



A Legal Checklist for Not-for-Profit Organizations

This 10-point checklist is written to help busy charitable organizations stay on top of today's regulatory compliance requirements. For further information, contact:

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1. REGISTRATIONS AND ANNUAL FILINGS

a) Secretary of the Commonwealth

- nonprofit corporation(s) articles of incorporation on file with Secretary of Commonwealth
- annual filing due November 1
- Secretary of State website: www.corp.sec.state.ma.us

b) Internal Revenue Service

- if tax exempt, file information return with IRS (Form 990, 990EZ, 990PF)
- due 4 1/2 months after fiscal year
- exemption from annual filing requirement:
 - organizations (other than private foundations) with gross receipts of not more than \$25,000
 - churches, organizations of churches, church auxiliaries, religious orders, mission societies, church affiliated elementary and secondary schools
- IRS forms and publications: www.irs.gov



c) Attorney General

i) Registration

- charitable organization(s) must be registered with Division of Public Charities before operating or raising funds in Massachusetts
- Attorney General forms and guides:
<http://www.mass.gov/?pageID=cagosubtopic&L=3&L0=Home&L1=Non-Profits+%26+Charities&L2=Charitable+Organizations&sid=Cago>
- definition of charitable organization: nonprofit organized to carry out a purpose to benefit a segment of the public
- Massachusetts accepts the Multistate Uniform Registration Statement
- if organization will solicit, need certificate (fee \$50) - religious organizations are exempt

ii) Annual Report

- due 4 1/2 months after fiscal year
- Form PC, copy of IRS tax return, audited financial statements (or review statement) if gross income over \$500,000 (\$200,000 for review statement)
- NOTE: Division of Public Charities does not require filing of list of donors that is attached to Form 990, but if filed with Division, it is part of the public record
- religious organizations are exempt

d) Other States

- make sure that the charitable organization is registered and up-to-date in other states in which the organization operates or raises funds
- Uniform Registration Statement: <http://www.multistatefiling.org>

e) Real and Personal Property Tax Exemption

- file Form 3ABC with Board of Assessors of each city and town in which the organization holds real or personal property by March 1
- to obtain Form 3ABC:
<http://www.mass.gov/Ador/docs/dls/publ/forms/3abc.pdf>
- must include a copy of the Form PC filed with Division of Public Charities

PRACTICE TIP: all of these are public documents. There is increased scrutiny by the public of these filings, including Internet access in many instances. Careful attention should be given to the information presented in these governmental forms so that the filings present an accurate and favorable view of the organization. Boards should be aware of these filings and review them thoroughly. You should make the best use of this public window into the organization and be mindful of this challenge and opportunity in organizational planning.

2. IRS FORM 990 PUBLIC AVAILABILITY

- under IRS regulations, charitable organizations and other exempt organizations must:
- make the three most recent Form 990s and the organization's exemption application documents available for public inspection during business hours without charge
- provide copies upon request made in person at the organization's offices, or by mail with 30 days upon written request, for no charge other than reasonable copying and mailing costs
- organization is exempt from the requirement of providing copies (but not public inspection) if the documents are posted on the Internet in a specified way
- donor list may be excluded from disclosure
- there are substantial penalties for noncompliance
- for private foundations, similar public availability requirements have been issued by the IRS

- donor list must be included

PRACTICE TIP: Congress, the IRS and the press are monitoring charity compliance with these requirements closely. Some charitable sector watchdogs are testing charity compliance with this requirement. It is highly recommended that all charities, regardless of size, take a moment now to gather these documents into a public inspection file, so that the charity does not find itself having to explain to the public why it is not in compliance with this requirement of public accountability.

3. CHARITY BOARD STEWARDSHIP

- charity should be governed by an active and well-informed board -
board must exercise careful oversight (duty of care)
- board members must act in good faith and in a manner that he or she believes is in the best interest of the charitable organization (duty of loyalty)
- executive compensation should be determined by the board without vote by the executive, and based on comparability information
- IRS Intermediate Sanctions rules impose taxes on persons who receive or approve excessive compensation (see No. 4, below, for safe harbor procedures)
- for conflict of interest, see No. 4, below
- Attorney General's Guide for Board Members of Charitable Organizations provides guidance for board members in carrying out their responsibilities

4. CONFLICT OF INTEREST

- charitable organizations should avoid business arrangements with board members and their relatives unless truly necessary for the best interest of the organization
- organization should have a written conflict of interest policy that requires:
 - disclosure of financial interest



- withdrawal from discussion and voting by the involved board member
- decision by disinterested board members that the transaction is in the best interest of the organization
- full disclosure on IRS and state filing forms
- IRS Intermediate Sanctions rules impose taxes on persons who are involved in or approve excess benefit transactions with organization insiders or insiders' family members
- executive compensation and any transactions with insiders or insider's family or business should be structured to satisfy the regulation's safe harbor provisions, so that the arrangement is presumed to be reasonable:
 - approval by disinterested board members, with interested person not present during the debate and not voting regarding the arrangement
 - reliance on appropriate data showing reasonableness
 - documentation by the board or committee of the basis of its decision

5. **FUNDRAISING**

a) Honest fundraising -- key to the organization's credibility!

- review fundraising materials to ensure that donors are correctly told how their contributions will be used
- monitor outside fundraisers [see (b), below]
- monitor compliance with donor restrictions, including promises in fundraising materials
- account carefully for donated funds in financial statements, in compliance with statutory limits on expenditure of appreciation
- for issues of Internet fundraising, see No. 9, below

b) Relationships with fundraising agents

- outside fundraisers and commercial co-venturers must register with Division of Public Charities and, in the case of solicitors and co-venturers, file financial reports



- and, if fundraising extends into other states, outside fundraiser and commercial co-venturer registration and reporting may also be required there
- for issues of Internet fundraising, see No. 9, below
- arrangements with fundraisers and co-venturers should be carefully negotiated to make sure that the charity is obtaining maximum benefit from the fundraising that will be done in its name
- the fundraiser or co-venturer should only be authorized to proceed after the organization carefully reviews fundraising materials and telephone scripts to make sure that the organization is comfortable with what the public will be hearing or reading in the name of the organization
- complaints or other indications of problems should be followed up aggressively by the organization
- a complete accounting of donations and expenses should be required on a periodic basis throughout the campaign

c) Raffles and Las Vegas Nights

- must be operated by the not-for-profit organization, not by professionals
- a permit from the city or town clerk is required
- subsequently, a financial report and tax payment to the Lottery Commission are required

d) Used auto donation programs

- used car donation programs must be structured carefully
- avoid deception to auto donor about how the charity will benefit, and about the extent of tax deduction for the donor (donor cannot claim deduction for Blue Book value if auto is in poor condition)
- avoid IRS claim that arrangement results in excessive private benefit to auto dealer and thereby jeopardizes exempt status

e) Charitable gift acknowledgments

- under IRS requirements, donors of cash or property worth \$250 or more must receive, in order to deduct their contributions, an acknowledgment or receipt from the charity, stating:

- i) the amount given or, in the case of a noncash contribution, a description (but not necessarily a valuation) of the property contributed;
 - ii) whether or not the charitable organization provided any goods or services to the donor in consideration; and
 - iii) if goods or services were provided to the donor, a description and good faith estimate of the fair market value of the goods or services provided.
- if the charity provides goods or services to the donor in return for a contribution of more than \$75, the charity must furnish the donor either in the solicitation or in a receipt, a written statement (the IRS may impose a penalty on the donee charity for failing to provide this statement):
- i) indicating a good faith estimate of the value of the goods or services provided to the donor; and
 - ii) informing the donor that the deductible portion of the contribution is limited to the excess of the contribution over the value of the goods or services received in return.

6. **AVOIDING UBIT**

a) **Taxation of Unrelated Business Income**

- unrelated business income is taxed, generally at business corporation rates
- if unrelated business income comprises a substantial portion of an exempt organization's income, loss of tax-exempt status may result
- unrelated business income is income derived from (a) a trade or business, (b) which is regularly carried on, and (c) which is not substantially related to the performance of tax-exempt functions.
- the fact that income is produced for use in furthering exempt purposes does not qualify the income as related; the income itself must be derived in the course of furthering an exempt purpose.
- where possible, attention to the structuring of income-producing activities may permit the organization to avoid paying UBI Tax. If



substantial unrelated business activities are contemplated, the organization may wish to establish a taxable subsidiary or affiliate to conduct the commercial activity.

b) Royalty Income and Fundraising Income Are Not UBI -

traditional donations and fundraising income are not UBI

- payments for permission to use charity's name or logo usually are considered to be royalty payments, which are not UBI

c) Advertising Income May Be UBI

- if the charity advertises the donor's product or service in return for the donation, the income relating to the advertising may be UBI

d) Corporate Sponsorship Payments

- a corporate sponsorship payment is exempt from UBIT even if the charity uses or displays the corporation's name or logo in an acknowledgment
- however, if the charity goes beyond a mere acknowledgment of the sponsorship and advertises the sponsor's goods or service, the advertising portion of the payment may be UBI
- also, if the sponsor is granted an exclusive provider arrangement (e.g., only the sponsor's product, and not a competitor's product, will be used at the event), the value of the exclusive provider arrangement may be UBI

7. ASSET DISPOSITIONS, MERGERS, AFFILIATIONS, CONVERSIONS, DISSOLUTIONS

- three fundamental principles of charities law apply to use of charitable assets:
 - charitable assets cannot be used for private enrichment
 - charitable organization cannot unilaterally transfer control of its assets
 - charitable organization cannot unilaterally change the purpose for which assets are used
- court proceeding may be needed to change the use of donated funds



- disposition of substantial assets requires 30 day notice to Division of Public Charities
- in mergers and affiliations, careful attention is required regarding future use of donated funds
- charities cannot unilaterally convert to for-profit status. Attorney General and IRS will monitor carefully
- dissolution require court approval, with court directing recipient and future use of assets

8. MAINTAINING NONPROFIT AND TAX EXEMPT STATUS

- avoid private benefit
- remain focused on mission as well as bottom line
- understand public concerns about excessive executive compensation when establishing compensation levels, with plan for addressing public concerns if high compensation is in the best interest of the organization
- educate constituency and general public about organization's activities, including full an effective reporting of program activities on Form 990 and PC Form
- authority of Attorney General, Secretary of the Commonwealth, and the courts

9. INTERNET ISSUES

a) Charitable Organization's Website

- issue of need to register in states other than Massachusetts
- for multi-state registration issues for websites and Internet fundraising, see "Charleston Principles" of state charity regulators at www.nasconet.org
- IRS charitable gift acknowledgment requirements apply



- be careful about lobbying content, so that the organization does not violate the IRS requirement that no more than an insubstantial portion of the organization's expenditures are devoted to lobbying
- be careful about political activity content, so that the organization does not violate the IRS requirement that a charitable organization may not intervene in a campaign for public office and remain exempt from federal income tax
- be careful about unrelated business content, such as advertising by businesses, which may trigger UBIT

b) Websites of Third Parties

- need for careful due diligence, written agreement, and charity review of content
- issue of third party's registration
- beware of establishing links to activity that is prohibited for charitable organization (e.g., political activity or substantial lobbying)
- negotiate arrangements (including links) carefully to avoid undue private benefit
- avoid consumer and donor deception
- be careful about unrelated business content, including endorsement advertising, which may trigger UBIT

10. CORPORATE MARKETING RELATIONSHIPS

a) Requirement of Charity's Permission

- businesses who advertise or raise money in conjunction with the charity's name should be permitted to do so only under a written agreement reviewed carefully by the charity and after strong negotiation to ensure that the charity is receiving the best possible financial benefit

b) Relationships

- contributor
- sponsor
- commercial co-venturer
- paid solicitor
- joint venture (IRS issues require careful attention)

c) Charity's Due Diligence and Agreement Terms

- the partner
- the terms and written agreement
- charity approval of fundraising appeal should be required
- partner should be required to report to the charity any complaints received
- the partner should be required to provide periodic full accounting

d) UBIT Issues

- payments from a business to a charity may raise Unrelated Business Income Tax (UBIT) issues (See No. 6, above).

e) Registration Issues

- registration and reporting requirements must be complied with in the affected states, both for the charity and for the business corporation

f) Consumer Deception and Disclosure Issues

- state and federal laws regarding representations and disclosures must be followed, including informing the consumer of the affect that a purchase will have on the money to be received by the charity
- some states have requirements for the content of Cause Marketing, Fundraising Counsel and Solicitor contracts
- the Attorneys General in many states have indicated concerns about several consumer issues in corporate advertising which uses a charity's endorsement or otherwise uses the name of a charity (e.g., misrepresentations regarding product endorsements or product superiority claims, misrepresentations of the effect of the consumer's purchase on the amount that the charity will receive, and failure to disclose the fact that the commercial sponsor has paid for the use of the nonprofit's name or logo)

g) Internet Issues

- there is much regulator and press attention to issues in Internet fundraising (see No. 9, below)