Chapter Legal and Tax Issues
National Institute of Governmental Purchasing
August 24, 2014
Kristalyn J. Loson, Esq.
VENABLE LLP
Washington, DC

Today’s Discussion

1. Organization and Governance
2. Tax Exemption
3. Fundraising

Organization and Governance
What Is a Nonprofit Organization?

Legal Form of Organization

- Most common legal structures:
  - Corporation
  - Unincorporated Association
- Governed by state law (statutes and common law)
  - Nonprofit Corporation Laws
  - Unincorporated Association Laws
- Non-distribution constraint is fundamental characteristic
- Nonprofit status is not synonymous with tax-exempt status

Legal Form of Organization – Corporations

- Limited Liability Protection
  - Incorporation grants organization "corporate shield" so long as operations are consistent with state corporate requirements
- Corporate Status Requirements:
  - File and maintain articles of incorporation with the state
  - Comply with state nonprofit corporation law governing organization and decision-making (i.e., elections, meetings, voting, etc.)
  - File annual report with the state to remain in good standing

Governance Legal Issues

Hierarchy of Governing Documents

- State Nonprofit Corporation Law
- Articles of Incorporation
- Bylaws
- Policies and Procedures
Governance Legal Issues

Governing Documents in Context – Articles

- Filed with the state
- Include only the most basic provisions necessary to form a nonprofit corporation because cumbersome to change
  - Full legal name
  - Statement of purposes
  - Whether the entity will have members
  - Registered agent/office
  - Provision for disposition of assets on dissolution
  - Provisions limiting the activities of the organization to qualify for tax-exempt status

Governance Legal Issues

Governing Documents in Context – Bylaws

- Internal governance document
  - Not required to be filed with the state
  - But must be submitted to the IRS with the Form 990 when significant changes are made
- Subordinate only to the articles of incorporation and state law
- Usually more easily revised than articles of incorporation
- Include core rules governing:
  - Organizational structure
  - Rights and obligations of participants in the structure
  - Essential procedures by which participants’ rights can be exercised

Governance Legal Issues

Governing Documents in Context – Bylaws

- Board-approved policies supplement the core governance rules of the articles and bylaws in greater detail; set parameters governing operational matters, programs
- Subordinate to the bylaws, articles of incorporation, and state law
- Most easily revised
- Common focus of policies:
  - Ethics and accountability (e.g., conflict of interest, whistleblower)
  - Finance and investments
  - Fundraising
  - Board operations
  - Committee responsibilities
  - Communications
  - Personnel
Governance Legal Issues
Role of the Board of Directors
- Board of directors is the ultimate decision-making body
- Boards generally are only allowed to act in a meeting or by unanimous written consent
- Authority to govern the corporation comes with duties—state statutory and common law require that corporate board members fulfill:
  - Fiduciary duty of care
  - Fiduciary duty of loyalty
  - Fiduciary duty of obedience

Governance Legal Issues
Fiduciary Duty of Care
- Standard is that of "ordinary and reasonable care," or what would an ordinarily prudent director do in the same or similar circumstances?
- Business judgment rule—bad decisions are more easily defended than ignorance; it is the due diligence process that matters most
- Compliance with fiduciary duty of care:
  - Review all materials
  - Ask questions
  - Actively participate in meetings

Governance Legal Issues
Fiduciary Duty of Loyalty
- Duty of undivided allegiance
- Duty to avoid conflicts of interest (actual, potential, and apparent)
  - Examples
    - Business dealings with association
    - Business dealings with competitors
    - Corporate opportunities doctrine
  - Remedies
    - Disclosure; recusal or resignation
- Confidentiality
Governance Legal Issues

Fiduciary Duty of Obedience

- Articles of incorporation, bylaws, other governing documents must be followed
- Applicable laws and regulations must be followed

Governance Legal Issues

Board Role Summary

- Meet and deliberate
- Act in best interests of the organization
- Document compliance through minutes

Governance Legal Issues

Apparent Authority

- As long as a board member, officer, or employee reasonably appears to be acting with the organization's approval, the organization may be liable for that individual's actions
- Often it is no defense to say that the board member, officer, or employee was not acting within the scope of his/her actual authority
Governance Legal Issues

Risk Management

- Insurance
  - General Liability
  - Directors and Officers
  - Meeting Cancellation
- Volunteer Protection Acts (state and federal)
- Indemnification of directors and officers
- Informed consent/waiver

Governance Legal Issues

Compensation and Expense Reimbursement

- Compensation
  - Directors of nonprofits generally not compensated for service as directors
  - Compensation may be paid for services rendered to the organization in another capacity
  - Conflict of interest policy should be followed
  - State laws often have rules governing approval of so-called related party or conflicted interest transactions
  - Consider IRS “rebuttable presumption” of reasonableness
- Expense Reimbursement
  - Expenses reasonably and necessarily incurred in connection with chapter leadership activities may be reimbursed if chapter chooses to do so
  - e.g., travel and lodging expenses incurred in attending a chapter board meeting
  - Consider expense reimbursement policy

Governance Legal Issues

Gifts

- Occasional non-cash gifts in appreciation of volunteer service are permissible
  - e.g., plaques, “thank-you” luncheon or dinner, etc.
  - Value should be reasonable and not excessive or lavish
- No gift cards or cash
Governance Legal Issues

Public Ethics Considerations

- NIGP chapter leaders who are government employees generally subject to public ethics laws
  - Restrictions on outside activities/employment
  - Loyalties owed to government employer
  - Restrictions on acceptance of gifts
  - Additional restrictions for procurement officials
- Potential for conflict of interest between duties owed to chapter and to government employer
  - Understand obligations of each role
  - Seek guidance where necessary

End of Topic #1

Questions?

Tax Exemption Issues
Tax Exemption Issues

Topic Overview

- 501(c)(3) and 501(c)(6) Requirements
- Lobbying and Political Activities
- Unrelated Business Income Tax and Key Exceptions
  - Convention and Trade Show Activities
  - Sponsorships
- Reporting

Tax Exemption Issues

Source of Tax Exemption

- Federal Tax Exemption
  - Internal Revenue Code provides exemption from federal income tax to qualified nonprofit organizations
  - Recognition by IRS obtained through application or group exemption
- State Tax Exemption
  - State statutes may provide exemption from state income or franchise tax, as well as state property, sales, and use taxes
  - May be conditioned upon recognition of federal tax-exempt status but not always tied together or automatically granted—application to state revenue agency may be required

Tax Exemption Issues

What Does It Cover?

- Revenue from activities related to tax-exempt purposes are not subject to federal income tax
- NIGP chapters’ tax-exempt purposes:
  - 501(c)(3)
    - Educating members in order to enable them to perform their duties more effectively
    - “Lessening the burdens of government” by providing training and facilitating procurement
  - 501(c)(6)
    - “Professional society” or “trade association” promoting the procurement profession as a whole
Tax Exemption Issues

Ways NIGP Chapters Are Recognized

- NIGP group exemption
  - 501(c)(3) only
  - Must be subject to NIGP supervision/control
  - Evidence of exempt status is NIGP group determination letter with letter from NIGP confirming participation
- Separate recognition
  - 501(c)(3)—must apply to IRS
  - 501(c)(6)—may apply to IRS or may self-declare
  - Evidence of exempt status is IRS-issued determination letter (only provided upon application to IRS)

Tax Exemption Issues

Section 501(c)(3) Tax-Exempt Status

- Tax-exempt purpose—educational, scientific, or charitable
- Contributions tax-deductible by donors as charitable contributions (minus value of benefits received in return)
- No “private inurement” or impermissible “private benefit”
- No “substantial” lobbying
- No political campaign activities
- Taxation of unrelated business income ("UBIT")

Tax Exemption Issues

Section 501(c)(6) Tax-Exempt Status

- Tax-exempt purpose—improvement of business conditions of industry or profession
- No “private inurement”
- No “particular services” for members
- Unlimited lobbying
  - Lobbying portion of dues not tax-deductible by members as a business expense
- Taxation of unrelated business income ("UBIT")
Tax Exemption Issues

Restrictions on Lobbying and Political Activities

- 501(c)(3)
  - Lobbying permitted, provided it is not a "substantial part" of the organization's total activities
    - Substantial part test v. 501(h) expenditure test
    - NO political campaign activities permitted

- 501(c)(6)
  - Unlimited lobbying permitted
  - Lobbying portion of dues not tax-deductible by members as a business expense
  - Political campaign activities permitted, provided they are not the organization's primary activity
  - Be aware of federal and state campaign finance laws, particularly with regard to restrictions on political activities of corporations

Tax Exemption Issues

When Do Tax Obligations Arise?

- Unrelated Business Income Tax (UBIT)—income is taxable if derived from:
  - a trade or business,
  - that is regularly carried on, and
  - that is not substantially related to furthering the exempt purpose of the organization

Tax Exemption Issues

Understanding UBIT

- Unrelated business activities permitted, but must be less than substantial portion of overall activities (otherwise tax-exempt status jeopardized)
- Revenue-generating activity itself must be related to exempt purposes; using the proceeds for good works is not enough to avoid UBIT
Tax Exemption Issues

Understanding UBIT

- Examples of “related” activities
  - Event registration fees
  - Exhibit booth rentals
- Examples of activities that can generate UBIT:
  - Sale of advertising
  - Sale of consumer products where selling product does not further mission
  - Performance of services unrelated to mission
  - Job referral activities (except might link to 501(c)(3) “lessening”)
  - Certification activities by 501(c)(3) organizations (can do to limited extent but note UBIT consequences)

Tax Exemption Issues

Understanding UBIT – Key Exceptions

- Qualified Convention and Trade Show Activities
- Qualified Sponsorship Payments

Tax Exemption Issues

Qualified Convention and Trade Show Activities

- Income from activities traditionally carried on at convention and trade shows is not subject to UBIT
- Traditional activities include (but are not limited to):
  - Activities designed to attract people to the show to view industry products or services
  - Activities designed to educate persons in the industry about new products or services or new rules and regulations
  - Incidental activities such as furnishing refreshments
Tax Exemption Issues
Qualified Convention and Trade Show Activities

- To be a “qualified” convention or show:
  - At least one purpose must be
    - education of members, or
    - promotion and stimulation of interest in and demand for the products or services of the industry of the members
  - Event must be designed to achieve the purpose through
    - character of a significant portion of the exhibits or
    - character of conferences and seminars held
- IRS considers a supplier-only show without educational component NOT qualified

Tax Exemption Issues
Qualified Convention and Trade Show Activities

- TIPS:
  - Incorporate educational programming for members with all shows
  - Demonstrate “qualified” purpose of show through marketing and promotional materials

Tax Exemption Issues
Qualified Sponsorship Payments

- Qualified sponsorship payments are excepted from the definition of UBI
- Sponsor neither gets nor expects any return benefit other than:
  - Goods, services, or other benefits, the total value of which does not exceed 2% of the sponsorship payment during the tax year; or
  - Recognition, i.e., use or acknowledgement of the sponsor’s name, logo, or product lines in connection with the nonprofit’s activities
    - Advertising does NOT qualify as permissible recognition
Tax Exemption Issues
Qualified Sponsorship Payments

- QSP exclusion applicable to broad range of activities, NOT including:
  - Trade show and convention activities
  - Advertisement or acknowledgment in regular periodicals (journals, e-newsletters, etc.)
  - Contingent payments

- If substantial return benefit provided (i.e., benefits other than recognition valued at more than 2% of the payment):
  - Only the portion of the payment that exceeds the fair market value of the substantial return benefit is a QSP
  - Use regular UBIT analysis to determine whether any other portion of the payment is subject to tax.

Tax Exemption Issues
Qualified Sponsorship Payments

- Permissible forms of recognition:
  - Use or acknowledgment of the name or logo (or product lines) of the sponsor’s business, as long as the use is not qualitative or comparative
  - List of sponsor’s location, telephone number, and/or Internet address, including a hyperlink from the exempt organization’s website to the sponsor’s website
  - Designating a sponsor as an “exclusive sponsor”
  - Product samples okay

Tax Exemption Issues
Qualified Sponsorship Payments

- Recognition v. advertising:
  - Advertising is defined as any message that promotes or markets any trade or business, or any services, facility, or product
  - Messages that include any of the following are advertising:
    - Qualitative or comparative language,
    - Price information or other indications of savings or value,
    - An endorsement, or
    - An inducement to purchase, sell, or use the products or services
Tax Exemption Issues

Qualified Sponsorship Payments

- Illustration
- ABC Corporation commits to $5000 sponsorship of Chapter program (2% = $100)
  - Ex. 1: $75 Return Benefit – Safe Harbor
    - $50 complimentary program registrations
    - $25 advertising opportunity in program marketing materials
  - Ex. 2: $125 Return Benefit – No Safe Harbor
    - $100 complimentary program registrations (not taxed, related)
    - $25 advertising opportunity in program marketing materials (taxed)

Tax Exemption Issues

Qualified Sponsorship Payments

- Analyzing benefits:
  - Recognition or advertising?
  - Eligible for safe harbor?
  - Determine value of benefits
- Essentials for sponsorship contracts:
  - Specify exact form of acknowledgment
  - Specify all return benefits
  - Specify value of taxable benefits, if any
  - Have right to approve any copy relating to sponsorship, or using tax-exempt’s name/logo
  - Specify site to which hyperlinks will link

Tax Exemption Issues

Reporting

- Form 990 Annual Filing Requirements:
  - All tax-exempt entities must file the 990, 990EZ, or 990N (e-postcard)
  - NIGP does not file a return on behalf of group exemption participants
  - Failure to file for three years in a row results in automatic loss of tax-exempt status

<table>
<thead>
<tr>
<th>Gross receipts $50,000</th>
<th>Form 990 (paper) or Form 990N (e-postcard)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross receipts &lt; $200,000 and assets &lt; $500,000</td>
<td>Form 990EZ or Form 990</td>
</tr>
<tr>
<td>Gross receipts $200,000 and assets $500,000</td>
<td>Form 990</td>
</tr>
</tbody>
</table>
Fundraising Issues

Raffles

- Federal law and all states prohibit lotteries (except state-run lotteries). A lottery has the following elements:
  1. The awarding of a prize,
  2. By chance,
  3. Where the participants have been required to submit consideration to enter.
- In many states, certain charitable or nonprofit fundraising raffles or games of chance are exempt from lottery prohibitions (but still regulated)
Fundraising Issues

Raffles

- What is consideration?
  - The giving up or undertaking something of value
  - Often defined in monetary terms
  - Some states take a broader view—consideration may be anything that involves a significant expenditure of one's time and effort ... “shoe leather consideration”
  - Rule of thumb: the less that is required of the participant, the less likely it is to be consideration—limit amount of personal information required

- Consideration issue may generally be avoided if the required action (e.g., attending an event) is not mandatory—provide a free alternative method of entry

Fundraising Issues

Raffles

- In states where nonprofit raffles allowed, permit or registration may be required
  - Some states have residency requirements
  - Restriction on ticket price
  - Limits on where raffle conducted and by whom
  - Distribution of proceeds of raffle

- If permit required, allow plenty of time (weeks or months)

- Know the raffle laws in your state, and review raffle laws before conducting a raffle in any other state

Fundraising Issues

Scholarship Fund Solicitations

- State charitable solicitation regulation
  - Registration and reporting of charitable fundraising required in about 40 states
  - Some states have exceptions if you are only soliciting members (seek counsel)

- IRS rules for substantiating charitable contributions for donor tax-deductibility (501(c)(3) only)
  - Disclosure to donors of a quid pro quo contribution in excess of $75
  - Contemporaneous written acknowledgment for donors claiming deductions of $250 or more

- Consider adopting policies governing fundraising and scholarship programs
Questions?

Kristalyn J. Loson, Esq.
Venable LLP
575 7th St. NW
Washington, DC 20004
kjloson@venable.com
202-344-4522

For More Information:
www.venable.com/nonprofits/publications
www.venable.com/nonprofits/events