


2019 Nonprofit Compliance Update
WNC Pathways
 April 30, 2019
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The views expressed are my own (for better or for worse).

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Presentation Overview

1. Nonprofit 101	6. Fundraising and UPMIFA
2. Governance	7. State Taxation
3. Basic 501(c)(3) Compliance	8. Employment Considerations
4. Advocacy	9. Miscellaneous

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What is a nonprofit?

- An entity under state law
 - Usually a nonprofit corporation
 - Sometimes a trust, unincorporated association or LLC
- Exempt from federal income tax
 - Usually under Section 501(c)(3)
 - Sometimes under another 501(a) provision or Section 115
- Governed by a variety of additional laws and regulations

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Nonprofit 101

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Compliance Sources

- NC Nonprofit Corporation Act (or other state)
- Internal Revenue Code
- Other applicable laws
 - Charitable solicitation, UPMIFA, Employment
- Governing Documents and Policies

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Governing Documents

Articles of Incorporation

- Filed with the Secretary of State
 - Non-NC nonprofits must file for a certificate of authority
- Should contain certain provisions
 - Purpose (broad)
 - Nonmember vs member
 - IRS required provisions

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Governing Documents

Bylaws

- Not filed with state; adopted and amended by the board and members (if applicable)
- Contains general governing rules
 - Rights of members
 - Board/officer elections/appointments
 - Meeting and voting procedures
 - Committees
 - Indemnification
- Should not conflict with articles of incorporation

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NC Nonprofit Corporation Act

Creates standards and default rules

- Bylaws must be consistent with standards
- Only one board member required (not recommended)
- Board committees only comprised of board members
- Action outside of meeting must be unanimous (e.g. voting by email)
- No state annual report required - yet

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Basic Roles in a Nonprofit

Board of Directors
Officers/Management
Staff

- Fundraising
- Program Staff
- Other Administration

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Governance


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General Role of Board

- Hiring, establishing comp. for, managing, and evaluating the CEO
- Setting vision and planning for direction
- Monitoring plan implementation vis-a-vis mission
- Financial and other oversight
 - Approving budgets
 - Monitoring reports
 - Audit
 - Independence


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General Role of Board

- Helping secure needed resources
- Managing risk
- Advocating for the organization
- Evaluating itself and planning for succession

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Fiduciary Duties

Legal obligations that inform not what board members do, but how they do it:

- Duty of Care
- Duty of Loyalty
- Duty of Obedience

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Duty of Care

Responsibility to carry out board roles:

- in good faith
- with the care an ordinarily prudent person in a like position would exercise under similar circumstances
- and in a manner the director reasonably believes to be in the best interests of the organization

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Duty of Care

Discharging the duty of care:

- Showing up
- Paying attention
- Remaining informed
- Asking questions until reasonably satisfied
- The more consequential the decision, the more diligence required

Protected by the "Business Judgment Rule" but not when there is a conflict of interest or misconduct. Also may reasonably rely on the reports/advice of officers, counsel, professionals, committees.

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Duty of Loyalty

Responsibility to put the interests of the organization above your own

- Conflicts of interest:
 - Know what constitutes a conflict and the process to handle it
- Corporate opportunity doctrine
- Confidentiality
- When appointed by an employer

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Duty of Obedience

Responsibility to remain true to mission and governing documents:

- Charter (Articles of Incorporation)
- Bylaws
- Policies

(sometimes this duty is seen as a subset of the other duties)

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Legal Protection for Boards

- Immunity - should be in Articles of Incorporation
- Indemnification – typically in bylaws
- Insurance

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Recommended Policies

Generally Applicable to All Organizations:

- Conflict of Interest
 - Requires disclosure and recusal, provides standard of review
- Document Retention
- Whistleblower

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Recommended Policies

Other Policies if Applicable

- Gift Acceptance
- Compensation
- Investment and spending
- Chapters/Affiliates
- Public disclosure/records requests
- Joint Venture

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Basic 501(c)(3) Compliance

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501(c)(3) basics

- Organized and operated exclusively for certain exempt purposes
 - “exclusively” means primarily
- No substantial part of activities = lobbying
- No campaign intervention
- No private inurement
- No more than incidental private benefit

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Form 1023 Application

Required for most charities (churches and some related entities exempted)

- Provides basis for exemption and public charity status
- Retroactive if filed within 27 months of incorporation
- 1023-EZ available for small organizations
- Public record – must be kept permanently and provided to public upon request
- Other types of 501(c)s file a Form 1024

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Annual Form 990

- Generally, a public charity must annually file
- Due on the 15th day of the 5th month following the end of fiscal year (e.g., May 15th for calendar year filers)
 - Financial penalties for late filings
 - Failure to file for three consecutive years results in automatic revocation of tax-exempt status
- Public record, but public charities can redact certain donor information from Schedule B

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Which Form 990?

Gross Receipts	Form to File	Description
Gross receipts normally ≤ \$50,000 Note: Organizations eligible to file the Form 990-N may choose to file a full return	990-N	Simple form filed electronically; no financial reporting required.
Gross receipts < \$200,000, and Total assets < \$500,000	990-EZ or 990	Moderately complex document, though materially simpler than the full Form 990.
Gross receipts ≥ \$200,000, or Total assets ≥ \$500,000	990	Full, complex document that covers financial information, governance practices, transactions with insiders, foreign activities, and other operational aspects.

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UBIT: Rationale

- Levels the playing field between exempt organizations and commercial counterparts
- No “destination of income”: tax-exempt organizations are out of the macaroni business

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UBIT: Framework

- Three elements must be present for UBIT:
 - Trade or Business
 - Regularly Carried On, and
 - Not Substantially Related
- Taxed at standard corporate or trust rates; reported on Form 990-T

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UBIT: Exceptions/Exclusions

Certain passive investments excluded:

- Dividends and interest
- Royalties
 - Presence of services in connection with use of intellectual property may cause some or all income to be UBTI
- Rents from real property

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UBIT: Exceptions/Exclusions

Certain activities are excepted, including:

- Substantially all of the activities conducted by volunteers
- Activities conducted for convenience of members, students, patients, and employees, and
- Thrift shop exception: selling merchandise, substantially all of which has been received by the organization as gifts or contributions

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UBIT: Recent Changes

Tax Cuts and Jobs Act

- Taxation of qualified transportation benefits
- Anti-siloing provision and UBIT
- Flat corporate UBIT rate

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Changes in Activities

- Changing activities: consistent with purpose?
 - May be ultra vires
 - May result in UBTI
 - IRS will not rule on effect on exempt status
 - Report on Schedule O
- Changes to governing documents may have other issues:
 - Some states require AG approval
 - Status of funds held for old purposes

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Private Inurement/Benefit

- Sibling Doctrines
 - Inurement: net earnings flowing to or for the benefit of insiders; no inurement permitted
 - Private benefit: operating to benefit private interests more than incidentally; flow of funds not necessary and benefit can flow to insiders or unrelated third parties; incidental private benefit permitted
- No bright lines: All facts and circumstances

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Intermediate Sanctions

- Alternative to revocation for violations of private inurement
- Penalizes transactions that convey greater value to a “disqualified person” than the exempt organization receives in return
- Penalties are imposed on the disqualified persons and potentially on organizational managers who approve a transaction knowing it conveys excess benefit
- Typical case: Excessive Executive Compensation

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Rebuttable Presumption of Reasonableness

- Organization can establish presumption that a transaction is not an excess benefit transaction
- approved in advance by an authorized body composed entirely of individuals who do not have a conflict of interest with respect to the transaction
- the authorized body obtained and relied upon appropriate data as to comparability prior to making its determination; and
- the authorized body adequately documented the basis for its determination concurrently with making that determination

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Public Charity Status

Significant Matter:

- Private foundation excise taxes
- Deductibility of contributions by donors
- Foundation expenditure responsibility requirements
- What a charity needs to monitor varies depending on public charity classification

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Public Charity Classification

A charity is presumed to be a private foundation unless it otherwise qualifies.

- Certain per se public charities (churches, schools)
- Charities that receive wide donative support (509(a)(1))
- Charities that have gross receipts from diverse sources (509(a)(2))
- Supporting organizations (509(a)(3))

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509(a)(1)

- Public support percentage must be at least one third
- Divide total support by public support (as each is defined)
- 10% facts and circumstances fall back
- Calculated on five year rolling basis
- Failing two years in a row results in reclassification as a private foundation

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509(a)(2)

Path for organizations that generally draw support from a combination of donative sources and exempt function income.

- Two prong test:
 - One third of total support must come from public sources, and
 - No more than one third of total support can be derived from investments and unrelated business activities.

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Supporting Organizations

- Derive public charity status by virtue of relationship with existing public charity
 - Operated to benefit, perform the functions of, or carry out the purposes of supported organization(s)
- Three types of supporting organizations based on the structural relationship with the supported organizations(s)
- Rules are complex but must be closely followed

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Advocacy

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Advocacy

Section 501(c)(3) organizations may conduct lobbying activities, but cannot constitute a “substantial part” of overall activities. Measured by either:

- A mushy facts and circumstances test; or
- Some charities may elect to be governed by the 501(h) expenditure test.

A 501(c)(3) may not intervene in a campaign for elected office

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Lobbying

What constitutes lobbying?

- Lobbying = attempts to influence legislation
 - Legislation = act of Congress, State legislature, local council or similar governing body
 - Also = public acts like referendum, ballot initiative, or constitutional amendments
 - Not regulatory matters of executive branch or administrative bodies
- Can be direct or grassroots

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Lobbying

What isn't lobbying?

- Nonpartisan Study, Analysis, and Research
- Examinations of Broad Social, Economic and Similar Problems
- Requests for Technical Advice or Assistance
- Self-Defense Communications

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Lobbying

How much is too much under no substantial part test?

- No consistent bright line
 - One case held that 5% of organizational budget was not substantial, but this does not establish a general binding precedent and subsequent cases have rejected percentage test
- Considers all the facts and circumstances – not just expenditures (e.g. volunteer time)

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Lobbying - 501(h)

- 501(h) election contains two expenditure tests:
 - The first test prohibits total lobbying expenditures from exceeding a declining percentage of exempt purpose expenditures (20% of first \$500,000, 15% of next \$500,000, etc. up to a total of \$1 million in lobbying expenditures)
 - Only 25% of lobbying expenditures can be grassroots
 - 25% excise tax on excess annual expenditures; no requirement to correct

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Lobbying - 501(h)

Lobbying Budget Per Expenditures

Exempt Expenditures	Lobbying Percentage	Maximum Amount
\$0 to \$500,000	20%	Up to \$100,000
\$500,001 to \$1,000,000	15%	\$100,000 plus 15% of excess over \$500,000, up to \$175,000
\$1.0 to \$1.5 million	10%	\$175,000 plus 10% of excess over \$1,000,000, up to \$225,000
\$1.5 to \$17 million	5%	\$225,000 plus 5% of excess over \$1,500,000, up to \$1,000,000
More than \$17 million	CAPPED OUT	

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Lobbying – 501(h)

The second test imposes a four year ceiling:

- Not to exceed 150% of four year total and grassroots limits
- Penalty is loss of exemption
- Organization must reapply to regain exemption going forward

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Lobbying – 501(h)

Advantages of 501(h) Election:

- Bright line limits
- Clearer definitions of what constitutes lobbying
 - E.g. grassroots lobbying must contain a “call to action”
- Helpful interaction with federal Lobbying Disclosure Act
- Can unelect if desired

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Lobbying

Other considerations:

- Federal and state lobbying disclosure rules
 - Require organizations and in house lobbyists to register and report on lobbying activities
 - Definitions of lobbying can be different from federal tax definitions
- Federal and state ethics rules may be implicated

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Election Related Activities

- Cannot participate or intervene in any political campaign on behalf of (or in opposition to) any candidate for public office – absolute prohibition
 - “Non-partisan” is misleading; political affiliation or lack thereof doesn’t matter
 - Determined under the facts and circumstances
- Easy: Endorsements, contributions, rating candidates, volunteer or paid labor, other tangible in-kind support
- Harder: Issue advocacy in the lead up to and during a campaign

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Election Related Activities

- Not all election- or issue-related activities are impermissible
 - Voter registration/GOTV
 - Voter education
 - Candidate education
 - Issue advocacy
 - Ballot measure (considered lobbying)
- BUT such activities cannot favor a candidate or party

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Election Related Activities


- Some general key factors in determining intervention
 - Referencing candidates
 - Timing of activity
 - Purpose of activity
 - Organization's history with issue
 - Nature of issue (hot button? wedge?)
 - Indicia of favoritism based on organization's preferences

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Fundraising and UPMIFA

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Fundraising

Impact of Tax Cuts and Jobs Act

- Doubled standard deduction for income tax
- New limits on key itemizations (SALT, mortgage interest deduction)
- Doubled estate tax exclusion to \$11 and \$22 million (inflation adjusted)
- Only 9% of taxpayers will itemize, down by more than 20 million
- Some donors will begin “bunching”


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Fundraising

- American Enterprise Institute estimated \$17.2 billion in revenue loss for the sector in 2018
- Will bunching mean less direct giving and more to DAFs?
- Competition from 501(c)(4)s in grassroots fundraising?
- Fewer estates with tax planning

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Early 2018 Data

Fundraising Effectiveness Project Report

- Giving up by 1.6% in 2018 (compared to 8% in 2017)
- 4.5% fewer donors than 2017
 - Gift revenue by size:
 - \$1000 and up INCREASED by 2.6%
 - \$250-999 decreased by 4.0%
 - Under \$250 decreased by 4.4%
- New donors dropped 7.4%

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Other Giving Changes

- Raised AGI limits on cash gifts to public charities to 60%
- College athletic boosters can no longer deduct any portion of a gift that provides seating rights.
- Form 990 disclosure does NOT count as a substantiation of a charitable gift
- “Newman’s Own” Exception to excess business holdings

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Substantiating Charitable Gifts

- For all cash donations, donor must have written evidence that includes certain information
- Contributions of \$250 or greater need a written substantiation with the name of the donee, amount of contribution, and either:
 - a statement that no goods or services were provided
 - description and good faith estimate of the value of goods or services, if any, that organization provided in return; or
 - a statement that goods or services, if any, that the organization provided in return for the contribution consisted entirely of intangible religious benefits

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Quid Pro Quo Gifts

If in excess of \$75, the acknowledgment must:

- (1) Inform donor that the amount of the contribution that is deductible is limited to the excess of value contributed by the donor over the value of goods or services provided by the organization in return, and
- (2) provide a donor with a good-faith estimate of the fair market value of these goods or services

Failure to comply can result in a penalty of \$10 per contribution, subject to a \$5,000 cap

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Non Cash Gifts

- Generally, charities must substantiate in writing all non-cash gifts regardless of value
- If \$250 or more, must include a statement that no goods or services were provided, or a description and good faith estimate of the value of goods or services
- If \$5,000 or more, charity must sign donor's Form 8283 (unless the gift is solely publicly traded securities). In addition, the charity may need to file a Form 8282 if it disposes of the property within three years
- Donors may have other substantiation and record keeping requirements

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Charitable Solicitation Registration

- If a nonprofit solicits for donations among NC residents/in NC, it generally needs to make an initial and annual filing with the NC Secretary of State
 - If the nonprofit receives \$25,000 or more in private grants and contributions per year, it needs a solicitation license
 - If nonprofit receives less than \$25,000, it may be eligible to be exempted
 - Certain nonprofits are exempt by statute- e.g. churches and schools.
- When is the filing due?
 - Fifth month and 15th day after year ends, with a three month extension available
 - Note that this does not line up with the IRS extension of six months
 - Most other states have similar general requirements, but specifics can vary

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Charitable Solicitation Registration

- Disclosures are required on solicitations
- Outside, paid fundraisers and consultants will be subject to similar licensing requirements
- Also commercial co-ventures (e.g. pairing with a for-profit where a nonprofit gets a dollar on every sale of an item) have licensure or reporting requirements
- Internet Fundraising

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Bingo/Raffles

- Up to four raffles permitted per year
 - Maximum cash prize of \$250,000; real property, \$500,000
 - At least 90% of proceeds must be used for mission
 - Tax reporting requirements for certain prizes over \$300 and withholdings required if above \$5,000
- Bingo games requires license
- No casino night fundraisers!!

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Donor Restrictions and UPMIFA

- Donors can restrict gifts by way of a gift instrument (e.g. a will or gift agreement)
 - Purpose restriction
 - Endowment
 - Other administrative restriction
- Honoring restrictions woven into fiduciary duties
- Uniform Prudent Investment of Institutional Funds Act (UPMIFA) governs how to release or modify such restriction (for nonprofit corporations)
 - If donor does not or cannot consent, court action generally required


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Investment/Endowment Management and UPMIFA


- UPMIFA requires that endowments be spent prudently to protect perpetual nature
 - Boards adopt a spending policy considering various factors
- UPMIFA also governs how nonprofit corporations invest charitable assets
 - Assets must be invested prudently considering various factors
 - Mission and program related investing is permitted
 - Investment management can be prudently delegated with appropriate oversight
 - Investment Policy Statement

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State Taxation

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State Taxation

NC Exemptions

- Corporate Income and Franchise Tax Exemption- Attained through NC Department of Revenue and linked to 501(c)(3) federal status
- Sales and Use Tax- Generally 501(c)(3) nonprofits are eligible for sales tax refunds on purchases made in furtherance of mission. The nonprofit needs to establish proper status as a nonprofit to the NC Department of Revenue and then it would file semi-annually Form E-585 with NC Department of Revenue as well.
 - Not available for nonprofits with the following NTEE codes:
 - Community improvement and capacity building
 - Public and societal benefit
 - Mutual and membership benefit

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State Taxation: UBIT

UBIT

- Nonprofits must pay state income tax on UBIT
 - Not applicable to the "parking tax"
- State corporate income tax rate is 3% in 2018 and 2.5% in 2019
- File and pay with Form CD-405

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State Taxation: Property Tax

Generally, real and personal property also exempt from taxation.

- Application made at the county level
- Must meet statutory requirements, which do not quite track Section 501(c)(3)
- Denials can be appealed to a local board, then to state board
- Increasingly becoming an issue for cash strapped counties

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State Taxation: Collecting Sales Tax

Generally, nonprofits are not exempt from collecting sales tax on selling goods and certain services and must collect and remit applicable tax

- Includes admission fees to entertainment and live events
 - Live entertainment the purpose of which is entertainment
 - Movies, films, museums, shows, guided tours, etc
 - Exemptions for tax-deductible portions, educational events, participatory events, all-volunteer organizations conducting all volunteer events
- Exemption for an annual sales event, e.g. Girl Scout Cookies

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Employment Considerations

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Employment Taxation

- Nonprofits must withhold and pay federal and state income and employment taxes
- State Unemployment Tax Applies
 - Exemption for nonprofits with fewer than 4 employees who work twenty hours per year (such workers get no coverage)
 - Can elect to reimburse claims rather than pay the tax
- ALSO: Worker's compensation insurance is required for nonprofits with three or more employees (full or part time)

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Employment Classification

- Nonprofits must appropriately classify the individuals working for them.
 - Tax purposes: withholding and employment tax
 - Labor purposes: fair labor standards act and other similar laws
- Determination based on a number of factors, but certain categories of individuals that are per se employees, including corporate officers
- The penalties for misclassification can be stiff and can even attach to the directors of the nonprofit

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Interns!

- Can be volunteer
- Paid interns may be subject to wage laws – i.e. stipend must equal minimum wage.
 - 7 factor test

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Other Employment Laws

- FLSA/NC Wage and Hour Act
 - Minimum wage, overtime, equal pay
 - Exemption for certain executive, professional, and administrative staff
- Family and Medical Leave
- Anti-discrimination
- Employment Verification
- ACA
- ERISA
 - File Form 5500!

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Miscellaneous

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State Grant Reporting

Receive State Funds?

- Nonprofits with less than \$25,000 must
 - File annual certification and accounting report
- Nonprofits between \$25,000 and \$500,000
 - Same as above plus report on activities and accomplishments with performance measures
- Nonprofits of \$500,000 and above
 - All of the above plus single or program specific GAAP audit

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Federal Funding

Receive Federal funds?

- Must comply with OMB Uniform Guidance
 - Indirect costs vs direct costs
 - Audit required if funding exceeds \$750,000 in one year
 - Includes internal controls review
 - Required procurement process

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Updating Records

Nonprofits should keep certain information current with the state:

- File for assumed name if using a name different than on articles of incorporation
- File with register of deeds in a county where business is conducted; added to Secretary of State database
- Update registered agent and principal office information


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Significant Changes

- Mergers and dissolutions may trigger Attorney General notification (and even court approval)
 - Exception for one charity merging into another
 - Bill currently pending for similar exception regarding distribution of assets from one charity to another upon dissolution

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QUESTIONS?

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