dues paid that are applicable to lobbying activities or pay a proxy tax.

Political campaign activity, however, is not a social welfare purpose.[26] Unlike charities, social welfare organizations may engage in political campaign activity as long as it is not its primary purpose.[27] If political campaign and other non-exempt activity becomes an organization's primary activity, revocation of tax exempt status is possible. Political expenditures may be subject to taxation under section 527(f). Membership organizations will also have to decide whether to provide notices to members with a reasonable estimate of the amount of dues allocable to nondeductible lobbying and political campaign expenditures or pay a proxy tax under 6033(e).

Labor, Agricultural, or Horticultural Organization—501(c)(5) and Business Leagues—501(c)(6)

Labor, agricultural, and horticultural organizations must be operated to better the conditions of people engaged in a particular pursuit, but the earnings of these organizations cannot inure to the benefit of the organizations' members.[28] Unions, farm bureaus, and breeding associations are all examples of section 501(c)(5) organizations.

Business leagues are associations of persons who have a common business interest and which promote that common interest.[29] However, these organizations may not conduct a regular trade or business for profit.[30] Rather, they must engage in activities that promote the common interest of their members.[31] Chambers of commerce, trade associations, and real estate boards are all examples of section 501(c)(6) organizations.

Like social welfare organizations, section 501(c)(5) and (c)(6) organizations can engage in an unlimited amount of lobbying activities, as long as it is related to their exempt purpose.[32] These organizations are also permitted to engage in certain political campaign activity as long as it does not constitute their primary activity.[33] The same taxes and

The level of political activity that a nonprofit can engage in depends on the section of the Internal Revenue Code (IRC) under which it qualifies for tax exemption.

risks that apply to social welfare organizations also apply to these organizations.

Political Organizations—527

Political organizations must be organized and operated primarily for the purpose of "directly or indirectly accepting contributions or making expenditures to influence the selection, nomination, election or appointment of any individual to federal, state, or local public office, office in a political party, or presidential and vice-presidential electors."[34] This includes candidate committees, political parties, and PACs that report to federal or state authorities. Unlike 501(c) organizations, political campaign activity is permitted as an exempt activity for political organizations.[35] A limited amount of lobbying and general advocacy is also permitted.[36]

Affiliated Entities

Given the limitations on tax exempt organizations, nonprofits may decide to create an affiliated tax exempt entity to engage in political activity. The following combinations of organizations demonstrate how this can be accomplished:

- A 501(c)(3) organization establishing a 501(c)(4) organization to conduct lobbying;
- A 501(c) organization establishing a 527 organization;[37]
- A 501(c)(3) organization whose officials, as permitted, establishing a 527 organization in their capacity as individuals; and[38]
- A triad arrangement with a 501(c)(3) organization that usually conducts educational advocacy, another 501(c) organization (usually a 501(c)(4)) that conducts lobbying, and a 527 organization that conducts political intervention.[39]

Except for a 527 organization, creating new affiliated entities would require establishing a new Michigan nonprofit corporation.

If a 501(c) organization (not a 501(c)(3)) decides to establish a "separate segregated fund" under section 527(f)(3), it can either create an internal fund to support or oppose candidates, but it would be subject to tax under section 527(f). Alternatively, the fund could be treated as a separate taxable entity under section 527. Under section 527, a 501(c) organization is generally encouraged to choose the latter option because it may pay for the indirect expenses of a section 527 organization without incurring tax under section 527(f).[40]

IRS Reporting Requirements for Political Activity

In general, tax exempt organizations must file an annual information return (Form 990, 990-EZ, or 990-N) with the IRS. Political campaign and lobbying activity is reported in Schedule C of Form 990 and 990-EZ. Section 527 organizations and certain 501(c) organizations must also file Form 1120-POL to report their political organization taxable income and income tax liability under section 527.

A 527 organization may be required to file Form 8871, which gives notice to the IRS that it is to be treated as tax exempt. This notice must be filed within twenty-four hours of establishment of the organization. Exceptions include:

- Organizations that are required to report under the Federal Election Campaign Act ("FECA") as a political committee;[41]
- Organizations that reasonably anticipate that they will not have gross receipts of $25,000 or more for any taxable year; and
- Organizations described in section 501(c) that are subject to section 527(f)(1) because they have made an "exempt function"[42] expenditure.[43]

A political organization may be required to periodically report on Form 8872 contributions to the organization and expenditures made by the organization.[44] Political committees required to file with campaign finance regulatory authorities are discussed in the next part.

Given the limitations on tax exempt organizations, nonprofits may decide to create an affiliated tax exempt entity to engage in political activity.

Committees Regulated Under Campaign Finance Laws

Federal Laws

The FEC is the independent regulatory agency that administers and enforces the federal campaign finance law, namely, FECA.[45] FECA applies to campaigns for the U.S. House of Representatives, U.S. Senate, the presidency, and the vice presidency.[46] It broadly covers the following three categories:

- Public disclosure of funds raised and spent to influence federal elections;
- Restrictions on contributions and

expenditures made to influence federal elections; and

- The public financing of presidential campaigns.[47]

In 2010, the United States Supreme Court famously decided *Citizens United v FEC*, __ US __, 130 S Ct 876 (2010), which continues to be the subject of much controversy. In *Citizens United*, the Court struck down a provision of the Bipartisan Campaign Reform Act of 2002 ("BCRA") that prohibited corporations (including nonprofits) and labor organizations from using their treasury funds to make certain contributions or expenditures in connection with federal elections.[48] Thus, nonprofit corporations may now use their treasury funds to make independent expenditures ("IEs") and electioneering communications ("ECs"). The ruling, however, did not affect the ban on corporate and union contributions, and it upheld the disclosure and disclaimer requirements for IEs and ECs.[49]

Nonprofits should consider whether their political activities will subject them to the Michigan Campaign Finance Act, MCL 169.201 *et seq.* ("MFCA").

An independent expenditure is a payment for a communication that expressly advocates the election or defeat of a clearly identified candidate that is made without cooperation or consultation or at the request or suggestion of the candidate.[50] Examples include newspaper and television advertisements that encourage voters to support or oppose a particular federal candidate, as long as there is no coordination with the candidate's campaign. Electioneering communications are broadcast, cable, or satellite communications that refer to a clearly identified candidate, are publicly distributed within specified time periods before an election, and are targeted to the relevant electorate.[51] Examples include issue or lobbying advertisements that mention a federal candidate and air in the candidate's district within 30 days of the primary or 60 days of the general election.

As a result of *Citizens United* and other recent federal cases,[52] nonprofits have begun to establish independent-expenditure only committees, popularly known as Super PACs.[53] Super PACs are popular because they can receive an unlimited amount of contributions to make an unlimited amount of independent expenditures.[54] Corporations and labor organizations that intend to make IEs or fund ECs should include disclaimers consistent with 11 CFR 110.11 in their communications and disclose IEs and ECs on FEC Forms 5 and 9, respectively.

Nonprofit corporations, other than section 501(c)(3) organizations, may also set up a PAC to contribute to candidates by registering with the FEC.[55] Under federal law, there are two types of PACs: separate segregated funds (SSFs) and nonconnected committees. Nonprofit corporations may sponsor an SSF, which collects contributions from a limited class of individuals to then make contributions and expenditures to influence federal elections.[56] The nonprofit corporation (i.e., the "connected organization") may pay for the costs of establishing, operating, and soliciting contributions for the SSF.[57]

State Laws

Nonprofits should consider whether their political activities will subject them to the Michigan Campaign Finance Act, MCL 169.201 *et seq.* ("MFCA"). If a group qualifies as a "committee" under the MFCA, it must register and file campaign finance disclosure statements with the Michigan Department of State (the "Department").[58] Committees are groups that receive contributions or make expenditures of $500 or more to influence voters for or against the nomination or election of a candidate, or the qualification, passage, or defeat of a ballot question.[59] Once the $500 threshold is reached in a calendar year, a committee is formed and it must register with the Department within ten days.[60] Reporting requirements vary depending on the category of the committee. The MFCA covers the following types of committees: candidate committees, political and independent committees ("PACs"), ballot question committees ("BQCs"),[61] and political party committees.

In overruling the U.S. Supreme Court case of *Austin v Michigan State Chamber of Commerce*, 494 US 652 (1990), *Citizens United* declared section 54(1) of the MCFA unconstitutional to the extent that it prohibits corporations (including nonprofits) and labor organizations from making independent expenditures.[62] In a recent case following *Citizens United*, *Michigan Chamber of Commerce v Land*, 725 F Supp 2d 665, 699–700 (WD Mich 2010), the court authorized corporations and labor unions to make contributions to political committees that are formed solely for the purpose of making independent expenditures. Like other committees, "independent expenditure political committees" must register with the Department once the $500 is threshold is reached. Even if the committee has not yet registered, it must file an Independent Expenditure Report with the De-

partment if it makes IEs between $100 and $499 in a calendar year.

Still, nonprofit corporations are prohibited from using their general treasury funds to make direct contributions to committees.[63] If a nonprofit corporation desires to contribute to a committee, it may establish a separate segregated fund.[64]

NOTES

1. There are two types of section 501(c)(3) organizations: public charities and private foundations. This article describes public charities. Different rules and regulations may apply to private foundations.

2. These can include charitable, religious, educational, scientific, and other purposes. IRC 501(c)(3).

3. IRC 501(c)(3). The term "candidate for public office" is defined as an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, state or local. Treas Reg 1.501(c)(3)-1.

4. Treas Reg 1.501(c)(3)-1.

5. *Id.*

6. See *Id.*

7. Kindell, Judith E. and John Francis Reilly, *Election Year Issues*, 2002 EO CPE Text, p. 344.

8. Rev. Rul. 2007-41.

9. Election Year Issues, p. 344.

10. The federal Lobbying Disclosure Act of 1995, 2 USC 1601 et seq., may apply.

11. Rev. Rul. 2007-41.

12. Kindell, Judith and Justine Lowe, *Rules for Exempt Organizations During a Tax Year*, available at http://www.irs.gov/pub/irs-tege/election_year_phone_forum_slides.pdf.

13. Election Year Issues, p. 344.

14. *Id.* at pp. 345–46.

15. Such factors include:

- Whether the statement identifies one or more candidates for a given public office;
- Whether the statement expresses approval or disapproval for one or more candidates' positions and/or actions;
- Whether the statement is delivered close in time to the election;
- Whether the statement makes reference to voting or an election;
- Whether the issue addressed in the communication has been raised as an issue distinguishing candidates for a given office;
- Whether the communication is part of an ongoing series of communications by the organization on the same issue that are made independent of the timing of any election; and
- Whether the timing of the communication and identification of the candidate are related to a non-electoral event such as a scheduled vote on specific legislation by an officeholder who also happens to be a candidate for public office. Rev. Rul. 2007-41.

16. *Id.*

17. *Id.*

18. Rev. Rul. 2007-41.

19. *Id.*

20. *Id.*

21. See *id.*

22. See *id.*

23. *Id.*

24. IRC 501(c)(4).

25. Treas Reg 1.501(c)(4)–1.

26. Treas Reg 1.501(c)(4)–1.

27. *Id.*

28. IRC 501(c)(5).

29. IRC 501(c)(6).

30. Treas Reg 1.501(c)(6)-1.

31 *Id.*

32. Rev. Rul. 61-177; Rev. Rul. 67-293.

33. G.C.M. 34233.

34. IRC 527(e).

35. IRC 527.

36. Kindell, Judith and Justine Lowe, *Rules for Exempt Organizations During a Tax Year*, available at http://www.irs.gov/pub/irs-tege/election_year_phone_forum_slides.pdf.

37. A 501(c)(3) organization is prohibited from establishing a 527 organization.

38. This is a complicated issue. For a discussion of the requirements, see Thomas, Ward L. and Judith E. Kindell, *Affiliations Among Political, Lobbying and Educational Organizations*, 2000 EO CPE Text, pp. 261-263.

39. Thomas, Ward L. and Judith E. Kindell, *Affiliations Among Political, Lobbying and Educational Organizations*, 2000 EO CPE Text, p. 263.

40. *See* Treas Reg 1.527-6(b)(2)–(3).

41. *See infra.*

42. An exempt function means "influencing or attempting to influence the selection, nomination, election or appointment of an individual to a federal, state, or local public office or office in a political organization. . . ." IRC 527.

43. *Id.*

44. All "political committees" under FECA are 527 organizations, but not all 527 organizations are required to file with the Federal Election Commission ("FEC").

45. Federal Election Commission, The FEC and the Federal Campaign Finance Law 1 (2011).

46. 14 USC 431(3).

47. Federal Election Commission, The FEC and the Federal Campaign Finance Law 1 (2011).

48. 130 S Ct at 917.

49. *Id.*

50. 11 CFR 100.16(a).

51. 11 CFR 100.29(a).

52. *See SpeechNow v. FEC*, 599 F.3d 686, 689 (D.C. Cir. 2010); *EMILY's List v. FEC*, 581 F. 3d 1, 10 (D.C. Cir. 2009) ("…individual citizens may spend money without limit (apart from the limit on their own contributions to candidates or parties) in support of the election of particular candidates").

53. AO 2010-09.

54. *Id.*

55. 11 CFR 102.1(c).

56. 11 CFR 100.6.

57. 11 CFR 114.1(a)(2)(iii). These expenses are exempted from the definition of "contribution" and "expenditure" in the FEC regulations.

58. MCL 169.224.

59. MCL 169.203(4).

60. *Id.*

61. A BQC is a "a committee acting in support of, or in opposition to, the qualification, passage, or defeat of a ballot question but that does not receive contributions or make expenditures or contributions for the purpose of influencing or attempting to influence the action of the voters for or against the nomination or election of a candidate." MCL 169.202(3). BQCs are, however,

allowed to accept contributions from corporations and labor organizations. MCL 169.254(3).

62. 130 S Ct at 913.

63. MCL 169.254.

64. MCL 169.255.

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Protecting Charitable Assets–A New Model Act

By Deanna M. Deldin

Introduction

Since most charitable organizations rely on the public and other organizations for support, accountability and transparency to donors are crucial to their success. Donors want to be to be assured that their contributions will be used for their intended purposes. The state has an interest in monitoring charities not only to protect the public from abuse, fraud, or misuse of funds, but also since many charitable organizations have among their purposes ones to lessen the burdens of government. Undoubtedly charities must be regulated to some extent to protect charitable assets and to solidify public confidence. Currently, at the federal level the Internal Revenue Service (IRS) provides oversight of tax-exempt organizations by requiring an annual IRS Form 990 (provided that the organization meets the threshold limitations for filing). At the state level, according to the Uniform Law Commission, thirty-seven states have statutes relating to the attorney general's duties with respect to charitable assets.[1] Many of these statutes may be based on the Uniform Supervision of Trustees for Charitable Purposes Act, which was approved by the Uniform Law Commission in 1954.[2] Other state statutes address registration of charities that solicit the general public and/or hired fundraisers.[3]

Michigan currently has a number of statutes applicable to corporations or trustees holding charitable assets. First, is the Nonprofit Corporation Act,[4] which provides the general corporate form for the conduct of lawful nonprofit activities. Also enacted in Michigan is the Supervision of Trustees for Charitable Purposes Act (applicable to all trusts and trustees holding property for charitable purposes over which the state or the attorney general has enforcement or supervisory powers); [5] Charitable Organizations and Solicitations Act (regulating charitable organizations, professional fundraisers, and other persons soliciting or collecting contributions on behalf of charitable organizations);[6] Dissolution of Charitable Purpose Corporations (requiring notice by charitable purposes corporations of dissolutions and withdrawals from the state);[7] and the Uniform Prudent Management of Institutional Funds Act (establishing duties and obligations of charitable institutions with respect to the management and use of funds held for charitable purposes).[8]

At its annual conference in July 2011, the Uniform Law Commission of the National Conference of Commissioners on Uniform State Laws approved and recommended for enactment in all of the states, the Model Protection of Charitable Assets Act ("MPOCAA").[9] The Uniform Law Commission is a nonprofit unincorporated association of state commissions on uniform laws from each state, the District of Columbia, the Commonwealth of Puerto Rico, and the U.S. Virgin Islands.[10] Unlike a *uniform* act, where uniformity of the provisions among the jurisdictions that adopt it are "principal and compelling objectives," a *model* act is one in which the principal purposes of the act can be substantially achieved even if all states do not adopt it in its entirety.[11] MPOCCA regulates "persons" who hold charitable assets in the state by imposing a registration requirement, clarifying the role of the attorney general to protect and oversee charitable assets, requiring an annual report, and requiring that certain events be reported to the attorney general. While many states may already have charitable statutes in place, MPOCCA would provide a template for those states that do not and would also allow some states to adopt portions of the act to address areas where their statutes may be lacking. It would also encourage or enhance cooperation among the states.

Key Definitions of MPOCAA

Under the MPOCAA, generally, a "person" is required to register and file annual reports if it holds "charitable assets" for a "charitable purpose." These key terms are described below.

- *Charitable Asset* means property that is given, received, or held for a charitable purpose, but does not include property acquired or held

for a for-profit purpose.[12] The comments give an example—such as where a university or a hospital is operated on a for-profit basis. Just because education is generally considered a charitable purpose, a for-profit university is not operating for a charitable purpose.

- *Charitable Purpose* means the relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose the achievement of which is beneficial to the community.[13] The definition follows the definitions contained in the Uniform Trust Code § 405, Restatement (Third) of Trusts § 28, Restatement (Third) of Trusts § 28 and the Uniform Prudent Management of Institutional Funds Act § 2(1). The comments to the MPOCAA suggest that the purposes must be charitable and not merely beneficial—for example, the activities of social welfare organizations, cooperative associations, and business entities benefit the community but are not charitable.[14]
- The definition of *person* is broad and includes entities and individuals—*Person* means an individual, corporation, estate, trust, business trust, statutory trust, partnership, limited liability company, association, joint venture, public corporation, or governmental subdivision, agency, or instrumentality or any other legal or commercial entity.[15]

Under the MPOCAA, generally, a "person" is required to register and file annual reports if it holds "charitable assets" for a "charitable purpose."

Authority of Attorney General to Protect Charitable Assets

Section 3 of the MPOCAA empowers the attorney general of the state with the duty to represent the public interest in the protection of charitable assets.[16] In carrying out this role, the attorney general is vested with the powers to (1) enforce the use of charitable assets for their intended purposes and in accordance with the law and terms governing their use, management, investment, distribution, and expenditure; and (2) act to prevent or remedy, or commence or intervene in an action to prevent or remedy: (a) a breach of a fiduciary or legal duty in the governance, management, or administration of a charitable asset; (b) misapplication, diversion, or waste of a charitable asset; (c) enforcement of the MPOCCA; or (d) to determine that an asset is a charitable asset. In connection with its duty to represent the public, the attorney general is authorized to conduct investigations, use administrative subpoena power, and promulgate rules to supplement the MPOCCA.[17] Critics suggest that this investigative power and subpoena power is overreaching and does not protect a charity's right to be free from unreasonable searches and seizures.[18]

Unlike for-profit corporations where a shareholder would stand to benefit from the corporation's operations, a charitable organization does not have the same type of interested parties since it is operated to benefit the public. As such, it is important that someone protect the public's interest in the charitable assets. Under common law and many state statutes, the attorney general may have standing to sue on the public's behalf. Some state statutes limit standing to the attorney general while others may allow private parties, generally a donor or charitable beneficiary to sue to enforce a charitable trust. The MPOCAA makes clear that the attorney general is responsible for protecting charitable assets.

Michigan's Supervision of Trustees for Charitable Purposes Act vests in the attorney general the responsibility of representing the people of the state of Michigan in all courts of the state with respect to "charitable trusts" and has jurisdiction and control to represent the people of the state and uncertain or indefinite beneficiaries in all charitable trusts in the state.[19] A charitable trust is defined broadly under the act and means the relationship where a trustee holds property for charitable purposes.[20] Similarly, trustee is broadly defined and includes *any* individual, group of individuals, association, foundation, trustee corporation or other corporation or legal entity holding property for any charitable purpose.[21] If adopted, the MPOCCA would replace and supersede the Supervision of Trustees for Charitable Purposes Act.[22] MPOCCA covers much of the same regulation as the Supervision of Trustees for Charitable Purposes Act but with a more modern view toward terminology. The reporting, disclosure, and oversight provisions of the attorney general under MPOCCA are also more extensive.

Registration

Registration under MPOCCA is generally based on a threshold amount of charitable assets held by the person and particular contact with the state. A person who holds, or within the preceding twelve months received, charitable assets of a certain threshold to be determined by the state, and who has the requisite contact with the state, must register with the attorney general.[23] The threshold suggested by MPOCCA is $50,000.[24] The valuation of charitable assets held for charitable purposes is based on the fair market value of the assets, as reasonably determined.[25] If the threshold amount is met, registration would be triggered if the person has one of the following significant contacts in the state: (1) is formed under the law of the state, or for trusts, has a principal place of administration in the state; (2) has a principal place of business in the state; (3) holds charitable assets in excess of the threshold other than assets held primarily for investment purposes; or (4) subject to exceptions, conducts activities in the state for charitable purposes. The intent is that negligible contact or activities in the state would not trigger registration so the following activities, if conducted alone, would not rise to the level of conducting activities in the state—maintaining, defending, mediating, arbitrating, or settling actions or proceedings; holding board or member meetings; maintaining financial accounts; holding real or personal property (without conducting activities or intent to conduct charitable activities); engaging in an isolated activity that is not in the course of similar activities; making a grant, scholarship, or award to a person in the state; or soliciting or accepting contributions. The aim is to limit registration to states in which the organization has sufficient contacts for the attorney general of that state to be concerned about proper administration. The implication of the registration requirements could be to require registration in multiple states—for instance, where a corporation has incorporated in one state but is active elsewhere.

Exemption from Registration

Certain entities would be exempt from registration, including governmental subdivisions, agencies, or instrumentalities, organizations the primary purpose of which is to influence elections or legislation, or a person having as its primary activity advocacy on issues of public or governmental policy. Financial institutions, investment companies, escrow agents, and storage facilities holding another person's charitable assets would also be exempt (unless holding assets as a trustee). Finally, a trustee of a revocable trust that becomes irrevocable because of the settlor's death, during a period of administration not to exceed two years, and a personal representative of a decedent's estate that holds a charitable asset during the period of administration of the estate would also be exempt. MPOCCA suggests that states consider other exemptions or alternatives for churches, religious organizations, and organizations that have as their primary activity advocacy on issues of public or governmental policy. MPOCCA offers four alternatives for defining religious organizations.

Reporting Relating to Registration

Information required of registration would be basic information about the person including (1) name and address, (2) registered agent and office, (3) federal employer identification number, (4) name of a contact person who is generally familiar with the affairs of the corporation, (5) description of charitable purposes, and (6) information relating to other registrations in the state. A copy of the record describing the person's charitable purposes and use and administration of charitable assets (e.g., articles of incorporation, bylaws, trust document) would also be required to be submitted with the registration.

Under MPOCCA, the attorney general is directed to maintain a registry of the persons who register. This would serve not only as a resource to the attorney general, but also to the general public who may research charitable organizations prior to making a donation. The comments to MPOCCA contain a form that may be used for registration. States are encouraged to use the same form to ease the burden for persons having to file multiple filings because of multiple state registrations.

Michigan's Supervision of Trustees for Charitable Purposes Act,[26] and the rules thereunder, require that charitable organizations holding property for charitable purposes register with the attorney general and provide annual reports. Michigan's registration requirements are not based on a minimum threshold amount or a minimum contact test. Like MPOCCA, Michigan's registration statute contains exemptions for certain organizations, and namely, certain governmental agencies or subdivisions, religious organiza-

Registration under MPOCCA is generally based on a threshold amount of charitable assets held by the person and particular contact with the state.

tions, corporations organized and operated primarily as educational institutions, including school boosters, and hospitals.[27]

Annual Report

Persons required to register under MPOCCA and holding charitable assets or receiving chartable assets during the fiscal reporting period are required to file an annual report by not later than the later of four months and fifteen days after the end of the accounting period or the date authorized for filing an informational return with the IRS.[28] This would allow an organization that received an extension to file its annual Form 990 to benefit from the extended deadline. Information required of the annual report is duplicative of the information contained in the initial registration, along with some additional information regarding activities for the reporting period. First, the organization must describe its most significant charitable activities during the period. Second, it must indicate whether it engaged in, entered into, or received notice of a variety of transactions or activities, including (1) reportable events under section 6 of the MPOCCA; (2) contracts or transactions with officers, directors, trustees, or fiduciaries, or family members or affiliated entities of those persons; (3) embezzlement, theft, or diversion of charitable assets; (4) payments of an officer, director, trustee, or other fiduciary of the registrant of a penalty, fine, or judgment with respect to the registrant; (5) use of restricted funds for other than their stated purpose; or (6) revocation, modification, or denial of its federal, state, or local charitable tax exemption. Affirmative answers to any of the preceding require an explanatory note. If the registrant is required to file an annual information return with the IRS, a copy of the return must be submitted with the annual report.

Notice Regarding Reportable Events

To avoid situations where the attorney general learns about the loss of charitable assets after the assets have already been disposed of, MPOCCA requires that a person holding charitable assets give the attorney general notice of certain planned events. Notice is intended to allow the attorney general to prevent the use of charitable assets for private purposes. Reportable events would include a dissolution or termination, disposition of all or substantially all of its property, a merger, conversion, or domestication, the removal of the charity or of significant charitable assets from the state, amendment of the record that describes the charitable purposes and use and administration of assets held, and revocation or modification of local, state or federal tax exemptions.[29] If a decedent's estate contains a gift to a charitable organization or creates a new organization through a gift under the will or a revocable trust, the attorney general must also be notified. An exception exists for nonresiduary bequests to a named charitable beneficiary in an amount less than $50,000.[30] Notice to the attorney general is unnecessary where there is a named beneficiary since the beneficiary would have an incentive to monitor the bequest.[31] Finally, notice is also required for certain revocable trusts that become irrevocable because of the settlor's death.[32]

To avoid situations where the attorney general learns about the loss of charitable assets after the assets have already been disposed of, MPOCCA requires that a person holding charitable assets give the attorney general notice of certain planned events.

Michigan's Dissolution of Charitable Purposes Corporations Act[33] requires that nonprofit corporations, foundations, trustee corporations, and other entities organized in Michigan and holding charitable property give notice to the attorney general at least 45 days before the filing of any document in respect of a dissolution.[34] Foreign entities intending to withdraw from the state must similarly give notice.[35] Although the act does not specify so, the Attorney General of Michigan has historically requested that notice be given of mergers, conversions, and withdrawals.[36]

Notice Regarding Action or Proceeding

Similar to the notice of reportable events, Section 7 of MPOCCA requires that the attorney general be notified of certain actions or proceedings held in state or federal courts in Michigan, if commenced by or brought against a "person" in Michigan and involving charitable assets. MPOCCA sets forth a number of actions for which the attorney general must be notified, including relief relating to management, distribution, and use of charitable assets; construction of a record under which a charitable asset is held, modified, reformed, or interpreted; termination of the terms of a record under which a charitable asset is held; or removal, appointment, or replacement of a trustee.[37] An order, decree, or judgment rendered in an action in which notice was not given would not be binding on the attorney general.[38]

For states where the attorney general is a necessary party to an action, section 7 may not be necessary since notice to the attorney general may be covered in other statutes. For instance, under the Michigan Uniform Prudent Management of Institutional Funds Act, except where a donor consents, the attorney general must be notified of a court action to modify a restriction contained in a gift instrument.[39] Similarly, under the Supervision of Trustees for Charitable Purposes Act, the attorney general is a necessary party to all court proceedings to terminate a charitable trust or liquidate or distribute its assets, modify or depart from the objects or purposes of a charitable trust, including any application of the doctrine of cy pres, and construe the provisions of an instrument with respect to a charitable trust.[40] Whenever a petition is filed for probate of a last will and testament containing any residuary bequest or devise to a trustee, or if a will purports to create a charitable trust, notice must be served on the attorney general as well.[41]

Waiver of Filings

MPOCCA would allow the attorney general to waive filings if they are duplicative of requirements under other state statutes—for instance a statute that requires registration to obtain a license to solicit charitable contributions, or if the person is registered in another state under a law substantially similar, in which case, the person could simply provide a copy of that registration.[42]

Fees

It would be up to the state to decide which one of the alternatives proposed by MPOCCA, if any, to adopt—Alternative A would require a registration and an annual reporting fee of $15, as well as a $100 fee for registering or filing a report late. Alternative B would authorize the attorney general to adopt rules for setting fees.[43] The comments to MPOCCA also suggest considering a sliding scale for determining fees, based on gross support and revenue received during the fiscal year.[44]

Miscellaneous

MPOCCA contains a number of miscellaneous provisions that would serve to coordinate the MPOCCA with other statutes and the roles of other officials. First, MPOCCA permits the attorney general to cooperate with other officials of the given state, another state, the United States, or a foreign government, including by providing and requesting information or documents in connection with the official's role in the oversight of charitable assets, and making public the records filed under MPOCCA.[45] MPOCCA would make clear that registration and annual filings constitute public records, but it would authorize the attorney general to retract certain information that the person requests be withheld from public disclosure if it does not relate to a charitable purpose or charitable assets and is not otherwise a public record.[46] Some states' Freedom of Information Acts may already cover records provided under MPOCCA as being public information. Finally, MPOCCA would modify, limit, and supersede the Electronic Signatures in Global and National Commerce Act.

Conclusion

Adoption of MPOCAA would do little to change the oversight of and processes for overseeing charitable assets that already exist in Michigan. It could, however, ease the burden of administering Michigan's multiple charitable protection laws since it would combine the regulations otherwise contained in Michigan's Supervision of Trustees for Charitable Purposes Act and the Dissolution of Charitable Purposes Corporations Act into one act. The more extensive reporting, disclosure, and oversight obligations could also promote better governance among charitable organizations.

Opponents of MPOCAA may view the act as burdensome and redundant to federal reporting requirements or even existing state requirements. Some of this burden may be relieved to the extent that the reporting requirements can be coordinated with existing state statutes. States will also need to consider how to enforce the act and the costs associated with monitoring compliance. Overall, however, the MPOCCA offers guidance and a favorable means for protecting charitable assets. Registration and reporting obligations would provide the attorney general with a resource for monitoring charitable assets, and if reports are easily accessible, provide donors and the general public with a means to verify charitable initiatives. For states that have no charitable protection regulation or oversight, MPOCAA would give regulators, donors, charities, and their advisors a road map and clearer direction with respect to protecting charitable assets.[47] If adopted in substantially similar form in other states, MPOCCA would also provide uniformity and consistency in protecting charitable assets where charitable activities cross state lines.

NOTES

1. *See* page 3 of prefatory note to the Model Protection of Charitable Assets Act at www.nccusl.org.

2. Uniform Supervision of Trustees for Charitable Purpose Act (1954) (available at www.nccusl.org).

3. *See* e.g., Michigan Charitable Organizations and Solicitations Act, MCL 400.271, *et seq*.

4. MCL 450.2101, *et seq*.

5. MCL 14.251, *et seq*.

6. MCL 400.271, *et seq*.

7. MCL 450.251, *et seq*.

8. MCL 451.921, *et seq*.

9. The MPOCCA (2011) with prefatory notes and comments (46 pages) is available at www.nccusl.org.

10. *See* www.nccusl.org.

11. *Id*.

12. MPOCCA 2(1).

13. MPOCCA 2(2).

14. Cmt to MPOCCA 2(2).

15. MPOCCA 2(3).

16. MPOCCA 3.

17. MPOCCA 3(b).

18. http://www.abajournal.com/magazine/article/with_charity_to_all--except_for_scammers_tougher_laws_seek_to_nail_bogus_no.

19. MCL 14.251; MCL 14.254.

20. MCL 14.252.

21. *Id*.

22. See July 11, 2011 Minutes of the Meeting of the Executive Committee of the Uniform Law Commission available at www.nccusl.org.

23. MPOCCA 4.

24. The threshold for filing IRS Form 1023 Application for Recognition of Exempt Status is $5,000. The comments to the MPOCAA suggested $50,000 as the threshold since it would minimize the burdens on smaller organizations and since the $50,000 threshold would correlate with the requirements imposed by the IRS to file information returns (charities with annual gross receipts of $50,000 or less file an on-line postcard called 990-N while charities with receipts greater than that amount file Form 990-EZ, Form 990 or Form 990-PF).

25. Cmt to MPOCCA 4.

26. MCL 14.255.

27. MCL 14.253.

28. MPOCCA 4.

29. MPOCCA 6.

30. *Id*.

31. See cmt to MPOCCA 6.

32. MPOCCA 6.

33. MCL 450.251, *et seq*.

34. MCL 450.251.

35. MCL 450.252.

36. *See* http://www.michigan.gov/ag/0,4534,7-164-17337_18095-45037--,00.html.

37. MPOCAA 7.

38. *Id*.

39. MCL 451.926.

40. MCL 14.254.

41. *Id*.

42. MPOCCA 8.

43. MPOCCA 9.

44. Cmt to MPOCCA 9.

45. MPOCCA 10.

46. MPOCCA 11.

47. *See* http://www.abajournal.com/magazine/article/with_charity_to_all--except_for_scammers_tougher_laws_seek_to_nail_bogus_no; http://www.thenonprofittimes.com/article/detail/protection-of-charitable-assets-act-on-agenda-for-uniform-law-group-3908.

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An Assessment of Risks for Nonprofit Organizations Operating Youth Camp Programs

By Daryl L. Barton and Howard Bunsis

Introduction

Nonprofit organizations often run youth-based camps as part of their mission of community service. The intent is to provide children with programs that differ from a traditional school setting. However, operating a camp program increases a nonprofit's liability risks. Nonprofits need to carefully assess their liability risks in relation to their mission statements.

Traditionally, parents sent their children to camp so they could spend time outdoors, gain independence, and provide the parents with a respite from parenting. Today, many parents view the outdoor experience with suspicion,[1] hover over their children from cradle to high school graduation,[2] demand constant contact with their children via cell phone or computer updates, and are just as likely to attend camp with their children.[3] When a child is injured at camp, parents often seek legal redress. The catch-22 of camp injury litigation is that most nonprofits operate with very little margin. A liability suit could end their camp operations, which in turn diminish nonprofits' opportunities to fulfill their missions. Another concern for providers of recreational activities for children is the Michigan Supreme Court's ruling in *Woodman v Kera LLC*[5] in which the court ruled that a *pre-injury* waiver of liability signed by a parent for a minor child is unenforceable.

A review of the types of liability claims arising from camp operations is helpful when discussing liability issues. For a liability claim to be actionable, the injured party must establish the basic elements of negligence: duty owed, breach of that duty, foreseeability/proximate cause, and actual injury. In general, children are entitled to care in proportion to their inability to foresee danger. Although the duty is one of ordinary care for adults, the standard is higher for children. Also, although the operator of a camp is not an insurer of the child's safety, there is a presumption that the operator will have sufficient personnel on the premises to provide adequate supervision. The lack of qualified staff is often the basis for filing suit against a youth camp. The liability of a nonprofit organization operating a youth camp is determined on the individual circumstances of each case. Camp activities that have been challenged in court fall into two broad categories: organized activities and free-time activities.

Organized Activities

Organized activities include: traditional team sports, horseback riding, and group games such as relay races. Games involving running on wet grassy areas while escaping from opponents have resulted in mixed liability decisions. In *Greaves v Bronx YMCA,*[6] a nine-year-old boy suffered a severe injury to his elbow when he slipped on a sloping grassy area adjacent to a swimming pool while playing a game involving counselors trying to "catch" the campers. The grass was wet as a result of water spilling over from the pool and the counselors had hosed the campers off when they emerged from the pool. At issue was the judgment of the supervising counselors to play the game on a surface that was reasonably foreseeable to add needlessly to the risks of the game itself. This resulted in a judgment for the plaintiff. In contrast, in *Fintzi v New Jersey YMHA-YWHA Camps,*[7] a ten-year-old boy, participating in a relay race on a grass field that was wet with morning humidity and fog, slipped and fell twice. On the second fall, he broke his arm. The court stated that merely allowing children to play on wet grass does not constitute negligent supervision. There was no evidence that the counselors increased the risk associated with the naturally damp field.

One example of a high risk camp activity is horseback riding. In *Cave v Woods,*[8] twelve-year-old Ashley Cave was injured while attending summer camp in Tennessee. She participated in the camp's horseback riding program. The horses were provided by a lo-

cal stable. The stable also provided a release form that Ashley's parents signed. While on a group ride, Ashley's horse came in contact with a tree, pinning her leg between the body of the horse and the tree, resulting in injuries to her knee. Ashley's father filed suit on her behalf. The complaint alleged improperly trained horses and improperly trained counselors and other failures on both the stable and the camp. The court's decision in favor of both defendants was based on the application of the Tennessee Equine Activities Act.[9] In 1992, the Tennessee legislature passed a statute that exempts most horseback riding activities from civil liability. Michigan's legislature has enacted a similar statute.[10] As stated in *Beattie v Mickalich,* [11] the purpose of the Michigan Equine Activity Liability Act (EALA) was to curb litigation against the equine industry and the correlative rising costs of liability insurance, and to stem the exodus of public stable operators from the equine industry.

The liability of a nonprofit organization operating a youth camp is determined on the individual circumstances of each case.

In contrast, in *Giardino v Brown,*[12] Meghann Giardino , an eleven-year-old, was injured while participating in the equestrian program during her first week of Girl Scout camp. The horses for the program were supplied by Bart Brown and Yosemite Equestrian Services. When Meghann attempted to tie her horse to the hitching post, the horse spooked, and her fingers were caught in the rope. Her injuries included the loss of a finger and later amputation of another finger. The camp was aware that the horse assigned to Meghann was head-shy and likely to panic when being tied up. The lower court granted summary judgment to the stable but the Court of Appeals reversed and remanded.

Free-Time Activities

Camps provide children with an opportunity for free, undirected play—something educators agree is missing in the childhood experience today. Free-time activities, however, pose a problem. Parents want their children to be "supervised," but in camp settings there should be time for campers to simply interact and learn to entertain themselves with a friend or organize a game with peers setting their own rules.[13] Although only a small amount of time each camp day is spent in free-time, twenty percent of injuries were reported during free-time.[14] Incidents can occur instantaneously between children. The spontaneous nature of children was recognized in *Murawski v Camp Nageela*.[15] Adam Murawski, a ten-year old boy, went into his cabin to get a baseball mitt. While in the cabin, he had a disagreement with a fellow camper who responded by hitting Adam with a hockey stick, which broke a bone in Adam's hand. The fracture completely healed but Adam's mother filed suit alleging improper supervision. The court's decision noted that in summer camp settings: "constant supervision is neither feasible nor desirable because one of the benefits of such an institution is to inculcate self-reliance in the campers which an overly protective supervision would destroy."[16] Camps, like schools, are not insurers of safety for they cannot reasonably be expected to continuously supervise and control all movements and activities of the campers.[17]

Waivers of Liability; Liability Costs

Nonprofit organizations that engage in offering youth activities should be aware of the Michigan Supreme Court's 2010 ruling that preinjury waivers signed by parents or legal guardians on behalf of minor children are unenforceable.[18] The decision on the facts of the case was unanimous but the reasons for concurring differed greatly. Justices Markman and Corrigan, in their separate opinion, disagreed that preinjury waivers signed by parents or legal guardians are unenforceable in Michigan. Some of the predicted consequences of the ruling are: 1) there will be an increase in recreational and sports-related litigation; 2) recreational providers such as schools, municipalities, and nonprofit organizations will be subject to increased exposure to lawsuits and higher insurance costs, which will lead to either an increase in costs for participants or a reduction in activities offered; and 3) nonprofit recreational providers will experience a drop in volunteers because of their fear of being personally sued if a child is injured.

For attorneys representing injured minors, the *Woodman* decision does not necessarily mean the plaintiff will prevail. The elements of negligence still need to be proved. The unenforceability of waivers for minors does not mean that the standard of care has changed for camps and other recreational activities. It is important to ask some fundamental questions of parents, such as, "If you had been present, could you have prevented the injury?" Risk is part of the growth experi-

ence for children. What message does a lawsuit send to a child about accepting responsibility for his/her actions? Will the result of the lawsuit put the nonprofit out of business? Attorneys should keep in mind that not all injuries have a legal remedy.

Research in the area of nonprofit organizations supports Justices Markham's and Corrigan's concerns about the increased liability costs. In 1991, H.P. Tuckman and C. F. Chang[19] developed a methodology for measuring the financial vulnerability of charitable nonprofit organizations consisting of four factors:

1. Equity Balance (the amount of equity),
2. Revenue Concentration (does the organization have varied sources of revenue),
3. Administrative Costs (if these are high in comparison to program or mission costs, this could indicate potential problems), and
4. Operating Margin ([Total Revenues–Total Expenses)]/Total Revenues).

Using the Tuckman/Chang model, Mark Hager (2001)[20] examined the four elements listed above for healthy and failed arts organizations. Low operating margin was significantly related to the failure of arts operations. The Hager paper analyzed 7,266 arts organizations from 1992 to 1994, and followed these through 1997. Hager found that the surplus margin was only 0.04 (4 percent) for those organizations that survived, versus -0.05 (-5 percent) for the organizations that failed. This demonstrates that even healthy nonprofit organizations have small margins, and that an additional $100,000 for insurance costs could turn a $1 million nonprofit organization from one that is solvent to one that is insolvent.

Trussel, Greenlee, and Brady(2002)[21] examined 7,082 nonprofits using IRS form 990 data and found that the average surplus margin for all 7,082 organizations was 0.0649 (6.49 percent). Thus, if liability insurance is more than 6.5 percent of total revenues, a nonprofit organization would go from being in the black to being in the red.

The following charts are useful in comparing three nonprofit groups that are engaged in offering camping programs for youth. Nonprofit A is a large organization with multiple camping interests and Nonprofits B & C are medium-sized camping operations.

An example of the potential effect of the addition of liability insurance can be seen with an analysis of the 2007-2009 IRS form 990 of Nonprofit A:[22]

NON-PROFIT A	2007	2008	2009	2007	2008	2009
Total Revenues	$1,356,349	$1,341,355	$1,283,006	100.0%	100.0%	100.0%
Salaries and Wages	$141,046	$175,301	$157,806	10.4%	13.1%	12.3%
Camping Services	$913,977	$885,056	$888,226	67.4%	66.0%	69.2%
Programs	$92,551	$88,724	$101,012	6.8%	6.6%	7.9%
All Other Expenses	$210,202	$196,415	$198,944			
Total Expenses	$1,357,776	$1,345,496	$1,345,988	100.1%	100.3%	104.9%
Surplus Margin	($1,427)	($4,141)	($62,982)	-0.1%	-0.3%	-4.9%

Nonprofit organizations that engage in offering youth activities should be aware of the Michigan Supreme Court's 2010 ruling that preinjury waivers signed by parents or legal guardians on behalf of minor children are unenforceable.

Although Nonprofit A has large revenues (over 1 million), Nonprofit A had a negative surplus margin each year. Any additional insurance costs would further drive this organization into a position of having to cut program services or borrow money.

Applying the same IRS form 990 analysis to two other nonprofit youth camps in Michigan, one can see that these organizations are also operating with low to negative margins.

NON-PROFIT B[23]	2007	2008	2009	2007	2008	2009
Total Revenues	$591,818	$534,957	$487,188	100.0%	100.0%	100.0%
Salaries and Wages	$326,072	$278,638	$228,314	55.1%	52.1%	46.9%
Other Expenses	$296,548	$243,389	$264,505	50.1%	45.5%	54.3%
Total Expenses	$622,620	$522,027	$492,819	105.2%	97.6%	101.2%
Surplus Margin	($30,802)	$12,930	($5,631)	-5.0%	2.4%	-1.2%

NON-PROFIT C[24]	2007	2008	2009	2007	2008	2009
Total Revenues	$617,107	$626,761	$511,688	103.1%	117.2%	105.0%
Salaries and Wages	$230,168	$254,451	$162,907	38.4%	47.6%	33.4%
Other Expenses	$458,240	$444,926	$359,688	76.5	83.2	73.8
Total Expenses	$688,408	$699,377	$522,595	115.0%	130.7%	107.3%
Surplus Margin	($71,301)	($72,616)	($10,927)	-11.9%	-13.6%	-2.2%

As with Nonprofit A, Nonprofit B has very thin margins. It lost money in 2007 and 2009, and the positive margin in 2008 was very slim. Nonprofit C had a loss in all three years. Therefore, any additional expense would be very problematic for the ability of these nonprofits to provide services. One should take note that all of these nonprofit organizations reduced salary costs in 2009, which was likely the result of layoffs and cuts in staff pay. Given the current economic conditions, nonprofit organizations cannot risk taking on additional nonmission-related costs.

Recommendations

Attorneys representing nonprofit organizations should review:

1. with the organization's leaders the types of liability claims that might occur as a result of operating a camp for youth.
2. the camp training manual for staff to make sure that statements of safety policies are clearly explained and established procedures are followed.
3. first aid logs to determine any pattern of injuries and develop a plan to reduce the risk of injury.

The likelihood of a camper being injured enough to impact his/her camp experience is very low (0.46 incidents per 1000 camp days),[25] but one incident without adequate insurance protection has the potential to cause the nonprofit organization to fail. Finally, attorneys representing nonprofit organizations with youth camp programs should review the organization's liability insurance coverage for both the limits of liability and the coverage of attorneys fees.

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10. MCL 691.1661 *et seq*.

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Lawyers and the Economy: Greasing the Gears of Commerce

By Douglas L. Toering[1]

Introduction

Do lawyers promote commerce? Do they contribute to their communities? Are there abuses and delays in the legal system? Overall, do lawyers have a positive effect on our daily lives? The answers are: Yes, Yes, Yes, and Yes (not necessarily in that order). So lawyers are, indeed, "economic drivers." How do they do this?

Specifically, we will see the following:

1. Lawyers contribute to the American economy.
2. Lawyers are necessary for commerce. Here, we will see the many areas where lawyers are needed and how without them, commerce in our complex society would slowly grind to a halt.
3. Lawyers contribute to their communities through volunteer work at thousands of nonprofits nationwide.
4. Lawyers help make the law more accessible to ordinary people.
5. Lawyers promote justice, which helps lead to a civil society.

Before we begin, please allow one caveat. Are there exceptions to the five propositions above? Of course. Like members of any profession or trade, some lawyers occasionally do not add value: they make agreements unnecessarily complex (that is changing, with the emphasis on plain English in contracts), file bogus lawsuits, or raise frivolous defenses to lawsuits when they should have encouraged settlement right away. But those are the exceptions. Here is why.

Lawyers Contribute to the American Economy

Lawyers Create Jobs

Although the focus of this article is not to quantify the macroeconomic effect of lawyers, it is still helpful to keep in mind that lawyers and law firms create jobs. How?

The typical argument against lawyers is that lawyers cost the U.S. economy billions of dollars every year. But what exactly does "cost the economy" mean? Does the money that a married couple pays to their lawyer for an estate plan or that a corporation pays to its in-house counsel for securities compliance simply vanish? Or is that money pumped back into the local and national economy?

Take a law firm, for example. True, some solo attorneys have no staff, but the majority of attorneys practice in firms that employ secretaries, legal assistants (paralegals), or clerical personnel such as office administrators, information technology experts, and office custodians. Who pays the staff? The law firm does. Both the attorneys and their secretaries, paralegals, and other staff members then spend what they earn on house payments, cars, appliances, furniture, entertainment, utilities, and the like.

Moreover, lawyers provide indirect jobs. They lease offices, purchase computers, rent copiers, buy office supplies, have lunch with colleagues at restaurants, and travel out of state to meet with clients. If somehow we could eliminate the need for most lawyers, how many office buildings would go largely vacant (with the property owners filing bankruptcy)? How many office supply stores would disappear? And what about restaurants and the companies that lease copiers or printers? What would happen to them?

Drive through any city's downtown. Imagine the number of vacant office buildings and restaurants that would close without the legal business. Many lawyers still entertain clients by taking them golfing or to the baseball game. Would the country clubs or the ballparks close? No, but they would suffer.

Let's use specific examples. With lawyers purchasing hundreds of thousands of computers every year, how much do lawyers add to the bottom line of, say, Apple, Dell, Hewlett Packard, and Microsoft? Given that virtually every law office has a printer-copier, how much do lawyers add to the revenue of Xerox, Ricoh, and Canon? And how many billions of dollars do law firms pay in rent to commercial real estate owners every year?

As inefficient as litigation is—and it is, which is why lawyers often recommend either settlement or alternate dispute resolution instead—lawsuits also provide jobs. How could that possibly be? Court reporters and expert witnesses (accountants, economists, engineers, physicians) are examples of people who earn money when a lawsuit is filed. If the suit is settled by one party paying money to the other, the one who receives the money spends it. Depending on the nature of the payment, the recipient may also pay taxes on it. Of course, the money could be spent elsewhere. But either way, it is spent (or maybe invested).

Do lawyers "cost the economy" money? Sure they do, but so do environmental engineers and accountants. But we value a clean environment as well as accuracy and honesty in financial statements. Justice and the rule of law have value, too. Which leads us to the next subject. But not just yet. There is another major way lawyers contribute to the economy: by paying taxes.

Lawyers (and Their Staff, Their Landlords, and Their Vendors) Pay Taxes

Lawyers Pay Income Taxes

Whatever lawyers are paid, they generally pay 40 percent in taxes, more in some circumstances. Assume the average lawyer earns $100,000. Self-employment tax (Social Security, Medicare) alone totals $13,300 at 2012's reduced rate. Then subtract federal and state income taxes. In addition, many lawyers work in large cities so they also pay city income taxes. Now, $100,000 becomes $60,000, or less in high-tax states. The rest goes to the government. But there's more.

Lawyers Pay Property Taxes

Whether at home or at the office, lawyers pay property taxes. As homeowners, they pay property taxes. Or, if they rent apartments, their landlord pays property taxes, which the lawyers (as renters) indirectly pay. Likewise, the building owners where lawyers work pay property taxes; again, lawyers (as tenants) pay the property taxes, either directly or through their landlords.

But there's still more. Many cities levy a personal property tax, which is a tax on office equipment, furniture, and the like. Lawyers pay that tax, too. Personal property tax is, of course, typically a tax on business. Homeowners generally do not pay tax on the value of their appliances and furniture.

Lawyers Help Reduce the Trade Deficit

Foreign companies manufacture and sell products in the United States. Examples are all around us: Toyota's truck plant in Texas, Hyundai's facility in Alabama, Nissan's North American headquarters in Tennessee, or Robert Bosch's offices in Michigan. When foreign companies want to build factories or construct office buildings in the U.S., they need to buy land and build on it. They need real estate and environmental lawyers, just as American companies do.

Eventually, foreign companies may get sued in the U.S., even if their products are made overseas[2]—so they retain U.S. attorneys to represent them. Their U.S. affiliates hire employees—those companies need employment lawyers to advise them on U.S. law. The U.S. affiliates, in turn, buy from their U.S. suppliers—they need attorneys who understand the Uniform Commercial Code (UCC). The U.S. affiliates also decide how to price their products—they need attorneys to advise them on antitrust laws.

So whether their need is to build a plant or to defend a lawsuit, foreign corporations need U.S. lawyers—who, in turn, are paid in U.S. dollars. So companies based in Japan or South Korea that locate on American soil pay American lawyers in American dollars. That reduces the trade deficit.

Lawyers Are Necessary If Commerce Is to Function

Lawyers Help the Economy Operate Efficiently

Lawyers promote efficiency in at least three ways.

First is specialization of labor. It is simply more efficient for professionals trained in the law to analyze statutes and regulations (and the court cases interpreting them) than for business owners to do it. Businesses, whether publicly-traded or privately-held, exist to provide a return for their owners. Companies do not earn money when their executives are busy trying to figure out "What in the world do these 1,200 pages of government regulations mean to our company?" Their time is far better spent designing, manufacturing, and selling products. Then leave the accounting to the CPAs and the legal issues to the lawyers. Rightfully so.

Second is certainty. The vast majority of commerce goes on without lawyers. After all, many routine contracts have been prepared

by attorneys and those contracts have stood the test of time; plus, people know that lawyers are available to sue if a party breaches. How often does a lawyer get involved in drafting a purchase order, car note, residential mortgage, or even a commercial lease? Seldom.

Indeed, over the years, most businesses have developed "form" purchase orders, requests for proposals, and so forth. Because those forms have been developed over time with the help of lawyers, and because businesses know generally what is in the forms, lawyers rarely get involved in the everyday purchase of goods. True, disputes occur. That's where Article 2 of the UCC comes in. But for every dispute taken to a lawyer, thousands of transactions proceed apace—no help from lawyers is needed, but thank you very much anyway.

Most people, whether individuals or business owners, want to obey the law. Lawyers help them do that.

Third is avoidance of litigation. By seeking legal advice early, businesses avoid expensive litigation later. Whether it be issues involving contracts, employment, or compliance with healthcare laws, lawyers help keep clients out of court.

By seeking legal advice early, businesses avoid expensive litigation later.

Laws Require Lawyers—Regulations Require More Lawyers—Complex Regulations Require Even More Lawyers

Is the problem lawyers themselves, or is it the hundreds of thousands of laws and regulations we have—and how complicated they are? Take a few examples. The statutory text alone of Dodd Frank is 849 pages (regulations to follow). (Some count the law at over 2,000 pages.) Banking attorneys must advise their financial clients how to comply. The statutory text alone of the Patient Protection and Affordable Care Act is 907 pages (plus regulations).[3] (Again, some count the law at well over 2,000 pages.) That is one reason we need healthcare lawyers. The Stark regulations are another example.

Take a few other examples. Is the problem with healthcare the doctors, or is it the illnesses we have? Come April 15, is the problem the CPAs, or is it the complicated tax code? (The Internal Revenue Code has countless thousands of pages, not to mention Revenue Rulings, Revenue Procedures, Private Letter Rulings, and so forth.) Is the problem with the air and water the environmental engineers and chemists themselves, or is it that we want a clean environment? Is the problem in our neighborhoods the police officers, or is it that we want to be protected from criminals? Are pharmaceutical companies the problem, or is it that we want ever-more effective medicines? Are insurance companies the problem, or is it that we get into car accidents, get disabled, or need healthcare?

Are the laws and regulations on the books wise? That is a political question. It is resolved in debates in Congress, deliberations at the Department of Health and Human Services or the Internal Revenue Service, or in discussions at each of the fifty state capitols. The fact is that the law, like our society, is complex. Hence, the need for lawyers.

But isn't it true that most legislators are lawyers? Probably. But those working in government agencies that adopt the regulations typically are not lawyers, unless those agencies involve law enforcement. Anyway, if their constituents don't like the laws the legislators pass, there is a solution: Vote them out of office! At the state level, lawyers do not get into politics for the money; most can earn more in private practice. That is probably true at the federal level also, although U.S. senators and representatives earn far more than state legislators do.

The fact remains that laws are complex, regulations much more so. Thus, it is no surprise that businesses need lawyers to advise them on what these laws and regulations mean and how they can comply with them.

To illustrate how our laws and our lives create the need for legal advice, let us briefly consider some of the many areas where lawyers get involved.

1. *Federal law enforcement*. Drug interdiction, child pornography, healthcare fraud. These are a few reasons why we need U.S. attorneys (federal prosecutors).
2. *Local law enforcement*. Robbery, rape, murder. We need county prosecutors or district attorneys to put dangerous criminals behind bars.
3. *Criminal defense*. For due process to occur, each person charged with a crime—whether wealthy, poor, or middle class; whether a shoplifter, the son of an executive arrested for drunken driving, or a drug dealer—is considered innocent until proven guilty beyond a reasonable doubt.

Those whose freedom is at stake deserve an attorney under the Sixth Amendment. That includes the poor. That is why public defenders are paid out of public funds.

4. *Military*. Law is important in the military, just as it is in civil life. Hence the need for the Judge Advocate General.
5. *Residential real estate*. Before vacant land can be converted to a subdivision, the developer needs to consult an attorney.
6. *Banking*. Dodd Frank is just one of the federal statutes applying to financial institutions.
7. *Immigration*. Is this important? Ask the many high tech companies that need to hire engineers from foreign countries because they cannot find enough qualified workers in the United States.
8. *Sale of manufactured goods*. Issues like purchase orders and UCC 2-207 come to mind. Still, the vast majority of commercial transactions occur with nary a lawyer anywhere.
9. *Infrastructure: buildings, roads, bridges*. Architects, engineers, and lawyers are all needed. For example, the government sometimes acquires land through eminent domain. Homeowners sometimes oppose this or contest the value of the property. They cannot fight the city or the state on their own; they need lawyers.
10. *Community organizations*. Whether it is the United Way, a soup kitchen, or a rescue mission, lawyers are typically involved. Sometimes it is rolling up their sleeves and serving stew at a soup kitchen; other times it is serving on the board of directors. In either case, the lawyers often donate both their time and their money. Likewise, many houses of worship (churches, synagogues, mosques) have lawyers giving them free legal counsel.
11. *Lawyers and the arts*. The symphony or the art museum probably has a lawyer on its board.
12. *Constitution*. Is free speech important? Corporations and labor unions have free speech rights. Would they have the same rights, if lawyers had not taken this issue all the way to the United States Supreme Court?[4] Speaking of the First Amendment, what happens when the free exercise of religion conflicts with anti-discrimination laws? Attorneys for a church and school fought the Equal Employment Opportunity Commission on this, all the way to the Supreme Court. The EEOC lost, 9-0.[5] Without lawyers, where would David have been in that battle with Goliath? Elsewhere, the Fifth Amendment right that property may not be taken for public use without just compensation is also important. What that means was also litigated all the way to the Supreme Court.[6]
13. *International human rights*. After the fall of communism, the former Soviet states needed to establish a new system of justice. Attorneys from the United States, often volunteers, came to help. Today, organizations like Advocates International are still involved in protecting human rights, religious freedom, and the rule of law in those nations as well as in countries in Africa and Asia.
14. *Exporting*. When exporting goods overseas, companies must know whether U.S. law restricts their activities. Is our company allowed to export to that country? If so, what restrictions apply? One little-known but important example is ITAR, the International Trafficking in Arms Regulations. Penalties for violators include stiff fines plus prison for individuals.
15. *Importing*. Companies that locate in America need attorneys in America. Those transplants need to hire lawyers. That, as we discussed above, helps to reduce the deficit and to assure that foreign companies comply with U.S. laws.
16. *Healthcare*. Federal regulations involving healthcare, Medicare, and Medicaid get more complex by the day.
17. *Privacy*. Federal law and laws of many states regulate how businesses may use personal information from their customers, and what they must do in the event of a data

[F]or virtually every nonprofit of any size, there is a lawyer providing advice (usually free).

security breach. Lawyers help businesses comply.

18. *Birth: Adoption*. Most states allow private adoptions. In addition, many couples adopt children from foreign countries. Lawyers help assure that this is done right. That protects everyone involved, including the children.
19. *Life: Marriage and family*. Paternity, divorce, and child support are some of the messy issues that family lawyers deal with every day. For second marriages, sometimes one party wants a prenuptial agreement.
20. *Life: Retirement: estate planning and elder law*. People want to make sure what they own goes to those they love or to the charity of their choice. Wealthier individuals want to know how they can legally avoid federal estate tax. None of this can be done without wise estate planning. Perhaps the hottest issue facing elder law attorneys today is a sad one: elder abuse—unscrupulous children and stepchildren using mom's power of attorney to help themselves to mom's money.[7]
21. *Death: Probate*. The probate courts and lawyers help assure that the deceased's desires are carried out and that creditors are paid.
22. *Environment.* Whether water pollution laws or emissions regulations for cars and manufacturing plants, businesses must make sure they comply with environmental laws.
23. *Technology.* As everyone struggles to keep abreast of today's technology, lawyers help their clients do the same. The latest challenges? The Internet, nanotechnology, and identity theft are a few.
24. *Social media.* Still in its infancy, social media can be quite creative. Who knows what legal issues social media will create over the next five years? Here are two of them. What is an appropriate social media policy for an employer? When may an employer fire an employee for comments made on Facebook or other social media? The National Labor Relations Board is active on both fronts.[8]
25. *Intellectual property.* Protecting U.S. patents is critical if the United States is to encourage innovation. Yet, inventions that don't qualify for patent protection shouldn't receive it. Either way, lawyers (usually with engineering degrees) are often needed. Similarly, companies must protect their trade secrets. And when an employee or a competitor steals company technology, the company needs an attorney immediately.
26. *Small businesses generally.* Just because a business is small does not mean it does not have a host of legal issues, such as employment, securities, succession planning, and taxes. The corporate counsel and the accountant help the business comply. Other issues include drafting articles of incorporation or organization, bylaws or operating agreements, shareholder agreements, and the like.
27. *Labor and employment.* Take collective bargaining agreements for example. Negotiating and drafting the agreements require cooperation of business people, union representatives, and lawyers. Moreover, employers are subject to a variety of anti-discrimination regulations; these include the Americans with Disability Act, Age Discrimination in Employment Act, Family Medical Leave Act, and other laws dealing with civil rights and whistleblowers.
28. *Foreclosures.* Banks hire attorneys to foreclose on real estate, whether the house next door, the hardware store down the street, or the apartment building downtown.
29. *State government.* The governor, the legislature, and the administrative agencies need attorneys to help them draft laws and regulations. The state attorney general is in charge of enforcing them.
30. *Federal government.* Where to start? The Securities and Exchange Commission, Equal Employment Opportunity Commission, the Department of Health and Human Services, and Internal Revenue Service all need lawyers to assist in drafting

regulations.

31. *Education.* School boards across the country face issues like IDEA (Individuals with Disabilities in Education Act). Or at the college level, issues like Title IX require compliance. And here is a fairly new activity for attorneys: representing universities in NCAA investigations.
32. *Debt collection.* Debt collection agencies hire lawyers to help them collect debts and to assure they comply with the Fair Debt Collection Practices Act. Banks sue credit card holders when they do not pay their bills. That is keeping a number of lawyers busy.
33. *Bankruptcy.* Whether it's chapter 7, 11, or 13, lawyers help individuals and companies in a reorganization or liquidation. How many American icons—General Motors, United Airlines, Kmart—have stayed alive due to a chapter 11 reorganization?
34. *Tax.* Where to begin? Federal estate tax, federal gift tax, challenges to property tax assessments. These often require advice of lawyers or accountants.
35. *Publishing.* Copyright protection is one legal issue that immediately springs to mind. Freedom of the press is another one. Newspapers that want to find out what is really going on at city hall often file freedom of information act requests (FOIA). Occasionally, the city does not comply. The newspaper has to hire a lawyer to file suit under FOIA or an open meetings act.
36. *Business torts.* Violation of noncompete agreements, unfair competition, and intentional interference with a contract are just a few causes of action here.
37. *Franchises.* Take a drive on any interstate. Virtually every exit is populated with franchises, from fast food restaurants to gas stations.
38. *Entertainment.* Whether it's radio, network television, cable television, or NFL football, legal issues abound.
39. *Public benefits.* Occasionally, people don't receive what they are entitled to under law, whether it is social security disability or unemployment compensation. Lawyers are sometimes required. Some work for law firms, other for legal aid agencies.
40. *Transportation.* The airlines need advice on Federal Aviation Administration regulations. Local transportation authorities face legal issues involving their buses, trains, or subways. Trucking companies must comply with regulations from the Federal Motor Carrier Safety Administration.
41. *Personal Injury.* People are injured due to the negligence of others. Automobile accidents are one example. The banker who was maimed by a drunk driver deserves damages. But sometimes there was no real injury or it wasn't the other party's fault, so that party should not have to pay. Most of the time, these issues are resolved directly between the individual and the insurance company. Sometimes not, and a lawsuit ensues. That is when the injured person hires a lawyer, and so does the defendant.
42. *Workplace safety.* As a culture, we have decided that protecting worker safety is important. Knowing what those regulations are and how to comply sometimes requires legal advice. Or when a worker is hurt on the job, lawyers are occasionally needed to resolve the worker compensation claim.
43. *Product safety regulations and consumer law.* From Federal Motor Vehicle Safety Standards to Consumer Product Safety Commission regulations to product recalls, lawyers work to assure that their clients comply. Sometimes products don't perform as warranted. Usually, this gets resolved directly between the manufacturer and the consumer. In the few cases it does not, the customer sues under the lemon law or deceptive trade practices act. Both the consumer and the manufacturer need to retain counsel.
44. *Medical malpractice.* On rare occasions doctors err; they are human. When they do, their patients are entitled to compensation. Are frivolous suits filed? Sure, just as patients, for whatever reason,

sometimes don't sue when actual malpractice did occur. If there has been abuse, this has been remedied in many states, which have adopted stringent requirements such as pre-suit notice, affidavits of merit (which must be signed by a physician in the same specialty as the defendant), or caps on damages.

45. *Pharmaceuticals.* What does it take to get approval for a medicine from the U.S. Food and Drug Administration? The process can be long and expensive, but scientists and lawyers work together to obtain this for their employers or clients.
46. *Energy.* Whether it's drafting oil and gas leases or making sure that an oil company complies with complex environmental or import regulations, lawyers are a must.
47. *Water.* This is not a major issue in Midwestern states, but it is a huge issue in the western United States. Who owns the legal rights to the water?
48. *Nonprofits.* From 501(c)(3) issues to unrelated business income to executive compensation, lawyers help nonprofits. They often provide their advice free.
49. *Insurance.* Healthcare, life, disability, auto. Each one has legal issues all its own, from federal regulations on healthcare insurers to state rules on life, disability, auto, fire, and casualty insurance.
50. *Election law.* Remember Election Day 2008?

Yes, lawyers get involved in all kinds of activities. By doing so, they help businesses comply with laws and regulations; they also represent individuals when they face (or want to avoid) legal problems. We could reduce the need for lawyers by, say, repealing environmental laws or anti-discrimination laws. That is unlikely, but it is a question for Congress. Most people want a clean environment; the question is how to accomplish this without unduly restricting growth. Likewise, most agree that employees should not be fired simply because they turn 50.

To the degree frivolous suits have been a problem, many states have enacted tort reform (called "tort deform" by its opponents). Federal judges may hit attorneys with sanctions under Rule 11 of the Federal Rules of Civil Procedure. State judges typically have a similar weapon in their arsenal.

Of course, behind every lawsuit a lawyer files is a client. *No one forces anyone to hire a lawyer.* Suppose the attorney is not properly representing the client. What to do? The answer is simple: fire the lawyer. Virtually every attorney, who has been in private practice for any length of time, knows what it is like to be fired. A client may fire a lawyer for any reason, or for no reason at all. Or if ethical issues are involved, the client may file a grievance or a malpractice suit. In Michigan, forms to grieve a lawyer are available online.

The Legal System Needs Improvement, Or, the Law Has Flaws

All that said, are there still faults in the legal system? Absolutely. Lack of access to civil justice for the poor and middle class, underpaid and overworked public defenders, and the occasional runaway jury verdict are examples. Regarding the last, the big verdict gets page one publicity. But for some reason when the court of appeals reverses or reduces the verdict, the article appears on page B17. Curious. Anyway, tort reform efforts are correcting abuses, whether actual or perceived.

Are some laws unfair? Yes. Are some laws and regulations overly burdensome on business? Yes. But these are issues for the legislature and the regulatory agencies to work through. Meantime, companies need to comply. For that, they need accountants, engineers, scientists, and lawyers.

Lawyers Contribute to Their Communities Through Volunteer Work at Thousands of Nonprofits Nationwide

Space does not permit me to detail the ways lawyers help improve their communities. But for virtually every nonprofit of any size, there is a lawyer providing advice (usually free). Try finding a YMCA, homeless shelter, or local Salvation Army that does not have an attorney on the board or giving free advice, ditto for the opera or the nearby liberal arts college.

It may be that some lawyers volunteer their time at nonprofits in the hope of somehow getting clients. If that is why they serve, they will probably be disappointed! Regardless of the reason, thousands of nonprofits across America receive free advice from lawyers.

Indeed, lawyers provide legal aid to the poor, to abused women, to homeowners who are having their utilities shut off, to tenants being evicted from their homes, to single mothers needing child support for their children, to…you get the idea.[9]

Today, the poor are all around us. They are our neighbors—the family across the street where dad is disabled and mom just lost her job. They are our co-workers—or they were, before they were laid off. These are the "new poor"—formerly middle class (or, in some cases, upper-middle class) people who are now indigent. Legal aid agencies, which have been underfunded for years, cannot handle the demand. Accordingly, some of the poor simply can't get representation. For thousands of such people, private attorneys step in to represent them for free.

But that's not all. Law schools often operate free clinics. The issues range from family law to immigration, from advising startup businesses to helping veterans and seniors. Those are just some of the issues with which the law schools in Michigan are involved. One law school even operates a mobile law office, so the law students and the supervising lawyer go where the people are.

What is all this worth? It is difficult to calculate, but a conservative estimate of the value of the pro bono time lawyers provide annually is in the ten-figure range.

Let's take a couple of specific examples. In the Detroit area, volunteer attorneys provide advice-and-referral legal aid to about 200 people per year and briefly field about 500 telephone calls per year. The budget for this faith-based organization is $18 per week.[10] Another Michigan attorney built his private law practice around doing pro bono work.[11]

But that's not all. Like everyone else, attorneys volunteer for community work, work that has nothing to do with the practice of law. That may involve cleaning up a park, helping to organize a Memorial Day parade, or coaching girls' soccer.

Lawyers Help Make the Law Accessible to Laypeople

Here is where lawyers are working to put themselves out of a job. In Michigan for example, routine court forms (probate, family law, debt collection, and others) are available online—free.[12] An aspiring business owner can obtain forms for articles of incorporation or articles of organization online—no lawyer needed.[13] Does a young couple need a will? If they can't afford one, a statutory will is available online—free.[14]

Of course, it is better to consult an attorney rather than to use free forms online. But for people who cannot otherwise afford a lawyer, the online forms may be helpful. In addition, many attorneys provide free information or updates on the law on their websites and blogs.

In the same vein, legal aid organizations sponsor seminars to low-income people on issues ranging from elder abuse to consumer fraud. Lawyers in private firms often volunteer their time to assist in those seminars.

Lawyers Promote Justice, Which Leads to a Civil Society

In addition to the fifty categories above, one more area must be discussed: justice. Without lawyers, we will not have justice.

Laws are important. But without lawyers to vindicate an individual's rights (or the rights of a corporation or a labor union or a nonprofit), we would be forced to rely entirely on voluntary compliance. Or we could rely on the government to enforce the laws, as the government sees fit. What a choice.

True, the United States has more lawyers per capita than, say, countries in Western Europe. What does that prove? We also have more cars per capita, larger houses, and more big-box stores than Western European countries. America also has more lawyers than the totalitarian countries.

But suppose it is true that overall "lawyers cost the economy" a certain amount of money every year. What is the dollar value of justice in America? What is the rule of law worth? We cannot quantify this, of course. But asking some questions may help:

1. What is the value to ordinary people, who know that they are equal under the law with the wealthy and powerful? What is the value to large corporations and insurance companies to know that they, too, will be treated fairly and that the jury may not base its verdict on sympathy?
2. What is the value to a woman who knows she cannot be asked for sexual favors to get promoted, and that if she does, she can sue?
3. What about the 53-year-old man, who never got an interview, but a less qualified 32-year-old got the job? How much is it worth for him to know he has recourse under the ADEA? What is it worth to a per-

son of color to know that he can hire a lawyer if he is discriminated against due to his race?

4. What about the businesswoman's daughter who is arrested for minor in possession of alcohol? Might she want her daughter to have access to a lawyer?
5. Or what about the company that finds federal agents at its door, ready to haul off computers and file cabinets of documents? What is the first thing the CEO does? Call the company lawyer.
6. What is the value to the parents of a special needs girl, who know that if need be, their attorney can meet with the school board to explain the requirements under IDEA?
7. What is it worth to a wealthy couple, to know that the trusts their lawyer drafted will be enforced and that their assets will go to the ones they choose?
8. What is it worth to a local soup kitchen to know that it has a lawyer on the board, who will provide legal advice on 501(c)(3) issues?
9. What is it worth to a corporation to be able to hire a lawyer and 24 hours later file suit for an injunction against a dishonest employee who swiped the company's hard drive complete with product plans, customer lists, and financial data?
10. What is a sheepskin worth for the college senior who was arrested for hacking the university's computers, but later released when his lawyer investigated and showed the prosecutor that the culprit was the student's roommate instead? The student now graduates *cum laude*. Or what is freedom worth for the business executive, who could have been jailed for years, had her attorney not warned her that the product her company wanted to sell overseas would violate the International Trafficking in Arms Regulations?

Conclusion

Lawyers do, in fact, contribute mightily to the American economy—by providing direct employment (secretaries, legal assistants, office administrators); by providing indirect jobs (helping keep office supply shops, computer companies, restaurants, and commercial real estate landlords in business); by spending money in their communities; and by paying taxes (federal, state, and local income taxes plus real estate and personal property taxes). And try to find a nonprofit of any size that doesn't have a lawyer—whose time is likewise "non-profit"—on its board of directors.

Even more importantly, lawyers help people, businesses, and nonprofits obey the law. They allow people to release their creative energies for making products and providing needed services, rather than by trying to keep abreast of the statutes and regulations that become more complex (and more voluminous) all the time.

Moreover, lawyers help assure equal justice under the law. Individuals, corporations, the federal government: they are all equal in a courtroom.

Without lawyers, the First Amendment would be fiction, and laws would be license for the wealthy and powerful (and who is more wealthy and powerful than the federal government?) to do whatever they want.

Murphy's Law has not been repealed.

You don't need a lawyer. Until you do.

NOTES

1. With minor modifications, this article originally appeared in Nelson P. Miller *et al.*, eds., *Lawyers as Economic Drivers: The Business Case for Legal Services* (2012).

2. This assumes, of course, that the plaintiffs can obtain personal jurisdiction.

3. The constitutionality of the Patient Protection and Affordable Care Act was decided by the United States Supreme Court in *National Fed'n of Indep Bus v Sebelius,* ___US___, 132 S Ct 1958 (2012); *Health & Human Servs v Florida,* No 11-398, 2012 US LEXIS 3099 (Apr 16, 2012); and *Florida v Health & Human Servs,* No 11-400, 2012 US LEXIS 2942 (Apr 16, 2012). Lawyers for the United States defended the law; lawyers for those challenging its constitutionality attacked the law.

4. *Citizens United v Federal Election Comm'n,* 558 US 50 (2010).

5. *Hosana-Tabor Evangelical Church & Sch v Equal Employment Opportunity Comm'n*, ___US___, 132 S Ct 694 (2012).

6. *Kelo v City of New London*, 545 US 469 (2005).

7. Mickey Rooney's case is perhaps the best known example. On March 2, 2011, the actor, then age 90, testified before Congress that he was the victim of financial elder abuse by a family member. http://newsfeed.time.com/2011/03/03/mickey-rooney-testifies-before-congress-on-elder-abuse-urges-others-to-speak-out/. The title of a recent study states the problem: *Under the Radar: New York State Elder Abuse Prevalence Study: Self Reported Prevalence and Documented Case Surveys Final Report*

(May 2011), www.lifespan-roch.org/documents/UndertheRadar051211.pdf.

8. See, *e.g., New Year Brings New Guidance from NLRB on Employees and Social Media*, www.wassom.com (2/7/12).

9. Examples of some of the things lawyers do for their communities may be found at the State Bar of Michigan website. See http://www.michbar.org/alawyerhelps/.

10. The $18 per week figure is not a typographical error. The organization is Christian Legal Aid of Southeast Michigan. Its motto comes from the Hebrew prophet Micah, in chapter 6, verse 8 of his Old Testament book.

11. See Dean Nelson P. Miller's upcoming book, *Building a Practice with Pro Bono*, which is expected to be published by ALI-CLE in 2012.

12. The forms are available through the Michigan State Court Administrative Office. *See* http://courts.michigan.gov/scao/courtforms/#forms.

13. In Michigan, these forms and a wide variety of other information for businesses may be found at http://www.michigan.gov/lara.

14. In Michigan, one may obtain a statutory will and a patient advocate (power of attorney for healthcare) at www.legislature.mi.gov/documents/publications/peaceofmind.pdf.

Before becoming a principal at Toering Law Firm PLLC, Douglas Toering practiced as in-house counsel for General Motors Corporation and later as a partner in Bowman and Brooke LLP and as a principal at Grassi & Toering, PLC. His practice emphasizes commercial, insurance, and probate litigation along with corporate transactional matters. In addition, Mr. Toering is a member of the Council for the Business Law Section of the State Bar of Michigan, where he chairs the Small Business Forum and the Law Schools Committee. He also serves as a volunteer director of the Christian Legal Aid of Southeast Michigan.

Case Digests

Tortious Interference with a Business Expectancy—Bidding on Construction Project

Cedroni Assocs, Inc v Tomblinson, Harburn Assocs, Architects & Planners, Inc, No 142339, 2012 Mich LEXIS 1221 (July 27, 2012). A public school district entered into a contract with defendant for architectural services regarding a construction project. As part of its contract, defendant agreed to assist the school district with the bid selection process, in part by evaluating bids submitted by contractors and making a recommendation as to which contractor should be awarded the project. Defendant recommended that the school district award the project to the second-lowest bidder. Plaintiff, the contractor that submitted the lowest bid, sued defendant for tortious interference with a business expectancy. The trial court granted defendant's motion for summary disposition, concluding that plaintiff did not have a valid business expectancy, but the court of appeals reversed, holding that a genuine issue of material fact existed.

The Michigan Supreme Court reversed the court of appeals, ruling that because the school district's fiscal management policy provided that contracts would be awarded to the "lowest responsible bidder" but the school district retained the right to choose the "lowest responsible bidder," plaintiff, the disappointed lowest bidder, did not have a valid business expectancy for the purpose of sustaining a claim of tortious interference with a business expectancy.

Income Tax—Applicability of Apportionment Principle to Individuals

Estate of Wheeler v Department of Treasury (In re Estate of Wheeler). Nos 302251, 302259, 302261, 302262, 2012 Mich App LEXIS 1513 (July 31, 2012). Petitioners were shareholders of an S corporation called Electro-Wire Products that acquired all of the business assets of a German business. To accomplish the asset purchase, two general partnerships were created: (1) an operating company that held all of the purchased assets (TKG) and (2) a holding company (EWG), which held a 99.5 percent partnership interest in the operating company. Electro-Wire held a 99 percent partnership interest in EWG, as well as the remaining 0.5 percent partnership interest in TKG. In 1994 and 1995, petitioners received flow-through income from Electro-Wire, which included Electro-Wire's distributive share of the partnership income from TKG. They reported this income by treating Electro-Wire and TKG as a unitary business and combining their apportionment factors. The Department of Treasury audited petitioners for those years and issued petitioners a tax bill, asserting that the unitary business principle (UBP) did not apply to individuals under the Michigan Income Tax Act, MCL 206.1 et seq., and that petitioners were required to apply Electro-Wire's apportionment factors to Electro-Wire's income alone and independent of TKG. A hearing referee found that the UBP applied to individuals like petitioners, and that Electro-Wire and TKG were a unitary business entitled to combining apportionment factors for tax purposes, but the Department of Treasury disagreed. Petitioners appealed to the tax tribunal and the tribunal ruled in favor of petitioners.

The Michigan Court of Appeals affirmed the tax tribunal's ruling. Where Company A is 99 percent owned by Company B, which in turn is 99.5 percent owned by Company C, Company A and Company C are not separate and distinct entities but are in a parent/subsidiary relationship, and the companies should be allowed to use multistate apportionment under the Income Tax Act under the UBP. Also, the Income Tax Act does not exclude foreign entities from being considered under the UBP.

Sales Representative Commission Act—Applicability

Radina v Wieland Sales, Inc, No 301090, 2012 Mich App LEXIS 1365 (July 17, 2012). Defendant truck dealership recruited plaintiff to establish a commercial truck rental and leasing business. Plaintiff agreed to work for defendant in exchange for a compensation package that included a regular salary and one percent of all lease revenues. The leases solicited by plaintiff were recorded by defendant as "sales," and the one-percent payments made to plaintiff were recorded as "commission." Because of defendant's cash flow concerns, plaintiff agreed to have the commission paid out over the term of the leases, rather than at the time the leases were executed. Plaintiff acknowledged that he only solicited leasing business for defendant and did not sell any trucks for defendant. In December 2008, defendant terminated plaintiff's employment and ceased making the one-percent payments on lease revenues generated under the leases solicited by plaintiff. Plaintiff filed a complaint against defendant, alleging, in relevant part, that defendant's failure to continue making the one-percent commission payments to plaintiff constituted a breach of the Sales Representative Commission Act, MCL 600.2961. Defendant filed a motion for summary disposition alleging that plaintiff was not a sales representative under the Act and thus could not avail himself of its protections. The court of appeals affirmed the trial court's denial of defendant's motion, ruling that because plaintiff was a person employed by a principal for the solicitation of orders for goods and was paid in part by commission, he was a sales representative under the Act.

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SECTION CALENDAR

Council Meetings

DATE	TIME	LOCATION
September 20, 2012*	4:00 p.m.	Sheraton Detroit Hotel, Novi
December 1, 2012	10:00 a.m.	Bodman, Detroit

*Annual Meeting