Legal Hot Topics for Nonprofit Organizations

Presented by Gene Takagi, NEO Law Group and Sarah Stegemoeller, Public Counsel
July 31, 2014

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I. Anatomy of a Fundraiser
Legal Issues Checklist

Risk Management
- Contracts with venue, caterer, music, auctioneer, photographer, security etc.
- Liability Insurance/Riders
- Performance Bonds
- Special Permits
- 1099s/ Overtime pay

Fundraising Compliance
- Gift solicitation registration required?
- Fundraising Executive involved?
- AG Permission required?
- Donation deductibility
- Sales Tax Due?
- Gift Receipts
- 990 reporting

Who regulates charitable organizations?

Internal Revenue Service
California Franchise Tax Board and Board of Equalization
California Attorney General
California Secretary of State
Local Jurisdiction
Local Solicitation Rules
State Fundraising Law: CA Nonprofit Integrity Act

What Does An Organization Have to Do?
• Register with AG Registry of Charitable Trusts (within 30 days of first receipt of property or money) and file annual report
• Establish and exercise control over all fundraising activities
• Raise and use funds only for the charitable purposes stated in articles of incorporation
• Make sure fundraising activities are conducted without coercion or misrepresentation
• Use only commercial fundraiser/counsel who are registered with the AG
• Have written contract if using third-party fundraiser or fundraising counsel
**Donations: What Does A Donor Need to Substantiate A Deduction?**

- **Monetary Contributions of under $250** – Taxpayer must maintain a bank record or written communication from the organization.
- **Contributions of $250 or more** – Taxpayer must have a contemporaneous, written acknowledgement from organization.
- **Special Rules for Noncash Donations**

**Donations: What is Charity Required to Provide?**

- **Written disclosure** to a donor who receives goods or services in exchange for a single payment in excess of $75:
  - IRS requires charities to state the market value of goods or services received by donor.
  - List deductible and non-deductible sums separately in any solicitation.
  - See IRS Publication 1771.
  - *Noncompliance penalty of $10 per contribution up to $5000 per event*.

Best Practice – Thank ALL donors in writing.

**How Much Can Donor Deduct?**

Donors who receive a benefit as a result of making a contribution (e.g. purchase at an auction, paying to attend a dinner) can only deduct the amount of the contribution in excess of the fair market value of the benefit received (i.e. the purchased item, the dinner).

**EXAMPLE:** Donor pays $100 to attend a dinner with a fair market value of $40. Donor’s tax deduction may not exceed $60. Also, because donor’s payment exceeds $75, organization must provide a disclosure statement to donor.
Sales Tax

- BOE Publication 18
- Organization may be subject to sales or use tax if fundraising activity involves the sale of goods, even if exempt from UBIT
- Organization must obtain seller’s permit if it intends to sell property that would ordinarily be subject to sales tax if sold at retail

Example: Organization may have to remit the sales tax portion of the $40 collected for annual dinner

II. Unrelated Business Income

Earned Income

What percentage of charities’ income?
Related or Unrelated?

Operational Test

Primarily for exempt (related) purposes

Commerciality Doctrine
Unrelated Business Income

1. Trade or business
2. Regularly carried on
3. Not substantially related

Exclusions from “Unrelated Business”

Passive Income Exclusion

- Dividends
- Interest
- Royalties
- Rents
Reporting Unrelated Business Income

Form 990-T

Underreporting Problem
- Misallocating expenses used not just for UB
- Reporting UB activities as exempt activities

Related or Unrelated?

Housing Business Activities

Program
Nonprofit
Subsidiary
III. Social Enterprise

What's a social enterprise?

- Directly addresses social need
- Commercial activity drives revenues
- Common good is primary purpose

Social Enterprise Alliance

Blurring Sectors

- Personal benefit
- Social benefit

Business corporation  LLC  Benefit corporation  Nonprofit corporation

Flexible purpose corporation
East side: For-profits

- Hospital
- School
- Theater
- Art gallery
- Restaurant
- Clothing store
- Credit union
- Insurance company
- Management consulting company

West side: Nonprofits

- Hospital
- School
- Theater
- Art gallery
- Restaurant
- Clothing store
- Credit union
- Insurance company
- Management consulting company
For-profits seeking to do good

Pure heart ---------------------------------- Charity-washing

“Hybrid” Entities

L3C

• Primary exempt purpose
• Profits/appreciation not primary purpose

Looks like a PRI

Market rate
Mixed
Social
Benefit Corporation

- General public benefit
- Optional specific public benefits

Public benefit? According to who?

Flexible Purpose Corporation

- Special purpose (charitable/public)

Balance competing interests

Starting a Social Enterprise

- Viable idea?
- Capacity?
- Related or unrelated?
- Reasonable risk / prudent investment?
- Other stakeholders / joint venturers?
- Choice of entity?
IV. Employee, Independent Contractor, or Volunteer?

Behavioral Control
Does the nonprofit have the right to direct and control the worker? The nonprofit does not have to actually direct or control the way the work is done – employment status can depend on whether it has the right to direct and control the work.

Financial Control
- Significant investment?
- Expense reimbursement?
- Opportunity for Profit and Loss
- Other Clients?
- Regular wage v. flat fee

Relationship of the Parties
- Employee Benefits
- Written Contract between Parties
### Statements Regarding Other IRS Filings and Tax Compliance

<table>
<thead>
<tr>
<th>Q No.</th>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Enter the number listed in Box 2 of Form 1099. Enter 0 if not applicable.</td>
<td>22</td>
</tr>
<tr>
<td>2</td>
<td>Enter the number of Form 1099-NEF issued in line 1a Enter 0 if not applicable.</td>
<td>15</td>
</tr>
<tr>
<td>3</td>
<td>Did the organization comply with backup withholding rules for reportable payments to vendors and reportable gaming (gambling) winnings to Johns winners?</td>
<td>Yes</td>
</tr>
<tr>
<td>4</td>
<td>Did the number of employees reported on Form W-3, Transmittal of Wage and Tax Data, meet the for the calendar year ending with or within the year covered by this return?</td>
<td>150</td>
</tr>
<tr>
<td>5</td>
<td>If line 2 is reported on line 2a, did the organization file all required federal employment tax returns?</td>
<td>Yes</td>
</tr>
<tr>
<td>6</td>
<td>If the sum of lines 1a and 2a is greater than 250, you may be required to file (see instructions).</td>
<td></td>
</tr>
</tbody>
</table>
An individual is considered a “volunteer” under Federal law if the individual:

- Performs hours of service for a public agency for civic, charitable, or humanitarian reasons, without promise, expectation, or receipt of compensation for services rendered (although a volunteer can be paid expenses, reasonable benefits, or a nominal fee to perform such services);
- Offers services freely without pressure or coercion; and,
- Is not otherwise employed by the same public agency to perform the same type of services as those for which the individual proposes to volunteer.

WHAT ABOUT UNPAID INTERNS?

Criteria for Unpaid Internship Programs Under The Fair Labor Standards Act

- The internship, even though it includes actual operation of the facilities of the employer, is similar to training which would be given in an academic/vocational environment;
- The internship experience is for the benefit of the intern;
- The intern does not displace regular employees, but works under close supervision of existing staff;
- The employer that provides the training derives no immediate advantage from the activities of the intern; and on occasion its operations may actually be impeded;
- The intern is not necessarily entitled to a job at the conclusion of the internship; and
- The employer and the intern understand that the intern is not entitled to wages for the time spent in the internship.
V. Permissible Lobbying for 501(c)(3)s
Lobbying activities that attempt to influence specific legislation

No Substantial Lobbying
What's substantial?

Substantial Part Test
Totality of Facts & Circumstances 5%
### 501(h) Expenditure Test

**Substantiality based on expenditures only**

<table>
<thead>
<tr>
<th>Exempt Purpose Expenditures</th>
<th>Permissible Total Lobbying Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>First $500,000</td>
<td>20%</td>
</tr>
<tr>
<td>Next $500,000</td>
<td>15%</td>
</tr>
<tr>
<td>Next $500,000</td>
<td>10%</td>
</tr>
<tr>
<td>Remaining</td>
<td>5%</td>
</tr>
</tbody>
</table>

Cap: $1 million

### 501(h): Direct vs. Grassroots Lobbying

**Direct Lobbying**

**Grassroots Lobbying**

\[
\text{CAP} = 25\% \text{ of Total Lobbying Expenditure Cap}
\]

### 501(h): Not lobbying

- Nonpartisan analysis, study or research
- Exams of broad social/economic/similar problems
- Technical advice or assistance
- Self-defense communications
Revocation of 501(c)(3) Status

Substantial Part Test
• Exceed limit in any year

501(h) Expenditure Test
• Exceed limit by > 50% over 4 year period

25% excise tax for exceeding limit in any year

Non-lobbying Advocacy

Education or Lobbying?
nonpartisan
full & fair exposition
timing
distribution
Other Laws

Registration  Reporting

VI. Election Year Challenges for 501(c)(3)s

No substantial part of the activities of this Corporation shall consist of carrying on propaganda, or otherwise attempting to influence legislation, and this Corporation shall not participate in or intervene in any political campaign (including the publishing or distribution of statements) on behalf of, or in opposition to, any candidate for public office.

THE FIRST AMENDMENT

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech or...
Raimondo ad featuring tax-exempt group raises IRS issue
CALIFORNIA STATE NAACP
2010 November Election
BALLOT MEASURE POSITIONS

November 2010 Statewide Ballot Measures

Proposition 20 – SUPPORT
REDISTRICTING OF CONGRESSIONAL DISTRICTS.
Initiative Constitutional Amendment (UO. 09-0227)
Removes elected representatives from the process of establishing congressional districts and transfers that authority to the newly authorized 14-member redistricting commission. Establishing commission is comprised of five Democrats, five Republicans, and four non-party registrants. Ballot measure will affect only party representation. Requires that any newly-adopted district lines be approved by all commission members, including those non-partisans. If Republicans, and then non-party registrants, vote to support the measure, the ballot measure will pass. Proposes an independent redistricting of state and local government. Probable no significant change in state redistricting units.

JANUARY 14, 2013
CANDIDATES DEBATE
The Candidates for City Attorney Debate
"Values, Ethics and Responsible Civic Leadership"
Moderated by Jim Newton
Editor-at-Large and Columnist, Los Angeles Times

Featuring:
Carsten Trautman, Los Angeles City Attorney
Mike Feuer, Former CA State Assembly Member
Greg Smith, Private Attorney
Nooel Weiss, Private Attorney

Monday, January 14, 2013
7:00 - 9:00pm
Temple Israel of Hollywood
7303 Hollywood Blvd.
Los Angeles, CA 90046

Co-sponsored by
Hollywood United Methodist Church.
Photo Opportunity and Contribution/VFCH

501(c)(3) Officers, Directors and Employees can participate in elections!
VII. Social Media

Social Media: What could go wrong?

Social Media: Some Risks to Manage

• Defamation
• IP infringement
• Electioneering
• Fundraising

GOAL!
Defamation

Where’s the libel?

Climate change is a hoax, you idiots!

F*** off, you child molesting moron!!

Soul Circus vs. PETA

PETA: SCI [Soul Circus] does not care about the treatment, health, or wellbeing of its animals.
Intellectual Property Infringement

Fair Use Exception

Electioneering & SM Issues

No endorsing/supporting candidates for public office
VIII. Charitable Asset Diversion
Where was the Board???

Excess Benefit Transactions

Intermediate Sanctions = Tax
- Recipient must return the excess benefit + 25% tax; 200% if not corrected
- Directors – 10% up to $20k

Embezzlement by a disqualified person is an automatic excess benefit transaction.
Directors have the duty to make reasonable inquiry when presented with matters of concern.

The Investigation: Some Practical Considerations

- Board skill/experience to lead the inquiry;
- Scale of the suspected misconduct/management level of the person(s) implicated;
- Establishing impartial investigation procedure that is consistent with existing personnel and whistleblower policies;
- Obtaining and/or preventing destruction of evidence;
- Evaluating coverage under the nonprofit’s insurance that might require prompt notice;
- Need for attorney/client privilege to protect findings from future discovery efforts.

Next Steps

- Personnel Decision – suspension with or without pay/termination warranted?
- Need to restrict physical access; change passcodes and account signatories?
- Notice to Insurer
- Police Report?
- Take Action to Recover Charitable Assets
- Communicate with Key Stakeholders
- Criminal Prosecution?
- RRF-1 and 990/4720 Reporting