

CORPORATE COMPLIANCE FOR NONPROFIT CORPORATIONS

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IDENTIFYING THE ENTITY

- Unincorporated Association
- Trust
- Municipal/Government Organization
- Nonprofit Corporation

UNINCORPORATED ASSOCIATION

- What documents exist?
 - Photocopied “constitution”
 - Bylaws
- How does it operate?
 - Fiscal Agents (gifts passed through another organization to an unincorporated association)
 - Whose EIN is used for banking purposes?
- Automatically dissolved corporation

UNINCORPORATED ASSOCIATION

- Treated as a partnership for state law purposes
- Governing documents are considered contracts among the members
- Registration and reporting requirements are unclear; nothing to rely on
- Cannot convey legal title. MCL 565.604
- Personal liability for those involved
- Reinstatement of automatically dissolved corporation

TRUSTS

- What documents exist?
 - Declaration of trust
 - Bylaws
- How does it operate?
 - Filing requirements
 - IRS
 - Local probate court
 - State Attorney General (if charitable)
 - Trustees have fiduciary duty

TRUSTS

- Higher accountability of trustees
 - No business judgment rule (reliance on others)
 - No self-dealing
 - Less ability to delegate, in general
- May be subject to probate court jurisdiction
- Document may be difficult to amend
- Filing Form 1023 to establish tax exempt status is probably required

MUNICIPAL/GOVERNMENT ORGANIZATIONS

- Formation is often governed by specific state laws
- Tax exemption found in IRC §115
- Authority to act is subject to the State legislature's grant of authority
- Public Body definition
 - Freedom of Information Act
 - Open Meetings Act

PURPOSE OF PRESENTATION

REVIEW COMPLIANCE ISSUES
FOR THE NONPROFIT
CORPORATION:

- FORMATION DOCUMENTS
- REPORTING REQUIREMENTS
- DISCLOSURE REQUIREMENTS
- DIRECTOR DUTIES

NONPROFIT CORPORATION DOCUMENTS

- Articles of Incorporation
- Bylaws
- Policies
- Regular Meetings
 - Minutes reflect action
 - May have action by written resolution
- State filings
 - LARA Corporations Division
 - Attorney General
- Federal filings
 - 1023
 - 990
 - 990-T

ARTICLES OF INCORPORATION

- Stock or Nonstock
 - IRS has a great deal of difficulty accepting a stock-based corporation as a tax-exempt entity
 - The concept that the stockholder might sell for a profit its interest in the nonprofit corporation is inconsistent with the idea that the subsidiary might be tax exempt
- If Nonstock, then membership or directorship
 - Members elect directors
 - Self-perpetuating board
- Need to have a Registered Office in the State of Michigan
 - This is a place mail will be sent, including forms that must be filed to maintain legal status.
- Need to have a Registered Agent
 - This should be a person, who will receive legal process on behalf of the corporation and know what to do with it.

ARTICLES OF INCORPORATION

- If the corporation will be seeking tax exemption under IRC §501(c)(3), certain provisions should be included.
 - Will not be operated other than for exempt purpose.
 - No part of the net earnings will inure to the benefit of insiders.
 - No substantial political activities.
 - Upon dissolution, after paying liabilities, assets will be distributed to an exempt organization.

BYLAWS

- Any substantive changes to the bylaws (or the Articles of Incorporation) must be reported to IRS (required in Form 990 and 990-EZ) and Attorney General
 - Bylaws should be broad statements
 - Most details of operations can be policy decisions
- Be sure statements in your Articles of Incorporation match statements in the Bylaws.

STATE REPORTING

- **Annual Filing with Corporation Division**
 - Due October 1 of each year
 - After 3 years of nonfiling corporation is automatically dissolved
 - Can be reinstated with filings and payment of fee
- **Filing with Attorney General**
 - License to Solicit/Registration of Charitable Trust
 - Soliciting \$8000/year
 - Annual report and Form 990 required unless receipts are less than \$25,000 and assets are less than \$100,000 AND WAIVER FILED.
 - Audit requirement for assets in excess of \$100,000
 - Some exemptions apply

REQUESTING TAX EXEMPTION

- **Which form to use?**

- Form 1023: Organizations applying under 501(c)(3)
- Form 1023-EZ: if you can answer “no” to 7 pages of questions
- Form 1024: Organizations applying under another section of 501(c)
- Some organizations are exempt from filing
 - “Normally” less than \$5000 gross receipts
 - Churches (beliefs truly and sincerely held and practices not illegal or against public policy)

- **User fee**

- \$850 or \$400, depending on gross receipts/which form filed

FORM 990

- You will lose exempt status if no Form 990 is filed for 3 years
- Determine eligibility to file the Form 990-EZ
- Even small organizations (<\$25,000) now file Form 990-N, which was added by the Pension Protection Act of 2006

FORM 990

- Identify schedules that you need to complete
- Identify key internal stakeholders to involve, including finance, program leaders, fundraisers, PR/government relations, and HR
- Identify key external stakeholders to involve, including directors, board members, trustees, grant makers, accountants, and lawyers
- Assign an internal leader to coordinate 990 preparation
- Identify related organizations and their officers, directors, trustees, key employees
- Be prepared to answer questions about governance, executive compensation, and insider transactions
- Determine overseas and joint ventures activities
- Establish or modify internal systems to gather information
- Tax exempt bond tracking is also reported

FORM 990-T

- Required if organization has \$1,000 gross UBI
- Additional surtax on taxable income between \$100,000 and \$335,000 (39% tax rate)
- More on unrelated taxable income to come

DISCLOSURES TO PUBLIC

- Form 990 must be available for public inspection for 3 years
- Form 990-T must be available for public inspection for 3 years
- Form 1023 must be available, with attachments
- Copies must be provided upon request within 30 days
- Organization may charge a reasonable fee for copying
- Form 990 requires disclosure of penalties paid

EMPLOYMENT TAX

- Nonprofit corporations are responsible for employment taxes, just as any employer is
- Taxpayer Bill of Rights II provides that volunteer board members are exempt from personal liability on payroll obligations so long as they had no actual knowledge and do not participate in day-to-day operations
- Exemption is inapplicable if it results in no one being responsible for the penalty

OTHER TAX/MISCELLANEOUS ISSUES

- Sales and Use Tax on purchases - no special filing is required for entity described in 501(c)(3) to be exempt, just give merchant a copy of the determination letter and a certificate saying the purchase is for exempt purpose.
- Property Tax – local assessor
- Special licenses for bingo, alcohol, lottery
- Michigan Business Tax applies if the apportioned or allocated gross receipts are \$350,000 or more from unrelated business activity
- Copies of contracts with professional fundraisers are filed with Attorney General
- Worker compensation insurance may be required

DONOR SUBSTANTIATION RULES

- Gifts of cash of less than \$250
 - Cancelled check OR
 - Receipt from charity showing name, date and amount of contribution
- Gifts of property worth less than \$250
 - Receipt from charity showing name, date and place of contribution and reasonably detailed description of property
 - If impractical to obtain receipt, need reliable written record of donation
- Raffles and lotteries are nondeductible

DONOR SUBSTANTIATION RULES

- Gifts of Cash of \$250 or more
 - Receipt from charity required
 - Receipt must be received no later than the due date of the tax return
 - Receipt must indicate whether any goods or services were provided in return, and if provided, the value of such goods or services
- IRS Publication 1391 describes requirement of disclosure of FMV of all non-deductible items
- Party admission with open bar. Rev. Rul. 67-246
- Each donation is viewed as a separate contribution regardless of the total. Reg. 1.170A-13(f)(1)

DONOR SUBSTANTIATION RULES

- Property donations of \$500-\$5000
 - Part A of Form 8283 (Noncash Charitable Contributions) must be attached to the return
 - Written records containing detail information
- Property contributions of >\$5000 (except publicly traded stocks)
 - Must have the above as well as qualified appraisal with appraiser signing Part B of Form 8283

DONOR SUBSTANTIATION RULES

- Contributions of Used Clothing and Household Items
 - Donations of less than \$500 do not require appraisal, but need to document that items are in good used condition or better
- Contributions of Qualified Vehicles
 - Form 1098-C required for contributions of >\$500
 - Name, TIN, VIN

DONOR SUBSTANTIATION RULES

- Contributions via Payroll Deduction
 - Need to keep pay stubs or W-2
 - Need to have official pledge card

UNRELATED BUSINESS INCOME

- Trade or business
- Regularly carried on
- Not substantially related to the exempt purpose
- Many exceptions
- Allocation of expenses to UBI is also an issue
- How much is too much?

TRADE OR BUSINESS

- Is the activity a threat to commercial endeavors?
- Most money-generating activities are considered a “trade or business” for this purpose

REGULARLY CARRIED ON

- Reg. §1.513-1(c)(1)
- NCAA v Commissioner, 914 F2d 1417 (10th Cir. 1989)
 - Final four souvenir booklets are not an activity regularly carried on (non-acquiescence)
- Generally, annual events are not “regular” by IRS standards. Rev. Rul. 75-201.
 - But see Rev Rul. 75-200, which finds selling ads for annual event is a regular process.

SUBSTANTIALLY RELATED TO EXEMPT PURPOSE

- Reg. §1.513-1(d); Rev. Ruls. 68-374, 68-376
- Most guidance is in the health care field
- Size and extent of activity in relation to nature and extent of exempt purpose served
- Patient/non-patient test
- Hands on medical care test
- Commercial availability
- By-products exception for sale of reclaimed silver from x-ray processing

UBI EXCEPTIONS

- Volunteer exception. IRC §513(a)(1). If a high percentage of the activity (85%) is carried on by volunteers, then it is not UBI. Volunteers may receive de minimus food and drink and still be “unpaid” Reg. §1.132-6T and GCM 39786 (March, 1988)
- Convenience exception. IRC §513(a)(2). A cafeteria for hospital employees that also serves general public.

UBI EXCEPTIONS

- Donated property exception. IRC §513(a)(3). The property needs to be “substantially” all donated, e.g., thrift stores
- Qualified public entertainment activities. IRC §513(d)(2). Very narrow exception. County fair, but cannot be likely to attract visitors.
- Trade shows. §513(d)(3)
- Bingo games. §513(f)

UBI EXCEPTIONS

- Certain hospital services to small rural hospitals (100 beds or fewer). IRC §513(e)
- Low cost (\$5.00 or less) distributed in conjunction with solicitation if not at the request of a donor and not subject to contribution. IRC §513(h)
- Exchange or rental of mailing lists with other tax exempt organizations. IRC §513(h)(1)(b)
- Research income generated by government, college, hospital, or freely available to the public. §512(b)(7)-(9) and Reg. §1.512(b)-1(f)(4).

UBI EXCEPTIONS

- Interest, dividend, annuity income. IRC §512(b)(1)
 - This does not apply to all exempt organizations
 - 501(c)(7),(9),(17)(20) are excluded unless funds are set aside for charitable purposes
 - Transfers (directly or indirectly) to controlling organizations from controlled organizations
 - If taxable subsidiary, then all is treated as UBI
 - If tax exempt subsidiary, then UBI to the extent of UBI in subsidiary.

UBI EXCEPTIONS

- Royalties. IRC §512(b)(2)
- Rents. IRC §512(b)(3), Reg. §1.512(b)-1(c)(2)(ii) for real estate (and incidental personal property), but not for debt-financed property
 - Debt-financed property rules require significant information and calculation to determine extent of UBI
- Capital gains. IRC §512(b)(5)

UNRELATED BUSINESS INCOME LEVEL

- “Primarily” engaged in exempt operations. Reg. §1.501(c)(3)-1. More than 50% UBI is jeopardy, 20% and less appears to be safe. PLR 8736046, PLR 8423083, PLR 8421070, PLR 7902006.
 - But see Orange County Agricultural Society, Inc. v Commissioner, 893 F2d 529 (2d Cir. 1990), which held 29-35% UBI causes revocation; however, also included private inurement issues.
- Organizations with high gross income have ability to shield large amounts of UBI
- Few actually profit from these activities

INUREMENT/PRIVATE BENEFIT

- Inurement applies to “insiders”
 - Intermediate sanctions and penalty tax applies
 - Former rule: Even \$1 of inurement risks loss of exemption
- Private Benefit
 - If the activity being conducted furthers the charitable purposes of the organization and the private benefits are incidental to the public purposes being served, then there is no violation.

INTERMEDIATE SANCTIONS-IRC §4958

- Penalty Tax on “excess benefit transactions”
 - Transaction provides a benefit to a “disqualified person” that is more than the benefit the organizations receives from that person
 - Non-fair market value transactions
 - Unreasonable compensation
 - Certain contracts for percentage of revenue
- May still revoke tax exempt status
- Applies to 501(c)(3) and (4), but not governmental entities

INTERMEDIATE SANCTIONS-IRC §4958

- Disqualified Person is any individual who exercises substantial influence over the organization
 - Director
 - Trustee
 - Organization manager
 - Employee
 - Related family members
 - 35%-owned entities
- Exemption for persons taking a vow of poverty

INTERMEDIATE SANCTIONS-IRC §4958

- Reasonable Compensation Safe Harbor
 - Form 990 requires statement regarding determination of reasonableness. What is reasonable depends upon size and type of entity
 - Compensation consultant may be required
 - May need to establish a compensation committee
 - Need to compare compensation of similarly situated executives
 - Approval by a state or other official does not determine reasonableness

INTERMEDIATE SANCTIONS-IRC §4958

- Improper reporting of compensation may trigger tax
 - Reimbursement of personal expenses are per se excess benefits unless properly reported
 - Reimbursement of travel and entertainment, imputed interest on interest-free loans, loan forgiveness

INTERMEDIATE SANCTIONS-IRC §4958

- Tax is tiered
 - Insiders benefiting are subject to 25% tax on amount of excess benefit first-tier tax
 - Managers, who participate knowing it is improper, subject to 10% tax on amount of excess benefit first-tier tax
 - Second-tier tax of 200% may be imposed on the individual if the transaction is not corrected
- Tax is on the individual, not the organization
- Form 990 requires disclosure of transaction and tax

LEGISLATIVE ACTIVITIES

- Prohibits political campaigning to elect or oppose a political candidate
- Lobbying
 - Direct or grass roots
 - Electing IRC §501(h)
 - Catholic Church challenge-Supreme Court did not grant certiorari
- Form 990 requires disclosure of excise taxes paid for excess expenditures to influence legislation and disqualifying lobbying expenditures

BOARD COMPOSITION

- Need representative board
 - This is a requirement for organizations described in IRC §501(c)(3)
 - Should not be comprised solely of the organization's employees, substantial donors, etc.
- Should have a reasonable number of directors
 - Michigan law now requires at least three
 - Too many may result in difficulty with quorum
 - Quorum is generally 50%

POLICIES-CONFLICT OF INTEREST

- Policy Recommendation
 - Any trustee having a relationship with another organization with which contracts or other arrangements are being considered by the Board of Directors must disclose the relationship and ask the remaining trustees to determine whether a conflict or duality of interest prevents the trustee from participating in the discussion and/or vote regarding the issue.
- Disclosure Form
 - List current employer or other principal business affiliation.
 - List any other employment or financial interest in which you or your immediate family have a position either as officer, director, trustee, partner, employee or agent of any business organization, which might give rise to a possible conflict of interest with the organization.
 - List all OFFICIAL positions which you or your immediate family members have as director, trustee, or officer of any charitable, civic or community organizations, as well as any UNOFFICIAL roles, such as significant donor, volunteer or advocate/advisor, which might give rise to a possible conflict of interest.

DUTIES OF DIRECTORS

- State law presumption that directors, who are absent from a meeting, voted in favor of all measures passed
 - Prime reason that directors should attend board meetings.
 - Directors need to voice objections immediately if a measure is passed that they believe is wrong.
- Business Judgment Rule
 - Directors and officers are not personally liable for their acts provided they act in good faith and with reasonable business judgment

DUTIES OF DIRECTORS

- State Law Limitation of Liability Permitted for *Volunteer* Directors
 - Include these provisions in the Articles or Bylaws
 - Not applicable to intentional or grossly negligent behavior
- State Law allows nonprofit corporation to assume liability for volunteers
- State Law allows for indemnification of directors and volunteers.
 - Purchase D&O Insurance

EMAIL VOTES

- Voting for directors
- Voting for members or shareholders

IMPORTANT NOTE

This presentation is for informational purposes only, and should not be construed as legal advice. Consult your own legal counsel for specific advice on how the law applies to your situation.

THANK YOU

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