ESSENTIAL

INFORMATION

FOR THE DIRECTORS OF

CENTER FOR NONPROFIT LAW
"Helping The People Who Change The World"
David E. Atkin, Director

HOW TO MANAGE YOUR NONPROFIT CORPORATION: RESPONSIBILITIES OF THE BOARD

The Board of Directors of a nonprofit corporation is responsible for managing the affairs and activities of the corporation. The Board is responsible for setting and overseeing the overall policies and activities of the organization. The Board is also responsible for managing the organization's financial activities and overseeing its general financial health.

1. LEGAL RESPONSIBILITIES OF DIRECTORS

Directors are required to fulfill a "Duty of Care" and a "Duty of Loyalty." To fulfill the duty of care, the director must attend most meetings, be reasonably well informed about the information necessary to make good decisions, and must exercise his or her own independent judgment. The duty of loyalty requires that a director make decisions and act in the best interests of the corporation and not use their position to further his or her own interests or the interests of any other entity.

Specifically, the law requires that the members of the Board of Directors "Shall discharge the duties of a director ...

1. In good faith;
2. With the care an ordinarily prudent person in a like position would exercise under similar circumstances; and
3. In a manner the director reasonably believes to be in the best interests of the corporation."

The law also states that in "discharging the duties of a Director, a Director is entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, if prepared or presented by" officers or employees of the corporation, legal counsel, public accountants, other experts or specialists, and board committees, so long as the Director reasonably believes that these persons are reliable and competent.

In a nutshell, Directors should give their duties for a nonprofit corporation the same level of attention and care that a prudent person would use for his or her own affairs, and may rely upon other persons to help her or him carry out those duties.

2. BASIC RESPONSIBILITIES OF NONPROFIT BOARDS

1. Determine the organization’s mission and objectives and see that the organization’s programs accomplish its mission.
2. Select the Executive Director and support and review his or her performance.

3. Determine, monitor, evaluate, and refine the organization's programs and services.
4. Ensure effective organizational planning.
5. Fundraising: Ensure adequate resources are available for the organization to accomplish its mission and objectives.
6. See that resources are managed effectively, that proper financial controls are used, that proper records are kept and necessary reports are filed.
7. Enhance the organization's public image and connection with its community, donors, members, and volunteers.
8. Establish personnel policies and monitor their application to staff by the Executive Director and serve as a court of final appeal.
9. To be responsible for Board development, including identification, and recruitment of potential new Board members, orientation, ongoing training of Board members and assessment of the Boards performance.

3. **WHAT MATTERS MUST BE FORMALLY DONE BY BOARD RESOLUTIONS**

As stated above, the Board is not required to personally be involved with every detail or activity. Instead, the Board sets basic policies and oversees the activities and finances of the organization. The Board can delegate responsibility for the actual work and is not expected to "micro-manage" the affairs and activities of the corporation. However, in fulfilling its role, there are some matters which the Board should always take care of directly through formal resolutions passed by a vote at a properly scheduled meeting of the Board of Directors.

As a minimum, the Board should meet and pass specific resolutions to accomplish the following:

1. to set or change the organization's basic mission, policies and goals,
2. to establish and authorize funds for and provide oversight for all significant programs or projects,
3. to authorize significant activities or events and any activity deemed to possess a significant risk of exposure to liability for injuries, damages, defamation, etc.,
4. to hire or fire an executive Director , if needed
5. to establish or change basic employee personnel policies and benefits, if applicable, and
6. to adopt budgets and authorize expenditures.

A Board may wish to be more involved in the details of the organization than is indicated by the above list of items, but should never be *less* involved than required to handle these items of business.

4. **USE NECESSARY CORPORATE FORMALITIES**

A nonprofit corporation is a separate legal entity. Many benefits of corporate status, such as limited personal liability and tax benefits, flow from the legal recognition of the corporation as an entity which is entirely separate from its individual Directors, officers and members. To maintain the separate identity of your nonprofit corporation you must consistently use certain important

"corporate formalities." While some of these requirements may seem overly formal at times, it is nonetheless essential that they be followed. They will soon become second nature to you, and may even help you better manage the affairs of the corporation.

The most common corporate formalities are already familiar to most people. They include such things as giving the required formal notice of meetings, conducting business only with the presence of a proper quorum, clearly stating all motions, following proper voting procedures to pass motions, keeping contemporaneous written notes, writing and distributing minutes, and officially adopting the minutes of the prior meeting at the next meeting of the Board. Many of the required corporate formalities you must follow are described in your Bylaws.

Be thorough and precise in composing and writing your motions and resolutions. Always adopt your written minutes. These must be distributed to the Directors either between meetings or at the beginning of the following meeting and must be approved (either "as read" or "as corrected") by a majority vote at that following meeting. The approval of the minutes of the previous meeting is itself recorded in the minutes of that meeting. This creates a clear written record of the decisions made on behalf of the corporation.

Give proper notice of meetings. The Bylaws set the notice required for meetings of the Board of Directors. If proper notice cannot be given, or if it is not certain that proper notice was given, use a Waiver of Notice to avoid potential complaints or challenges later.

The minutes, consent resolutions, waivers of notice, and other formal documents of the corporation should always be kept in the Corporate Minutes Book. This book should be stored in a safe and secure place, and only removed from that place to add new materials. To insure that the formal records cannot be lost or misplaced, it is very important to also keep a copy of the corporate minutes, resolutions, etc. in a second "working notebook" that can be used for reference and daily management purposes.

5. <u>SIGNING DOCUMENTS ON BEHALF OF THE CORPORATION</u>

Directors are often called upon to sign contracts, leases or other documents for their corporation. In doing so, you should avoid any indication that you are dealing in a personal capacity. When signing documents you should make it clear that you are acting on behalf of the corporation by writing (after or under your signature) "On behalf of X Corporation."

This information package contains reports to help you with special topics such as how to deal with conflicts of interest, how to avoid personal liability for debts of the corporation, how to raise funds before you have your own tax exempt status, etc. If you have any questions regarding the information in this letter or concerning other aspects of your responsibilities as Directors for your corporation, please do not hesitate to call us.

HOW TO AVOID LIABILITY AS A MEMBER OF A NONPROFIT BOARD

The members of the Board of Directors for nonprofit corporations are frequently concerned about their liability for the debts or actions of the organization. Oregon law, like the laws of most other states, provides a strong "corporate shield" which protects unpaid Directors of nonprofit corporations, and the courts have faithfully enforced those protections. In addition, the Federal Volunteer Protection Act, adds another layer of protection to volunteer (unpaid) Officers and Board members of nonprofit organizations. Together, these two statutes make it safe for Board Members and Officers to volunteer their time and services to nonprofit organizations, so long as they fulfill their duties with reasonable care. Further, case law shows that the courts have faithfully followed the intent of these statutory protections for volunteer Directors and Officers of nonprofit organizations.

I. <u>YOUR LEGAL PROTECTION AGAINST PERSONAL LIABILITY</u>. There are two major portions of the Oregon Nonprofit Corporation Act which provide this protection to Directors and Officers:

1. The unpaid Officers and Board members of qualified nonprofit organizations are protected against personal liability so long as they are not guilty of gross negligence or intentional misconduct. The statute (ORS 65.369) specifically states:

    > "The civil liability of a qualified director for the performance or nonperformance of the director's duties shall be limited to **gross negligence** or **intentional misconduct.**"
    >
    > 'Qualified director' means a person who serves without compensation for personal services as" ... An officer, director or member of an executive board for the purpose of setting policy and controlling or otherwise overseeing the activities ... of a nonprofit corporation..." ORS 65.369

Gross Negligence
A Director is not likely to be guilty of "gross negligence" if he or she exercises reasonable prudence and responsibility. For example, so long as a Director attends most meetings of the Board, and he or she is reasonably well informed by reviewing the activities, expenses and income of the organization, then she or he would not be liable for the debts of the corporation. Directors will not become liable simply because they exercise poor business judgment or suffer a lack of fundraising success. However, if a Board of Directors continues to incur debts on behalf of the corporation without making any attempts to raise money to pay for them, at some point this would become "gross negligence" and they may be held to be personally liable.

Intentional Misconduct
If you commit some intentional act which injures or damages some other party, even if you did it as part of your duties as a Director or on behalf of your nonprofit corporation, you can

be held personally liable for those injuries or damages. This is especially true if your acts constitute a crime or an intentional tort, such as assault or defamation.

2. The second major protection for Directors and Officers comes from two separate provisions of the Nonprofit Corporation Act, ORS 65.357(4) for Directors and ORS 65.377(4) for Officers. ORS 65.357(4), which is duplicated for Officers in ORS 65.377(4) states:

> **"A director is not liable to the corporation, any member or any other person for any action taken or not taken as a director, if the director acted in compliance with this section. The liability of the director for monetary damages to the corporation and its members may be eliminated or limited in the corporation's articles to the extent provided in ORS 65.047(2)(c)."**

The section referred to in the first sentence, to which the Director must comply to gain the protection, states:

> (1) "A director shall discharge the duties of a director, including the director's duties as a member of a committee:
> (a) In good faith;
> (b) With the care an ordinary prudent person in a like position would exercise under similar circumstances; and
> (c) In a manner the director reasonably believes to be in the best interests of the corporation."

This section is duplicated for Officers in ORS 65.377 (1)(a)-(c).

II. <u>FURTHER PROVISIONS LIMITING LIABILITY.</u> There are some additional means for giving even greater protection from liability to the Directors and Officers of a nonprofit corporation. For example, ORS 65.047 allows a statement to be put in the organization's Articles of Incorporation which will provide even further protection, as follows:

> "A provision eliminating or limiting the personal liability of a director or uncompensated officer to the corporation or its members for monetary damages for conduct as a director or officer, provided that no such provisions shall eliminate or limit the liability of a director or officer for any act or omission occurring prior to the date when such provision becomes effective, and such provision shall not eliminate or limit the liability of a director or officer for:
> (a) Any breach of the director's or officer's duty of loyalty to the corporation or its members; or
> (b) Acts or omissions not in good faith or which involve intentional misconduct"

III. <u>THE BOARD CAN MEET SOME OF ITS RESPONSIBILITIES THROUGH DELEGATION.</u> To make it even easier for volunteer Board members and Officers to fulfill their duties, the law allows Directors and Officers to delegate some of their duties to qualified persons, and to rely upon those persons to perform those duties, unless they have reason to know otherwise. The law states:

(2) In discharging the duties of a Director, a Director is entitled to rely on information, opinions, reports or statements, including financial statements and other financial data, if prepared or presented by:
   (a) One or more Officers or employees of the corporation whom the Director reasonably believes to be reliable and competent in the matters presented;
   (b) Legal counsel, public accountants or other persons as to matters the Director reasonably believes are within the person's professional or expert competence;
   (c) A committee of the Board of which the Director is not a member, as to matters within its jurisdiction, if the Director reasonably believes the committee merits confidence; or

(3) A Director is not acting in good faith if the Director has knowledge concerning the matter in question that makes reliance otherwise permitted by subsection (2) of this section unwarranted." *see* ORS 65.357

IV. <u>HOW TO AVOID OTHER POSSIBLE SOURCES OF INCREASED EXPOSURE TO PERSONAL LIABILITY.</u> Directors and Officers should realize that their "Corporate Shield" will only protect them if they properly maintain their nonprofit corporation's legal status and comply with legal requirements. That involves the following considerations:

1. Always Use the Proper Corporate Formalities. If the Board allows the separate identity of the corporation to be lost by failing to use the standard "corporate formalities," the Directors may be found to have been acting as individuals and can be held personally liable. To avoid any possibility of liability, be sure to make decisions for the corporation in the proper way: make all decisions at properly called meetings for which legally adequate notice was given, and at which a quorum is present. Make decisions by stating motions and voting on them and always keep good written minutes of the Board's decisions. Mere technical violations or occasional lapses of corporate formalities will not, by themselves, bring individual liability to Directors.

2. Do Not Act Without Proper Board Authority. If the Directors or Officers of a nonprofit group act outside the authority delegated to them by the Board of Directors, they may be individually liable for any losses or liabilities the corporation incurs as a result. You can avoid this risk by passing clear resolutions regarding the corporation's programs, activities, expenditures, policies and delegations of authority.

3. Always Follow the "Conflict of Interest" Transaction Rules. Whenever a Director has a direct or indirect conflict of interest, she or he must use a 3-step process: "Declare, Disclose and Abstain." That is, whenever an issue arises in which a Director may have a conflict of interest, the Director must formally declare that conflict of interest, disclose the nature of the conflict of interest, and abstain from any ensuing discussion and the vote. The minutes of the meeting should report that the Director did follow these steps. The rest of the Board must then analyze the issue and ensure that no Directors receive any special unearned benefits. Failure to properly handle conflicts of interest may cause a Director to lose the protection of the "Corporate Shield." (See report on Handling Conflicts of Interest)

4. Don't Participate in Breaches of Conduct by Other Directors. If a Director knowingly allows another Director to gain improper financial benefits, they too may be held liable. Any Director present at a meeting where another Director knowingly breaches his or her fiduciary responsibility to act in the best interests of the corporation may be personally liable, unless a dissent is entered in the minutes, or a written dissent is filed with the secretary before adjournment, or filed by registered mail immediately after the meeting.

5. Always File State and Federal Reports as Required. The Directors are responsible to make certain that the corporation files all state and federal tax returns and other required reports in a timely fashion. If the necessary forms and applications are not properly filed due to the fault or inattention of a Director, and the Director(s) do not remedy the error after notification by the IRS or state agency, the Director(s) may be personally liable, under some circumstances, for the payment of some taxes or penalties.

6. Comply with IRS Restrictions. If a nonprofit corporation is penalized by the IRS for acting improperly, for instance by lobbying too much or by allowing donors to take improper tax deductions, then any Directors who knowingly allowed or participated in allowing those actions could be held personally liable by the IRS for penalties, under some circumstances.

7. Insurance. Finally, a Board may decide to talk with an insurance agent about purchasing "Directors and Officers" insurance (often called "D & O" Insurance). Many small and medium sized organizations with relatively "normal" or "common" operations feel that these policies do not add that much to the protection they already have from state law to make the policies worth the price; however if you have questions you should contact your insurance agent.

Alternatively, individual Directors can often add a "rider" to their homeowners insurance policy or their personal liability umbrella insurance policy, to protect them from liability incurred for volunteer activities (such as serving as a Director or Officer of a nonprofit organization). This is usually much, much less expensive than purchasing formal D & O insurance.

PROPER FINANCIAL PROCEDURES AND RECORDS FOR NONPROFIT CORPORATIONS

It is extremely important that the funds of a nonprofit corporation be handled properly, and that proper financial records be kept of all of the income and expenses. The following information should help you comply with relevant requirements.

1. FINANCIAL RECORDS

The financial records which nonprofit organizations must keep are similar to those of any small business. That is, you must keep a record of all income and all expenses with enough documentation and receipts to substantiate the source of your income and the purpose of your expenses. To keep track of your expenses you can use the ordinary "expense categories" (postage, telephone, office supplies, travel, printing, etc.) used by most for-profit businesses. You ordinarily will not need a CPA or attorney to do your books, an experienced bookkeeper should be able to help you set up your records and financial books. You can do the bookkeeping yourself, have a staff member or volunteer do it, or have it done by a hired bookkeeper.

You must keep a record of all of your significant contributions, including the name of the donor, the amount they donate, and the date of the donation. You should give a written receipt to all donors who wish to take a tax deduction for their donation. The IRS requires a written receipt for donations of $250 or more. However, you do not have to keep a record of the names of donors who give small donations, or contribute small amounts at fundraising events, and will not take a tax deduction. You can either give a receipt for each donation or a combined receipt for all donations at the end of the year.

All financial records and receipts must be kept for at least three years. Receipts for the purchase of durable goods which remain usable for longer than three years must be kept for the useful life of those goods.

2. OPEN A SEPARATE CHECKING ACCOUNT FOR THE CORPORATION

To insure that the nonprofit corporation's funds are kept scrupulously separate from all other money, and to make sure that you have a good clear record of all income and expenses, it is essential that you have a checking account used just for the corporation. It is a good policy to require that all income and expenses of the group go through that checking account.

The bank will likely want to see a copy of your filed Articles of Incorporation (with the Corporation Division file stamp on them) and your EIN /tax ID number when you open the account. They will provide you with the appropriate signature cards for corporations.

Keeping good financial records is essential. The more information you have, the easier it is to guarantee that your financial records are complete. For this reason, when you order checks and a checkbook, we strongly recommend that you get business size checks with large "check stubs" that have enough room for you to completely document information for every deposit into the account and every check or withdrawal out of the account. The small,

personal sized checkbooks simply do not have enough room for all of the information and notes you should keep.

3. <u>**THE PERSON WHO SIGNS THE CHECKS SHOULD NOT KEEP THE FINANCIAL RECORDS**</u>

It is important to insist on certain basic financial controls to prevent or reduce the possibility that money can be taken or misused. One of the most basic safeguards is insisting that the person who signs the checks is not the same person who is responsible for keeping the books. Ideally, you should not have the organization's Treasurer do the bookkeeping. Instead, have them review the books to catch any errors or problems with the records or any unauthorized expenditure of funds.

4. <u>**MONEY IS SPENT ONLY WITH PROPER AUTHORIZATION**</u>

To protect the staff and Directors who sign the checks and are responsible for spending the corporation's money, and to protect the nonprofit corporation itself, it is important that the Board formally authorize all expenditures. The best, and most efficient, way to do this is through adopting budgets. There are many kinds of budgets that you can use to ensure proper authorization, including an annual budget, a quarterly budget, or even just a series of monthly budgets. In addition, the Board can also adopt budgets for individual events, projects, or programs. If a large expense must be incurred that is not part of a budget already adopted by the Board, it is important that the entire Board be informed about the expense, and that a motion be properly passed authorizing the expenditure.

5. <u>**PREPARE AND IMPLEMENT A FUNDRAISING PLAN**</u>

Finally, developing a realistic fundraising plan and putting a high priority on fundraising is essential to the success of your organization. Whether your organization needs a substantial amount of money or just a little to perform its charitable and educational work, it is important that you prepare a "business plan" to guide you in your fundraising venture. This fundraising plan should, ideally, include income from a variety of sources, including earned income, grants from foundations, large contributions from major donors, smaller contributions from ordinary contributors, membership fees, and money from fundraising events. Everyone in the organization, including Board members, volunteers, and staff should consider themselves part of the fundraising effort and fundraising team.

HOW TO WRITE MINUTES

1. <u>GENERAL INFORMATION</u>

It is essential that a written record of every Board meeting be properly prepared, adopted and stored. These minutes must contain the exact wording of each formal resolution passed by the Board. However, the minutes do not necessarily need to describe the contents of the various discussions and statements made at a meeting. If your minutes are quite long and contain more than just the formal resolutions, it is best to list the resolutions first, separately, to make them easy to find later.

2. <u>ADOPTION</u>

At the beginning of each meeting, you should make sure that the Board reviews the minutes of the previous meeting and adopts them, either "as written" or "as corrected". If a correction was made prior to adoption, the original minutes should be corrected, and the correction itself should be briefly described in the minutes of the meeting where they were adopted.

3. <u>CONTENTS</u>

The minutes of every meeting (other than the initial, or organizational meeting) should contain at least the following basic information:

Introductory Information

1. Time (date and hour)
2. Place (address)
3. Statement that the meeting was properly called:
    a. By whom;
    b. By what kind of notice (Attach a copy of the notice and attach any signed waiver of notice)
4. Presiding Officer
5. Secretary of the meeting
6. Names of those present
7. Quorum statistics (how many were present in person, and how many by proxy)
8. Reading, correction (if any), and adoption of minutes of the previous meeting

Decisions Made and Reports Given at the Meeting:

9. Resolutions proposed
10. Resolutions adopted (the name of the person who made the motion is often included, as well as who seconded it, but this is not legally required)
11. Record of those who voted for or against a proposal (if you or they wish to have this in the record)
12. Reports of Officers and committees
13. Adjournment (time)

Certification of Minutes:

14. Signature of the Secretary at the end of the document

15. Signature of the Secretary certifying the adoption at a following meeting, and giving the date and place of the meeting at which the minutes were adopted.

Points to Remember

- Keep minutes of all meetings
- Keep them in a clear, concise form, properly verified
- Keep them in a minutes book
- Transcribe minute notes as soon as possible after the meeting
- The Secretary should keep the minutes and guard them
- Do not use printed-form minutes
- Make changes or corrections only with approval of the members and initial every change
- Include the essential points of each resolution
- Remember the binding legal effect of the minutes. Be careful what is said in them, but also remember that minutes are prima facie evidence, not conclusive proof of what they state and that they can be opposed by oral testimony.
- No privilege against self incrimination applies to the minutes
- Be particularly careful in writing up the organizational meeting minutes
- Include important documents (such as budgets, waivers of notice, etc.) into the corporate minutes book with the minutes which refer to them.

HOW TO DEAL WITH CONFLICTS OF INTEREST

When Directors or their related parties engage in business transactions with the nonprofit organization they serve, it is defined as a Conflicts of Interest transaction. Conflicts of interest are legal but they can become a form of 'insider self-dealing' if not handled properly, and thereby jeopardize both the nonprofit corporation and the individual Director(s) involved. Accordingly, it is very important that your Board of Directors deal with such conflicts correctly.

Conflicts of interest involve situations in which a Director's or Officer's personal finances, or those of his family members, will be affected by a decision or action of the corporation. Any conflict between a Director's personal interest and the nonprofit corporation's interest must be resolved in favor of the corporation and such transactions must not give improper benefits or unearned payments to Directors or Officers or their families. While conflicts of interest should generally be avoided and minimized, nonetheless it is relatively common for nonprofit corporations to engage in some limited transactions involving their Directors or Officers, when it will benefit the organization to do so.

Conflict of interest transactions are not illegal or prohibited, but the proper procedures must be followed, as explained below. There are five separate steps that must be followed, and documented, to satisfy Federal laws and regulations:

1. <u>CONFLICT OF INTEREST TRANSACTIONS MUST BE APPROVED BY THE BOARD</u>. All transactions involving a conflict of interest must be taken to the Board of Directors for approval, and such transactions specifically cannot be approved by an organization's staff members, including the Executive Director. This means that even very simple types of decisions that are otherwise always made by the staff, cannot be made at staff level if they involve a conflict of interest.

2. <u>"DECLARE, DISCLOSE AND ABSTAIN".</u> This simple three-step process meets the legal requirements for dealing with conflicts of interest. That is, when a conflict of interest arises, a Director must:

A. <u>DECLARE</u> that he or she has a conflict of interest,
B. <u>DISCLOSE</u> the nature of the conflict (usually how it will affect his or her personal finances), and disclose the details of the proposed transaction such as the goods or services involved and the price.
C. <u>ABSTAIN</u> from voting on the matter(s) involved.
D. <u>LEAVE THE MEETING</u> so that the Director cannot see or hear the discussion or vote.

IF IN DOUBT, DISCLOSE any dealings or matters which may represent a conflict of interest.

3. ANALYSIS BY THE BOARD TO ENSURE REASONABLE DEALING. When a conflict of interest transaction has been proposed to the Board, the "disinterested" Directors at the meeting must analyze the proposed transaction to make sure that it is fair and reasonable and based on free-market prices and payments. The organization cannot pay a Director or Officer a higher price for goods or services than the price they could find with a reasonable search and effort, in the open marketplace for such items. The Board is expected to obtain "independent and reliable" information regarding the fair market value of the goods or services involved. To accomplish this requirement, the Board will often need to get price quotes or price lists, or the advice of an independent expert, in order to assure themselves that the price being paid is reasonable.

4. SPECIAL VOTING RULES. The Conflict of Interest Policy requires that conflict of interest transactions must be approved by a majority of ALL of the organization's disinterested Directors serving in office, including those Directors who did not attend the meeting.

5. DOCUMENTING YOUR COMPLIANCE WITH THESE RULES. The minutes of any Board meeting where a conflict of interest transaction was considered, must specifically document the organization's compliance with the above rules. This means that the minutes must:

A. Show that the affected Directors and Officers properly "Declared, Disclosed and Abstained" from voting on a conflict of interest transaction; and

B. Clearly state that the conflicted Director left the room before discussion and the vote.

C. Clearly say what information the Board reviewed and relied upon in making a finding that the organization was not paying more than reasonable, fair-market prices and rents, and the source of that information; and

D. State the names of all Directors who voted for, and against, approval of the Motion to approve a conflict of interest transaction.

FEDERAL AND STATE REPORTING REQUIREMENTS FOR TAX EXEMPT NONPROFIT CORPORATIONS

INTERNAL REVENUE SERVICE

The Internal Revenue Service requires most nonprofit corporations to file reports with them each year; only churches and certain other organizations are exempt from this filing requirement.

Small tax-exempt organizations whose annual gross receipts are normally $50,000 or less are not required to file Form 990 or Form 990-EZ. With the enactment of the Pension Protection Act of 2006 (PPA), these small tax-exempt organizations are required to electronically file Form 990-N, also known as the e-Postcard, with the IRS each year. However, if the organization is a private foundation it must file a Form 990-PF annually, *regardless of the income*.

Organizations with annual gross receipts of more than $50,000 but less than $200,000, and with assets less than $500,000 at the end of their tax year, are required to file Form 990-EZ.

Organizations with more than $200,000 in gross receipts or $500,000 in total assets at the end of their tax year are required to file Form 990.

Exceptions.
Exceptions to the annual 990 reporting requirement include organizations that are included in a group return, private foundations required to file Form 990-PF, and section 509(a)(3) supporting organizations required to file Form 990 or Form 990-EZ. In addition, this filing requirement does not apply to churches, their integrated auxiliaries, and conventions or associations of churches.

Due Dates. If your organization is required to file a Form 990, 990-EZ, 990-PF or 990-N, it is due by the 15th day of the 5th month after your accounting year ends. This return is due on May 15 for nonprofit corporations who use the calendar year as their fiscal year. The IRS is authorized to impose penalties if your organization files the Form 990, 990-EZ, or 990-PF late without requesting an extension. The Form 990, 990-EZ, 990-PF or 990-N and the instructions for completing them, can be obtained directly from the IRS at www.irs.gov.

Penalties. If, in filing any of the series of 990 Forms, information is left out, incorrectly entered, incorrectly reported or the report is unsigned or submitted late, the IRS can assess a $20 a day penalty up to the smaller of $10,000 or 5% of the gross receipts. If an organization's gross receipts exceed one million dollars ($1 million) annually, the penalty is $100 a day to a maximum of $50,000. Organizations that do not file every year will be classified as inactive.

Individual Responsibility. If an organization does not file a complete return or does not furnish correct information, the IRS will send the organization a letter that includes a fixed time to fulfill these requirements. After that period expires, the person charged with this responsibility on the organization's behalf, but who fails to comply can be charged a penalty of $10 a day. The maximum penalty on all persons for failures with respect to any one return shall not exceed $5,000.

Revocation of Tax Exempt Status. The Pension Protection Act requires the IRS to automatically revoke the tax-exempt status of any organization that fails to meet its annual filing requirement for three consecutive years. Therefore, organizations that are required to file and do not file the e-Postcard (Form 990-N), or an information return Form 990 or 990-EZ for three consecutive years, will have their tax-exempt status automatically revoked immediately upon missing the filing due date of the third consecutive year.

STATE OF OREGON

Department Of Justice. All public benefit nonprofit organizations incorporated in the state of Oregon are required to register with the Oregon Department of Justice, Charitable Activities Section. *Only those organizations incorporated as mutual benefit or religious are exempt from this requirement*.

The Oregon Department of Justice also requires all Oregon nonprofit public benefit corporations to file an annual financial information return, Form CT-12. This report will include copies of the IRS Form 990, 990EZ, 990-PF or 990-N. The report must be filed within five months and 15 days from the close of the organization's fiscal year. For organizations operating on the calendar year, the returns are due on May 15. An extension of time can be gained by submitting a written request *before* the due date. You should contact the Department of Justice to make sure you have the most recent forms and instructions, at: DEPARTMENT OF JUSTICE, Charitable Activities Section, 1515 S.W. Fifth Avenue, Suite 410, Portland, Oregon 97201-5451, or www.doj.state.or.us.

Oregon Corporation Division. All nonprofit corporations must complete a simple "Annual Report" which is sent out by the Oregon Corporation Division approximately 30 days before the anniversary of the incorporation of the organization. It takes only a few minutes to complete and is merely a request for updated corporate information. The filing fee is currently $50 per year. Failure to comply results in the administrative dissolution of the organization by the Corporation Division which will put the organization's tax exempt status in jeopardy. If David Atkin is listed as the registered agent of the nonprofit corporation, the Annual Report notice will be sent to the Center for Nonprofit Law office and completed and submitted by our staff after contacting the organization for its current corporate information.

IRS REPORTING REQUIREMENTS FOR NONPROFIT CORPORATIONS

The Internal Revenue Service requires most nonprofit corporations to file reports with them each year; only churches and certain other organizations are exempt from this filing requirement. Organizations with annual gross receipts of more than $50,000 but less than $200,000, and with assets less than $500,000 at the end of their tax year, are required to file Form 990-EZ. Organizations with more than $200,000 in gross receipts or $500,000 in total assets at the end of their tax year are required to file Form 990. Tax Exempt organizations with less than $50,000 in gross receipts are required to file Form 990-N. If the organization is a private foundation it must file a Form 990-PF annually, *regardless of the income*.

Small Organizations and Exceptions. Small tax-exempt organizations, whose annual gross receipts are normally $50,000 or less, are not required to file Form 990 or Form 990-EZ. With the enactment of the Pension Protection Act of 2006 (PPA), these small tax-exempt organizations are required to electronically file Form 990-N, also known as the e-Postcard, with the IRS each year. Exceptions to this requirement include organizations that are included in a group return, private foundations required to file Form 990-PF, and section 509(a)(3) supporting organizations required to file Form 990 or Form 990-EZ. In addition, this filing requirement does not apply to churches, their integrated auxiliaries, and conventions or associations of churches**.**

Due Dates. If your organization is required to file a Form 990, 990-EZ, 990-PF or 990-N, it is due by the 15th day of the 5th month after your accounting year ends. This return is due on May 15 for nonprofit corporations who use the calendar year as their fiscal year. The IRS is authorized to impose penalties if your organization files the Form 990, 990-EZ, or 990-PF late without requesting an extension. The Form 990, 990-EZ, 990-PF or 990-N and the instructions for completing them, can be obtained directly from the IRS at www.irs.gov.

Penalties. If, in filing any of the series of 990 Forms, information is left out, incorrectly entered, incorrectly reported or the report is unsigned or submitted late, the IRS can assess a $20 a day penalty up to the smaller of $10,000 or 5% of the gross receipts. If an organization's gross receipts exceed one million dollars ($1 million) annually, the penalty is $100 a day to a maximum of $50,000. Organizations that do not file every year will be classified as inactive.

Individual Responsibility. If an organization does not file a complete return or does not furnish correct information, the IRS will send the organization a letter that includes a fixed time to fulfill these requirements. After that period expires, the person charged with this responsibility on the organization's behalf, but who fails to comply will be charged a penalty of $10 a day. The maximum penalty on all persons for failures with respect to any one return shall not exceed $5,000. This is a new requirement and should be taken seriously.

Revocation of Tax Exempt Status. The Pension Protection Act requires the IRS to automatically revoke the tax-exempt status of any organization that fails to meet its. annual filing requirement for three consecutive years. Therefore, organizations that are required to file and do not file the e-Postcard (Form 990-N), or an information return Form 990 or 990-EZ for three consecutive years, will have their tax-exempt status automatically revoked immediately upon missing the filing due date of the third consecutive year.

Payroll Taxes. Nonprofit corporations are subject to the usual withholdings for Social Security taxes (FICA) for any employee paid $100.00 or more during a calendar year. Nonprofit corporations are not liable for taxes imposed under the Federal Unemployment Tax Act (FUTA).

"Unrelated Business Income" Note: If a nonprofit corporation earns "unrelated business income" it is required to report it by filing Form 990-T and to pay a tax on this income (commonly referred to as UBIT for Unrelated Business Income Tax). Unrelated business income is discussed in a separate report in this handbook.

UNRELATED BUSINESS INCOME

Not all income received by tax exempt nonprofit organizations is exempt from taxes. All income from gifts, grants, donations and occasional fundraising events are tax exempt. Income earned from the sale of products or services which are related to the accomplishment of an organization's charitable or exempt purpose is also tax exempt. However, income earned in activities which are "unrelated" to an organization's exempt purpose is taxed. Income from those unrelated activities is referred to as "Unrelated Business Income" (UBI) and the taxes which must be paid on that income are referred to as "UBIT" which stands for "Unrelated Business Income Taxes."

The fact that the income earned in unrelated business is used entirely for your organization's tax exempt purposes does not make it tax exempt. The IRS defines "Unrelated Business Income" as income which is:

1) produced in a regularly conducted trade or business, and
2) the trade or business is not substantially related to the organization's tax exempt purposes.

The sale of products which result from the performance of exempt activities is generally "related" and the income produced is not taxed. For example, a school can charge for its classes, a symphony orchestra can charge for its performances, and an organization which teaches members of the public how to garden in an ecologically sustainable manner can charge for the classes, and the same organization can also sell vegetables which are produced by its students. All of these income sources are tax exempt "related" income. Similarly, the sale of tee-shirts, posters, mugs or other items which show or contain words or pictures that help accomplish your organization's exempt purposes, are generally a "related" activity and will not be taxed.

Income from activities which are not themselves "related" to your exempt purposes may still be tax exempt because they happen so infrequently that they do not constitute a "regularly conducted trade or business." This would mean that income from occasional bake sales or garage sales is not taxable, even though baking cookies or selling used goods are not related to exempt or charitable purposes. However, if an organization held the same type of bake sale or garage sale every week, that would likely be defined by the IRS as an "unrelated" business which is carried out regularly enough to make it taxable income.

Some special activities are granted exemptions from UBI taxes even though the activities themselves are unrelated and are regularly conducted. The most important exception is income produced by activities in which substantially all of the work is performed by unpaid volunteers without compensation. For example, if unpaid volunteers run an organization's thrift shop and the proceeds go to fund the organization's exempt purposes, the income from that thrift shop is not taxable. Similarly, income from a trade or business which sells merchandise in which all, or substantially all, was donated to the organization, is also excluded from taxation. Income from dividends, interest and

annuities, as well as the deductions directly connected with those types of income, are excluded in computing unrelated business taxable income.

On the other hand, certain kinds of income are virtually always treated as taxable income. For example, income from the sale of advertising in a newsletter, newspaper or magazine is usually taxable, unrelated income. There are complex rules governing advertising income, and you should consult with an attorney regarding the taxation of that type of income. Similarly, income from selling mailing lists or membership lists is virtually always taxable as unrelated income.

Unrelated business income is taxed at the usual tax rates for corporations. The costs of producing the income can be deducted from the gross unrelated income, and only the resulting net income is taxed. If the has income that is taxable at corporate rates, the corporation is also liable for the "minimum tax." If the organization has income that is taxable at trust rates, the corporation is also liable for the "alternative minimum tax."

Finally, another common exclusion for nonprofit organizations is that they are not required to report and pay UBIT taxes if they received *less* than $1,000 in unrelated business income during their accounting year. Nonprofit organizations which earn gross unrelated business income in excess of $1,000 in their fiscal year must report that income to the IRS on form 990-T, along with any required schedules and attachments. Like other forms in the 990 series, the Form 990-T must be filed by the 15th day of the 5th month after the end of the organization's tax year (May 15, for groups using the calendar year as their fiscal year). Form 990-T and the instructions for filling it out can be obtained from the IRS.

EMPLOYEES AND INDEPENDENT CONTRACTOR STATUS

When a growing, active nonprofit organization finds it is necessary to have certain work done reliably and consistently, they may find themselves facing the question of whether to hire someone to work as an independent contractor or as an employee. Initially, it may seem like a good idea to hire an independent contractor, and thereby relieve the organization of extra bookkeeping and payroll costs. However, if your organization is not meticulous about defining the expectations and responsibilities of both sides of the relationship it may find itself on the receiving end of fines and penalties. In some circumstances, the Board of Directors may even be held personally liable for errors and omissions in worker classification. This is a situation that should be carefully considered and analyzed before any definite policy or action is taken.

THE IRS 20 FACTOR TEST:

To determine whether a worker qualifies as an independent contractor or an employee, the IRS uses a "20 Factor Test" to analyze the nature of the relationship between the organization and its hired worker. In the eyes of the IRS, the key question underlying most of these factors is the amount of control the organization has the right to exercise over the hired worker. The more right to control the worker held by the nonprofit, the more likely the worker will be classified as an employee.

A "no" answer to the factors listed below indicates evidence of independent contractor status (or lack of control by the nonprofit organization), while a "yes" answer indicates evidence of employee status. Ideally, for a clear independent contractor relationship, there should be a "no" answer, with detailed explanations, to all 20 common law questions. Note, however, that no single factor or criteria is conclusive and it is not necessary that you answer "no" to every one of the 20 factors in order to prove compliance with the test for an independent contractor. Similarly, a "score" of 11-9 does not indicate a specific status.

The 20 factors the IRS analyzes are as follows:

I. Is the worker required to comply with instructions about when, where, and how he or she is to work?

2. Is the worker being trained to perform the service in a particular method or manner?

3. Are the worker's services necessary as an integral part of the business operations?

4. Must the services be rendered personally?

5. Are any assistants of the worker hired, supervised, or paid by the business?

6. Is there a continuing relationship between the business and the worker?

7. Does the worker have established work hours?

8. Must the worker devote substantial time to the business?

9. Must the work be performed on the business premises or designated premises?

10. Must the worker perform the service in a set sequence?

11. Is there a requirement that the worker must submit regular or written reports to the business?

12. Is payment made to the worker by the hour, week, or month?

13. Is the worker reimbursed for business or travel expenses?

14. Does the business supply the worker with tools and materials?

15. Does the business invest in equipment or facilities for the worker's use in providing services?

16. Does the business realize a profit or loss based upon the services of the worker?

17. Does the worker provide services primarily for the business rather than for several businesses?

18. Does the worker make his or her services available to the public?

19. Does the business have the right to discharge the worker for reasons other than nonperformance of the contract?

20. Can the worker terminate his or her relationship with the business without incurring a liability?

PENALTIES AND SANCTIONS FOR IMPROPER CLASSIFICATION OF AN EMPLOYEE:

A working relationship with an independent contractor must be carefully constructed, in action as well as in writing, because the IRS will examine, not only the paper relationship, but also the actual working relationship between the organization and the worker. The written contract by itself is not sufficient to substantiate the relationship, but it is an essential part of the IRS 20 Factor Test. If both parties are aware of the guidelines and design the relationship to meet them, things will proceed much more smoothly in the event of an IRS audit or review. If no work is done until the IRS knocks on the door, the nonprofit will be on the defensive and the advantage will have shifted to the IRS. There

are some very costly consequences to having the IRS reclassify independent contractors to employee status. Some of these are:

- ♦ Payment of back taxes, interest and penalties.
- ♦ Additional penalties assessed against responsible parties.
- ♦ The extension of employee benefits to the reclassified worker.
- ♦ The risk of having the company's pension plan disqualified, which would leave legitimate employees without a tax-sheltered retirement plan and with a large tax bill.

An erroneous designation as an independent contractor can increase the organization and Director's exposure to penalties, fines and claims from not only the IRS, but also the State of Oregon Attorney General, the Oregon Department of Revenue and the Worker's Compensation Department.

ESTABLISHING AND SUPPORTING YOUR USE OF INDEPENDENT CONTRACTORS:

While the 20 common law questions serve as a guide to assessing a nonprofit organization's relationship with its independent contractors, the following suggestions will help to solidify a worker's classification as an independent contractor. Ideally, you should always try to implement as many of these suggestions as possible:

- ♦ Use an independent contractor agreement signed by both parties. The agreement should emphasize the lack of control of the organization over the worker. However, the IRS will analyze the actual relationship and a contract stating a worker is an independent contractor, while it should definitely be done, is little protection if the actual relationship is contrary to the contract.
- ♦ If possible, hire independent contractors that are have their own business and use a business name and/or are incorporated, have their own phone listing, business cards and federal tax ID number.
- ♦ Emphasize that it is the independent contractor's responsibility to deal with their own income and self-employment taxes as well as obtaining any licenses, permits and, if necessary, insurance.
- ♦ Do not provide any benefits and ordinarily do not reimburse any expenses.
- ♦ Be sure that the service performed is paid for by the job, not by the hour, day, etc.
- ♦ Do not set working hours—use start and completion dates only.
- ♦ Workers should be responsible for their own training, tools and supplies, additional labor, etc.
- ♦ Avoid exclusive working arrangements: independent contractors should have other clients.
- ♦ Do not provide working space or the necessary tools.
- ♦ Refrain from the use of the term "employee" when referring to the worker.
- ♦ Issue a Form 1099 for the independent contractor's services at the end of the year.

OTHER CONSIDERATIONS:

Note that there are other issues besides saving money on payroll taxes and for accounting services that must be considered as well. For example, if in doubt, ask yourself whether the amount of money saved in a questionable classification of independent contractor status is worth the risk of potential taxes, interest and penalties that could be assessed by the IRS later. Another key element to factor into the decision is the increased control the organization will have over the actions and procedures of an employee that they will not have over an independent contractor. This may be well worth the extra expense and can translate into a more efficient operation and improved service. Additionally, the ownership of intellectual property (copyrightable material, trademarks, patents, etc.) developed by an employee is clearly owned by the employer, whereas only some intellectual property developed by an independent contractor may legally be owned by another party (and there must be a written agreement for such ownership).

CONCLUSIONS:

If the nonprofit uses or plans to use independent contractors, make certain that the organization properly analyzes the nature of the relationship between the organization and the hired worker, and also the nature of the job itself, to ensure that you have properly classified the worker's employment status. If you hire a worker as an independent contractor, make sure that you create a paperwork trail that supports this choice. Issue the proper 1099 Forms to all independent contractors to whom you have paid over $600 per year, at the end of each year. Use a written contract that clearly defines the relationship in terms that satisfy the 20 Factor Test. Monitor the situation to make sure that the actual working relationship follows the contract you have written.

PAYMENTS AND REIMBURSEMENTS TO VOLUNTEERS AND PAID WORKERS

1. ARE PAYMENTS TO WORKERS AND VOLUNTEERS CONSIDERED TAXABLE?

One of the most common questions is whether *small* payments to volunteers or interns are counted as taxable compensation to them. The answer is generally "yes" if the payment is made to a person in return for any labor or services provided by that person. Even if the form of payment is not calculated as hourly wages or made directly in return for help with a specific task, it will still be counted as taxable compensation, if the volunteers or interns who receive the stipend are required to help the organization or assist in its activities in return for the stipend. A final note: it is best not to try too hard to get around this rule – always remember that it is the ***organization*** which is tax exempt, NOT the individuals who work for, or with, it.

2. DOES IT HELP AVOID TAXATION IF WE DEFINE OUR WORKERS AS VOLUNTEERS OR INTERNS?

Generally not. Simply labeling someone as a volunteer or an intern does not, by itself, change the tax consequences of making payments to them. If a person receives any payment at all in return for providing any labor or services, then that payment will be considered taxable compensation and that person be classified by the IRS as either an employee or an independent contractor. This includes small monthly stipends paid to "volunteers" or "interns" who provide some services as part of their participation in the organization's activities.

Further, labeling someone as a "volunteer" does not help avoid taxation of any payments to them, because those terms are commonly understood to mean that the person does indeed provide some assistance, labor or services to the organization. On the other hand, accurately labeling someone as a "student" or simply calling them "participants" in the activities of the organization may help clarify your organization's relationship with them, because students and participants generally do not provide labor or services. Accordingly, if you provide a stipend, per diem payments, meals or lodging to anyone, and those benefits are provided as a gift or grant, and that person does not provide any services or assistance to the organization in return, then the payments or the value of the meals or lodging are not taxable compensation and for the sake of clarity it is probably better to define that person as a student or simply as a participant in your organization's activities.

3. CAN A NONPROFIT ORGANIZATION PAY LESS THAN THE LEGAL MINIMUM HOURLY WAGE?

All businesses are legally required to pay the "minimum hourly wage" and overtime, when applicable, to all employees, and they cannot legally allow people to volunteer to work for them for less than minimum wage or deny overtime payments. There are three narrow exceptions:

A) The person is an “exempt” employee as defined under state and federal law;

B) The person is an intern as defined under state and federal law;

C) NOTE ON USING VOLUNTEER LABOR: Because former employees and disgruntled volunteers frequently file claims for unpaid minimum wages and overtime, it is prudent to have all of your volunteers sign a statement agreeing that they are voluntarily working as a form of donation to the organization and do not expect any compensation whatsoever.

4. MUST WE REPORT THE PAYMENTS TO OUR WORKERS TO THE IRS?

All businesses, nonprofit organizations and individuals must report all compensation and wages paid to “employees” on “W-2” forms each year, and must report (using the MISC-1099 form) all payments to any “independent contractors” who are paid $600 or more during the year.

5. ARE PAYMENTS MADE TO REIMBURSE WORKERS TAXABLE?

Generally, no. Payments made to volunteers or workers to reimburse them for certain expenses they incur on behalf of the organization, are not considered taxable income. For example, payments to workers or volunteers to reimburse them for purchasing office supplies, making photocopies, making long distance phone calls or driving their vehicle to perform, so long as these things are done for the benefit of the organization, are not considered taxable income.

NOTE: It is important to have receipts and written documentation from the worker when they submit a request for reimbursement, including a written statement describing the “business purpose” of the expense.

NOTE ON REIMBURSEMENTS FOR VEHICLE USE: There are special rules for reimbursing “mileage” expenses. If a worker or volunteer wants to take a tax deduction for donating the mileage expense of driving his or her vehicle for the organization, the current standard deduction for donating such mileage is 14 cents per mile. However, the organization can reimburse a volunteer or worker for mileage at the current standard business mileage rate. To find the current rates, please check the Internal Revenue Service website at www.irs.gov. In either case, the worker must submit documentation which includes the make and model of the car, the purpose of the trip, where the person drove on the trip, the number of miles, and the starting and ending odometer readings for the trip.

6. ARE PAYMENTS FOR “LIVING EXPENSES” OF VOLUNTEERS OR WORKERS WHO TRAVEL CONSIDERED TAXABLE?

Generally, payments made to cover the living expenses such as meals and lodging for volunteers or workers are considered taxable income. However, there is a major exception for workers who must travel to perform their services for the organization. If a volunteer or worker is working for the organization at a substantial distant away from his or her home for twenty-four (24) hours or more, then the organization may pay for that person’s meals and lodging.

1) MEALS: The IRS rules allow the organization to simply pay the worker a daily "per diem" allowance for meals and related food costs. The usual per diem amount the IRS allows for meals/incidental expenses varies significantly according to location. These rates can be found at www.gsa.gov. Any CPA should be able to tell you the current per diem amount allowed for daily meals in any specific location. It is not necessary to save receipts from restaurants and grocery stores if the person is paid the standard daily per diem amount for food. Alternatively, the worker and the organization may elect to reimburse the person for the actual cost of all meals, in which case the worker must submit all of the receipts and documentation, along with a descriptive statement about the purpose and situation for which the reimbursement is requested.

2) LODGING: If a volunteer or worker must travel to a distant location away from his or her home for twenty-four (24) hours or more to perform services for the organization, the organization may pay the actual costs of his or her lodging, so long as the expense is reasonable as determined by location (available at www.gsa.gov). There is no standard per diem payment allowed for lodging. Instead, the organization may pay only the actual costs as limited by reasonableness. The organization can pay a hotel or apartment owner directly for the actual cost of the worker's lodging, or it can reimburse the worker for the actual costs the worker paid for the lodging. Receipts and documentation proving the actual cost of lodging are always required.

A NOTE REGARDING LONG TERM TRAVEL: A person cannot be considered to be "traveling" if they are working at a location away from their home for more than one year. After one year they will be considered to have relocated their home to the new place and any further payments to that person for meals and lodging will be counted as taxable income, just as if the organization provided housing or meals to a person in the town where that person already lives.

7. IF AN ORGANIZATION PROVIDES FOOD OR LODGING FOR PEOPLE WHO STAY AT ITS RETREAT CENTER OR OTHER PREMISES, IS THAT CONSIDERED TAXABLE COMPENSATION?

Generally, the rule is that the value of meals or lodging provided to a person in return for his or her labor or services must be counted as taxable compensation. (It might be helpful at this point to review the answer to questions number one and two, above.) A person (such as a student or a participant in the organization's activities) who is staying at the organization's facility and who is not expected to perform any services or assistance, may receive meals or lodging from the organization as a form of grant or gift. In that case, a gift or grant is not considered taxable income and the person does not have to pay taxes on the value of the meals or lodging.

There is one exception to this rule: A worker can receive his or her food and lodging at the facility or premises owned by the organization, without counting it as taxable income IF that person is required by an employer to live or stay on the premises of the employer for the convenience and purposes of the employer. Examples of this type of situation would include a caretaker who must live on the premises to provide security and handle any emergencies, or a resident manager of a retreat center who must be available at all times to deal with the needs

of guests, or a resident manager of a live-in education center who must be available at all times to deal with the needs of the resident students. In this situation, an employer may also provide small personal supplies such as towels, soap and shampoo, snacks and other similar items for its workers who must live at its premises. Similarly, if there is some logical reason that a worker must eat meals on the employer's premises, for the convenience of and to accomplish the purposes of the employer, then those meals will not be counted as taxable compensation. In all such cases, there must be a clear and logical reason for the employer's requirement that the worker must live on the premises, or must eat meals on the premises. Finally, to legally protect this situation, the requirement that the worker must live on the employer's premises, as well as the reason for this requirement, should be stated in the written job description for the worker's position.

This exception is not available if the employer provides lodging or meals simply to help a worker save money, or for the convenience of the worker (for example to help him or her avoid commuting). If an employer provides lodging for the convenience of a worker, or to help a worker who otherwise could not afford reasonable lodging, then the value of the lodging must be counted as taxable income to that worker.

8. IF WE PAY A "STIPEND" TO VOLUNTEERS, OR PROVIDE HOUSING OR LODGING FOR THEIR CONVENIENCE, SHOULD WE CLASSIFY THEM AS EMPLOYEES OR INDEPENDENT CONTRACTORS?

As stated above, the IRS requires that all persons who receive compensation of any kind in return for labor or services (including monthly stipends) must be treated as paid workers. Paid workers must all be classified as either "employees" or as "independent contractors." Regular paid workers are generally classified as "employees" and the employer must withhold certain taxes and payroll deductions from the employee's pay. The IRS is quite aggressive about auditing organizations which may misclassify its employees as independent contractors in order to avoid withholding the various required taxes and payroll deductions from employees' paychecks. The payments and penalties the IRS can impose for violating this rule can be quite large. The IRS uses a "20 factor test" to determine whether any particular worker is an employee or an independent contractor. Standard examples of independent contractors include attorneys, CPA's consultants, carpenters, plumbers, electricians, and others who work for themselves and provide services to many different people or businesses. The "20 factor test "includes such questions as: Does the person work for just one employer, or for many different employers at the same time? Does the person advertise their service and hold themselves out to the public for hire? Does the person work at his or her own place of business, or at the employer's premises? Does the person provide his or her own tools, or use those of the employer? Does the person set his or her own hours and choose the methods for accomplishing the work, or is the person expected to perform the work when and how the employer chooses? [See Section 8 of this manual for more information on worker classification.]

NOTE: You should have a written employment agreement that specifically states that the person is an employee, or alternatively, that the person is an independent contractor. It the latter, the agreements should state that the person is responsible for reporting all earnings to the IRS and paying any taxes which are due on those earnings.

9. SHOULD WE CLASSIFY WORKERS AS EMPLOYEES IF THE ORGANIZATION INTENDS TO REGULARLY PROVIDE MEALS OR LODGING FOR LONG PERIODS?

Yes, if the value of the meals and lodging is not considered taxable compensation because the person is required to stay on the premises of the organization for the convenience of and to accomplish the purposes of the organization. In this situation, it is generally best to hire that person as an employee. This is because independent contractors would usually provide their own housing and meals while traveling, and would usually not be provided with meals or lodging for a substantial amount of time on the premises of the organization. Consequently, the rules allowing organizations to pay for the meals and lodging for workers who travel, or to provide meals and lodging to workers who are required to stay on the organization's premises, are most commonly applied to employees, and not to independent contractors. Finally, application of the "20 Factor Test" will usually lead to the conclusion that a paid worker living at the premises of the organization for the organization's convenience and benefit is extremely likely to be properly legally classified as an "employee" rather than as an independent contractor. Accordingly, it would generally be best to classify any paid workers as employees if the organization intends to provide them with food or lodging.

10. FINAL THOUGHTS:

If in doubt, be mindful of the advice at the beginning of this letter: It is the organization that is tax exempt, and not the individuals who work for it. Taxes are simply a fact of life for everyone who receives money, food or lodging in return for his or her labor or services. It is a mistake to try too hard to create a situation in which volunteers or workers can receive food and lodging or payments without paying taxes on them.

HOW TO SUCCESSFULLY GAIN YOUR FEDERAL TAX DEDUCTIBLE STATUS: 501 (C) (3)

Tax deductible and tax exempt status is not granted automatically just because an organization has filed articles as a nonprofit corporation. Nonprofit corporations must file an application with the IRS to gain tax deductible and tax exempt status.

Even though it takes time and costs money to apply for tax deductible status, if an organization intends to raise funds through donations or grants it will undoubtedly wish to submit this application. Without Federal IRS recognition of its "501(c)(3)" status, an organization cannot offer tax deductions to its donors and many foundations will not consider the organization for grants or other forms of support. Merely incorporating a nonprofit organization under state law is generally not sufficient to gain these benefits.

Application Deadlines. The IRS recommends that organizations apply for tax exempt status within their first fifteen (15) months of existence. However, the IRS acknowledges that it may take longer than fifteen (15) months to recruit a solid reliable Board, develop programs, implement activities, establish fundraising goals and create and approve budgets, all of which need to be described in detail in the application for tax exempt status. With this in mind, unless the IRS directly notifies an organization that it must file, the organization can assume an additional twelve (12) months in which to apply. This means that under ordinary circumstances an organization has twenty-seven (27) months in which to apply to the Internal Revenue Service for tax exempt status.

If the organization files before the twenty-seven (27) month deadline, its tax deductible status is granted retroactively to the date the organization was incorporated. But if the organization applies after this twenty-seven (27) month period, its tax deductible status may not become effective until the date the IRS receives the application. This may be a critically important difference if individuals or businesses have previously made contributions for which they expect to take tax deductions.

Applying for 501(c)(3) Status. To apply, an organization must fill out IRS Form 1023. This form can be obtained from our office, from an IRS office, or downloaded from the Internal Revenue Service website at www.irs.gov. The application is substantial and preparing it will take some time and effort, but the organization should be able to do most of the work. It is very important, however, that the application be reviewed by an attorney specializing in nonprofit law for advice on some of the more technical issues in the application prior to submitting the final documentation to the IRS.

The IRS charges an application fee which must be sent in with the Form 1023. The application fee is $600.

The IRS application requires that an organization describe all of its projects and activities, both planned and actual, in a narrative fashion. To insure the success of the application, the organization should keep a detailed journal of all of the corporation's activities during the entire first year prior to

submitting the application. Every time anyone attends or holds a significant meeting, works on a project, organizes an event, publishes or distributes educational materials, or performs any other activity on behalf of the organization to fulfill its goals, a record and description should be entered in the journal. This will assist the organization in describing its initial activities in significant and appropriate detail to the IRS. Similarly, the organization should save any documents, articles and newsletters prepared or published by the group, and any reports or articles discussing the group or its work written by others, to send to the IRS with the application.

An organization is also required to report, in detail, all of its income and expenses when it applies for tax deductible status, so the organization's financial records must be current and in good order. Keep a clear, concise record of all income and expenses with appropriate documentation, such as receipts, check stubs, and purchase orders, etc. List donors by name and record the amount given, date of contribution, and similar information.

Make sure that the organization is active during the first year prior to applying to the IRS, so that it can demonstrate that it has provided valuable educational and/or charitable services to the public. If the nonprofit is inactive during this critical period, it may have difficulty gaining tax deductible status.

Avoiding "Private Foundation" Status: the One-Third Public Support Test. In addition to applying for tax deductible status, the organization will want to be declared a "public charity" by the IRS. The alternative is to be designated a "private foundation" and that will subject the corporation to many additional regulations, to certain taxes, and to increased scrutiny and reporting requirements. The IRS assumes that a nonprofit corporation is a private foundation unless it is proved otherwise. The most important test they use in reaching their determination is the "one-third public support test." Generally, this means that at least one third of the organization's income must have come from the general public. Contributions made by Directors or people who are closely associated with the corporation may not count as public support and those donations may make it harder to achieve the required percentage of public support.

To meet the one-third public support test, an organization can include membership dues, money from the sale of items like posters or tee-shirts promoting its nonprofit purposes, or contributions from members of the public who are not closely associated with the corporation, its Directors, Officers or staff. Similarly, grants or gifts from foundations or from the government will be counted as public support. Large donations from individuals or businesses may be only partially counted as public support. This means that if the organization's total income is low and it has received quite a few contributions which are large in comparison with total income, it will make it harder to achieve one-third public support.

RAISING MONEY AND USING FISCAL SPONSORS DURING THE FIRST MONTHS OF EXISTANCE

Even though you have properly incorporated your organization as a nonprofit corporation, it does not have a guarantee of tax deductible or tax exempt status until it receives formal recognition of that status from the IRS. Our report "How to Successfully Gain Your Federal Tax Deductible Status: 501(c)(3)," goes into this subject in more detail (included in this Handbook). Some organizations may not be able to submit their application for 501(c)(3) status for a year or more after they were incorporated. It is likely you will have to raise the funds necessary to run your organization before you have tax deductible status. This report will help you understand the rules and limits imposed on fundraising during this early period.

METHODS OF FUNDRAISING BEFORE YOU GAIN IRS RECOGNITION OF YOUR TAX DEDUCTIBLE STATUS:

1. You can accept donations from individuals or businesses for which no tax deduction is taken.

2. You can sell products or services. Whenever possible, tailor all activities which produce "earned income" to make them closely related to your nonprofit mission and purpose. Minimize the amount of "unrelated business income" you earn.

3. You can accept grants from foundations or from the government. Many foundations protect themselves from possible sanctions, however, by refusing to award grants to organizations which do not have their own 501(c)(3) status. One way around this problem is to find an existing 501(c)(3) organization which is willing to be your group's "fiscal sponsor." Because fiscal sponsor relationships are often misused, the fiscal agent must be responsible for and exercise control over the project you work on with the grant they helped you gain.

4. You can ask potential donors to make a "donor advised grant" to an existing foundation or charity, and then apply to the foundation for a grant. It must be completely clear to all parties that the donor can nominate your group as the grant recipient, but completely relinquishes control over the selection and distribution of any grants. You should have a contract signed by the donor acknowledging this arrangement.

5. You can inform potential donors that you have already or will soon apply for your tax deductible status and that so long as your application was received by the IRS within twenty-seven (27) months of your incorporation the IRS will make the tax deductibility retroactive to the date of your incorporation. If you fail to gain retroactive tax deductible status from the IRS, however, you must

inform all donors who might have taken a deduction of this fact. They are then required to file amended returns to remove any deductions they took for donations to your organization.

6. You can apply for loans.

You should be aware that accepting too much money from members of your Board of Directors or from Officers or staff may hurt your efforts to gain full 501(c)(3) public charity status from the IRS. The IRS will apply a "1/3 public support test" to see whether you received at least 1/3 of your total income from contributions from the general public. Funds from the government and from foundations qualify as public support. Usually, only a portion of large donations from individuals or businesses qualify as public support, although the rules allow you to designate some such donations as "unusual grants" on your application to the IRS and minimize their effect on the 1/3 public support test. Donations from "disqualified persons" such as the Directors, Officers or staff usually are also limited in the portion that qualifies as public support. The portion from these donations that do qualify as public support is based on IRS regulations, is usually small, and based on overall income and relationships between donors.

Once your group receives its own 501(c)(3) status from the IRS, you will no longer need to use donor advised grants or fiscal sponsors. Nonetheless, you should continue to make sure that your organization continues to achieve a high level of public support through contributions, and by earning income from activities related to your nonprofit purpose so that you continue to satisfy the 1/3 public support test.

CENTER FOR NONPROFIT LAW

PROHIBITED POLITICAL ACTIVITY FOR 501(C)(3) ORGANIZATIONS

IRS regulations and federal laws place strict limits on the political activities of nonprofit organizations. If you violate these limits, your organization will have to pay penalties, and could lose its tax deductible status, or fail to gain that status in the first place. Accordingly, it is critical that you understand these limitations. There are three classes of political activities, one of which is generally allowed, one of which is completely prohibited, and one of which is allowed but subject to restrictions:

1. INFLUENCING AGENCIES OR EXECUTIVE BRANCH DECISIONS

There are no limits on the amount of time, effort or money that 501(c)(3) organizations may spend on efforts to influence the decisions, plans or policies of executive branch officials or agencies. This includes, city, county, state and federal officials and agencies. The only exception to this rule involves certain very rare, quasi-legislative formal rule-making procedures used primarily just by a few federal agencies.

2. ELECTORAL POLITICS

Charitable 501(c)(3) organizations cannot support or oppose political parties or candidates for public office, or engage in any activities which are undertaken to influence the outcome of elections of candidates for political office. This means that the nonprofit organization (or people acting in its name) cannot endorse candidates, oppose candidates, give money to candidates or their campaigns, or suggest that the organization's members vote for or against a candidate. These activities are strictly prohibited, and violations are routinely reported to, and investigated by, the IRS. The penalty for violating this "zero tolerance" prohibition can include loss of the organization's 501(c)(3) status.

Some other types of nonprofit organizations, such as Political Action Committees and organizations which are tax exempt under Section 501(c)(4) of the Internal Revenue Code, may support or oppose candidates or political parties. If your organization wishes to engage in any "electoral politics" you should operate a separate nonprofit corporation which has the legal right to engage in those activities.

A CAUTION ON VOTER EDUCATION. Your 501(c)(3) organization may be able to perform some even-handed, unbiased, non-partisan voter education on electoral politics, but ONLY if your organization has specifically informed the IRS that it intends to do so and received the IRS's permission. If the IRS approves your application to perform voter information activities, you may be able to distribute accurate, fair, balanced and educational information, provided it gives the same kind of information about *all* of the candidates for a given office. The rules for these kinds of activities are detailed and strict. The organization must be very careful not to show any kind of bias for or against any party or candidate.

3. LOBBYING

Nonprofit organizations with 501(c)(3) status may engage in a limited amount of lobbying. Lobbying is defined by the IRS as a communication to legislators (or urging the public to contact legislators) undertaken to influence the passage of specific legislation, whether at the city, county, state or federal level of government. There are two different “tests” or limits which the IRS applies to lobbying activities by 501(c)(3) organizations: the older “insubstantial part” test and the newer, and more favorable, “Section 501(h)” rules. They operate as follows:

A. THE “INSUBSTANTIAL PART” TEST:

The law states that “no substantial part” of the activities of a 501(c)(3) organization may be the influencing of legislation. This has been interpreted to mean that lobbying can be an "insubstantial part" of the activities of such an organization. This is a very poor rule and it is difficult to know when an organization has lobbied more than that “insubstantial amount. In determining whether an organization has engaged in more than an "insubstantial amount" of lobbying, the IRS will consider all of the circumstances, including the time, effort and money spent on lobbying as a percent of the organization's total budget and workload, the authority and organizational positions held by the persons involved in the lobbying, and the frequency of such lobbying activities.

Because this test can be so vague and unpredictable, organizations subject to this test should carefully restrict their lobbying activities. The general guideline is to keep your total lobbying activities to less than 5% of your organization’s activities, efforts, time or money.

B. THE “SECTION 501(H)” RULES:

There is another, more recent set of IRS rules which are clearer, more predictable, and more favorable towards groups involved in lobbying. All nonprofit groups which expect to engage in any lobbying should elect to be covered by them. They are called the 501(h) rules, and nonprofit groups can elect to be covered by them by filing IRS Form 5768. There is no fee charged for filing this form or making this election.

The 501(h) election provides a financial limit for lobbying. There are two separate expenditure limits: one for total lobbying expenses, and a second limit for “indirect” or “grassroots” lobbying expenses.

LIMITS ON TOTAL LOBBYING EXPENDITURE. Groups with annual expenditures of $500,000 or less can spend up to 20% of their annual “related expenditures” on lobbying. The percentage of the income that can be spent on lobbying decreases for groups with expenditures over $500,000, although the absolute amount of their allowable lobbying budget is higher. (“Related expenditures” simply means all expenditures of the organization except those funds which are spent on activities which are not related to the

organization's charitable or educational purposes. These expenditures generally come in relation to "unrelated business income" (UBI) activities.)

DIRECT LOBBYING. The IRS defines direct lobbying as directly communicating with a legislator about a topic that is the subject of legislation. A 501(c)(3) organization can spend up to 20% of its annual expenditures (for the first $500,000 in expenditures) on direct lobbying.

INDIRECT LOBBYING. Indirect or "grass-roots" lobbying occurs when an organization communicates with the general public about a matter which is the subject of legislation and making a "call to action" such as urging them to contact their legislators, or even just listing the name(s) and addresses of their legislators. An organization may not spend more than 25% of its total lobbying budget, which is a maximum of 5% of the organization's annual expenditures, on indirect "grass-roots" lobbying.

SPECIAL RULES.

- **Ballot Measures:** Although ballot measures appear on election-day ballots, they are not considered to be "electoral activities" because they do not involve the election of candidates for public office. Ballot measures are simply another form of legislation, in which the general voting public itself is the legislative body. Therefore, 501(c)(3) nonprofit organizations may be involved in lobbying concerning ballot measures. Further, because the public itself is the legislative body, lobbying the general public is not considered "indirect" or "grassroots" lobbying. Therefore, an organization can spend its entire allowable lobbying amount (20% of its total annual expenditures) rather than the smaller limit for indirect lobbying (5% of its total annual expenditures) to influence the passage or a ballot measure. Consequently, a 501(c)(3) nonprofit organization can be quite deeply involved in lobbying for or against ballot measures.

- **Testifying Before A Legislative Body:** It is considered lobbying for a group to testify before a legislative body or present information to a legislative committee or subcommittee, UNLESS it is done at the written invitation or request of that committee's chair or staff. The request must be from the committee itself; the invitation of a member of that committee is not sufficient.

- **Lobbying by Volunteers:** Note that the "expenditures" test in the Section 501(h) rules do not limit lobbying activities which do not cost money. Accordingly, an organization can utilize volunteers to engage in as much lobbying as it desires, and has no duty to report those activities, so long as no other expenditures are involved.

- **Lobbying Communications With Your Members:** There are special IRS rules regarding making lobbying communications to your own members. Basically, a group can communicate with its members and urge them to contact the legislators, and since that is solely internal communication, it is not considered lobbying. However, if a group urges its members to urge others to contact their legislators,

that communication is considered lobbying because it is not longer strictly internal between a group and its members. There are many other more detailed and complicated rules to cover situations in which communications concerning legislation are made to a mixture of members and non-members.

- **Mass Media Lobbying:** There are special rules for lobbying through mass media such as television, radio and newspapers. If the mass media lobbying concerns a legislative bill that is before the House or Senate in either the State or federal legislature, or a vote in a Committee of the House or Senate, and if the mass media communication appears within 14 days before the vote on that legislation, then that communication will be considered to be lobbying even if there is no "call to action" in it.

- **Six-Month Subsequent Use Rule:** There is a special IRS rule stating that if money is spent to produce materials that consist of non-partisan analysis or study, then if that material is later used for lobbying purposes, the cost of producing that material must be reported as lobbying expenses, UNLESS the material is used six months or more AFTER the material was produced.

- **Education on Issues Involving Legislation:** There is no limit to the amount of public education which a 501(c)(3) organization can engage in, even if that education involves matters which are the subject of specific pending legislation. A communication with the public is NOT considered lobbying if it is factual, fair, non-partisan, and allows the reader / member of the public to make up his or her own mind about the issue, and the materials do NOT contain a "call to action" urging the reader to contact the legislators. An organization can spend as much time and money as it wishes on educating the public in this manner, so long as the material allows the reader to make up his or her own mind and the organization does not contain a "call to action" encouraging members of the public to contact their legislators, and does NOT urge the passage or rejection of the legislation.

TRACKING AND REPORTING LOBBYING EXPENDITURES. The IRS requires 501(c)(3) nonprofit organizations to carefully track and record the expenses it incurs for lobbying, including travel and phone costs, the costs of any television or radio ads, the cost of literature and "action alerts" and the cost of portions of regular newsletters or other materials which involve lobbying. If an organization falls under the reporting requirements for filing a Form 990-EZ or 990 and they have had any lobbying activity, they must file a Schedule C.

SANCTIONS AND PENALTIES. Under the old "insubstantial amount" test, a nonprofit could lose its 501(c)(3) status for exceeding the allowable amount of lobbying. If a nonprofit group which is covered by the 501(h) rules exceeds its lobbying limits, instead of potentially losing its nonprofit status, it simply has to pay a 25% excise tax on its excess lobbying expenditures. Only if the group spends 150% or more of its annual allowable lobbying expenditures amount, averaged over a period of four years, would it be threatened with the loss of its tax deductible status.

TOO MUCH LOBBYING? CREATE A "LOBBYING ORGANIZATION". If your organization cannot achieve its goals within the limits described above, then it should consider creating a related but separate "sister" or "associated" nonprofit organization which has the right to engage in more lobbying. For example, a 501(c)(3) organization can incorporate a 501(c)(4) "action" organization which is not subject to any limits at all on lobbying. These organizations are tax exempt but cannot give tax deductions, so they are limited in their fundraising abilities. There can be substantial overlap between the Board of Directors of the two groups, however, they must be established and operated as completely separate entities and their funds should be kept in completely separate accounts and never co-mingled. There are other rules regarding the nature of the relationship between these two types of related organizations, but they are somewhat complex. If you have any questions please contact us for further advice.

SOLICITING AND DOCUMENTING TAX DEDUCTIBLE CONTRIBUTIONS

There are many different IRS categories for tax exempt organizations, and only contributions to some allow the donor to take tax deductions. The most common nonprofit organizations with tax deductible status are the standard "charitable, educational, scientific or religious" organizations which have 501(c)(3) status.

There are some rules and requirements regarding contributions to 501(c)(3) organizations which the Directors, Officers and managers of every nonprofit organization should know.

1. SOLICITING CONTRIBUTIONS

All written solicitations of contributions must clearly state that donations are, or are not, tax deductible. Once your tax deductible status is granted by the IRS, you are allowed to put a statement in your written solicitations saying that contributions are tax deductible.

To avoid problems, even when verbally asking for contributions, you should remember to state clearly whether contributions to your organization are, or are not, tax deductible.

However, the IRS regulations state that the corporation’s tax deductible status will be granted retroactively to the date of the filing of proper Articles of Incorporation, as long as the organization’s corporate documents, purposes, plans, programs, activities, expenses, income and general financial situation comply with the state and federal laws and regulations governing public benefit and religious nonprofit organizations described in Section 501(C)(3) of the Internal Revenue Code. According to IRS regulations, contributions will be granted tax deductible status, retroactive to the date the Articles of Incorporation were filed.

In the interim, while the corporation is preparing to file for tax exempt/tax deductible status, you can state that the nonprofit corporation is in the process of gaining 501(c)(3) tax deductible status, and that retroactive status is expected according to the IRS rules. Once the application is filed, you can state that the application for gaining 501(c)(3) tax deductible status has been filed, and that retroactive status is expected according to the IRS rules.

2. DOCUMENTING CONTRIBUTIONS

IRS regulations state that no deduction will be allowed for charitable contributions **unless the donor has an acceptable record of the contribution. Bank records such as a canceled check, a bank statement, or a credit card statement are sufficient for amounts under $250. A contemporaneous written acknowledgment from the charity is required for contributions of $250 or more**. In addition, in cases where the nonprofit organization has provided goods or services to the donor in exchange for making the contribution (a "quid-pro-quo" contribution) the contemporaneous written acknowledgement **must include a good faith estimate of the value of such goods or services**. Further, for donation of goods or products (an "in- kind" donation) rather than cash, the IRS requires that there be

documentation of some "reasonable basis" for the value assigned to the donated items. Failure to follow these requirements could result in the loss of the deduction to the donor.

The requirement that the documentation be "contemporaneous" means it must be received by the donor no later than the date the donor actually filed the return for the tax year in which the contribution was made. If the return is filed after the due date or extended due date then the receipt must have been obtained by the due date or the extended due date of the return.

There is no required format for the written acknowledgement of contributions. Letters, postcards or computer generated forms are acceptable. The receipt does not have to include the donor's social security or tax identification number. It simply must contain sufficient information to show:

1. name of the donor
2. the amount of the contribution
3. the date of the contribution
4. the organization to which the donation was given
5. A statement that no goods or services were given or sold in exchange for the contribution
6. the recipient organization's Tax Identification Number or EIN

"Quid-pro-quo" contributions and "in-kind" contributions must also contain some extra information, as explained below.

We recommend that you adopt the practice of giving a receipt for all contributions over $50, not just those over $250. You can easily combine the receipt with a "thank you" style letter to the donor, and in any event, donors appreciate the receipts for their tax records, even if it is not strictly required. It is always a good idea to keep a copy of the receipt for your own files after you send or give the original to the donor.

Non-Cash/In-Kind Donations: Donors sometimes wish to give physical items or products instead of cash. These are referred to as non-cash/in-kind donations. It is the donor’s responsibility to determine the value of all non-cash/in-kind contributions. The IRS requires that there be some reasonable basis for the value which is assigned to an in-kind donation, and that the donor must document that reasonable basis. For donations which involve brand new products or products which were just purchased, the value will be the price which the donor paid. For donations of used items, or any item which was not recently purchased for its real market value, the donor must have a reasonable basis for his or her estimation of the value of the gift.

If a donor wishes to claim an in-kind donation of at least $250 but not more than $500, the donor must get and keep an acknowledgment of the contribution from the qualified organization. For in-kind donations worth more than $500, or, if the amount of all non-cash gifts is more than $500, the donor must file an IRS Form 8283. Among other things, that form explains to the IRS the calculation used to determine the estimated value of the gift. Accordingly, for gifts over $500, you should advise the donor to take the item to some independent business or appraiser who can tell them what that object is worth. For example, for a donation of used furniture or office equipment, it would be adequate to simply go to a used furniture or equipment dealer and ask them what they would pay for that object(s).

The donor should get a simple statement from the person doing the appraisal, preferably on business letterhead, that states that the person has looked at the object, gives a brief description of the object, and gives her or his estimate of its monetary value. This documentation will protect both the donor and your nonprofit organization from later charges of tax fraud.

For any in-kind donation in excess of five thousand dollars ($5,000.00), the gift must be formal written appraisal prepared by a qualified professional appraiser, who must also sign the IRS form 8283.

Quid-Pro-Quo Donations: Quid-pro-quo donations are donations for which the donor receives something of value in return. For example, it is a quid-pro-quo donation if you ask for donations and indicate that donors who give $25 or more will receive a free coffee mug with your emblem or motto on it. Purchases of tickets to concerts, plays or other performances can also be quid-pro-quo donations if the ticket price is greater than the ordinary price or value of tickets to such performances.

The IRS rules require that in solicitations for quid-pro-quo donations, where the donor will receive something in return, if the total contribution exceeds $75, then the nonprofit organization must give the donor a receipt stating what the donor received in return and what its fair market value is. The nonprofit organization is required to disclose the amount the donor may take as a tax deduction, and that a tax deduction can only be taken for the amount the contribution exceeds the value of anything the donor receives in return. For example, if they donated $80 and received a $15 calendar and a $15 T-shirt in return, they may take a tax deduction only for $50. The IRS does not require a quid-pro-quo accounting if the goods and services provided to the donor have an "insubstantial value." An organization should verify that the goods or services they are providing have an "insubstantial value" before deciding a quid-pro-quo accounting and receipting is not necessary. The current IRS guidelines for insubstantial value are:

1) The fair market value of all benefits received by the donor is not more than the lesser of two percent of the payment or $102, whichever is less, OR
2) The donor payment is at least $51 and the only benefits the organization provides the donor in connection with the payment are token items (bookmarks, calendars, key chains, mugs, posters, tee shirts, etc.) bearing the organization's name or logo and the cost, not fair market value, of all items received by the donor in the calendar year cannot exceed $10.20 ("low-cost articles"), OR
3) The organization mails or distributes free unordered items, without the patron's request or express consent, along with a request for a charitable contribution and as statement that the patron may retain the item whether or not the patron makes a contribution (the $10.20 limit also applies)

An annual membership benefit is also considered to be insubstantial if it is provided in exchange for an annual payment of $75 or less and consists of annual recurring rights or privileges, such as:

1) free or discounted admissions to the charitable organization's facilities or events;
2) discounts on purchases from the organization's gift shop;
3) free or discounted parking;
4) free or discounted admissions to member-only events sponsored by an organization, where the per-person cost (not including overhead) is within the "low-cost articles" limits.

The receipt for a quid-pro-quo donation must disclose that the donor has received something of value for the donation, and must state the nature of the item or service and its value, as well as the amount of the deduction the donor is allowed to take.

Even if a receipt is not required because the total transaction involved does not exceed $75, the nonprofit organization still has a duty to inform all donors how much they may deduct. Often this can be done with a sign at the door of events or right on the tickets sold for admission to an event.

3. LIMITS TO DEDUCTIONS FOR CONTRIBUTIONS

A donor may take a deduction from their adjusted gross income for contributions to qualified tax deductible nonprofit organizations. Note that this is **not** the same thing as a tax credit, which would reduce the taxes owed by the full amount of the contribution. The usual maximum limit for total amount of tax deductions that a donor may take for their contributions is usually 50% of their adjusted gross income. Any excess amount of deduction can be carried forward to future tax years until it is used up. The maximum limit for tax deductions to nonprofit organizations other than standard 501(c)(3) public charities and foundations may be lower. The limit for donations to private foundations is 30% of adjusted gross income.

The maximum limits are also different for certain kinds of gifts. For example, there is an exception for "appreciated long term gain" capital property (such as some kinds of art) and real property (such as land, houses and buildings). Such gifts may only be deducted up to a maximum of 30% of adjusted gross income, or 20% if the donation is to some kinds of private foundations.

4. OTHER IMPORTANT RULES

No Deductions for Donations of Time: Deductions are not allowed for the value of donated time or services. This means that volunteers cannot take a deduction for the time which they give. This also means that professionals who do work for free or at reduced rates, such as accountants, attorneys and architects, are not able to take a deduction for the value of their services for which they do not charge. Similarly, time and services contributed by artists, carpenters or other workers is not tax deductible. Artists in Oregon may be able to take a special state tax deduction for certain kinds of art work.

To help insure that your organization consistently uses the proper receipts to document donations to it, you can make copies of some type of standard receipts and simply fill them in whenever someone makes a donation to you. Alternatively, you can put the receipt forms on your computer and generate a customized receipt and thank you letter for each donor. Either way, be sure to save a copy of the receipt letter for your own files.

COMMON MISTAKES MADE IN SOLICITATIONS FOR TAX DEDUCTIBLE CONTRIBUTIONS

1 NO ONE IS ALLOWED TO TAKE A TAX DEDUCTION FOR DONATING THEIR TIME. The IRS prohibits tax deductions for donating time. This means that no one, including attorneys, artists, carpenters, engineers or physicians, can take a deduction if they perform services free of charge or for a reduced rate. For example, a carpenter who provides remodeling service to a nonprofit organization will not be able to claim his time as a charitable donation. There is no way around this requirement; it is simply never allowed.

2 GENERALLY, A BUSINESS CANNOT TAKE A DEDUCTION FOR CONTRIBUTING THE USE OF BUSINESS EQUIPMENT, SHOP TIME, OR STUDIO WORK. The IRS rules generally do not allow a business to claim a deduction for allowing a nonprofit group to use a business' equipment or space for free or at a reduced rental rate.

3 GENERALLY, A BUSINESS CAN ONLY TAKE A DEDUCTION FOR THE FAIR MARKET VALUE OF USED BUSINESS EQUIPMENT WHICH IT DONATES. IRS rules generally do not allow a business to take a deduction for the original purchase price or the remaining undepreciated basis of a business asset. Instead, a business can deduct only the fair market value of the used equipment.

4 GENERALLY, A BUSINESS CAN ONLY TAKE A DEDUCTION FOR THE PRICE IT PAID TO PURCHASE SUPPLIES WHICH IT DONATES. When a business donates materials from its inventory of goods for sale, the IRS rules generally prohibit it from taking a deduction for the retail value of those goods (the price it would have received if it had sold those goods). Instead, a business can only take a deduction for the amount of money it paid (generally the wholesale price) for the goods donated.

5 "IN KIND" (NON-CASH) DONATIONS HAVE SPECIAL REPORTING REQUIREMENTS AND SPECIAL RULES FOR ESTABLISHING THE AMOUNT OF DEDUCTION ALLOWED. You must file Form 8283 if the amount of your deduction for all non-cash gifts is more than $500. The donor must list the items donated and must state the basis for assigning the value to those items. Household items and clothing must be at least good used condition to be deductible, unless a donor has a signed appraisal for the item at $500 or more (this rule does not apply to: food, paintings, antiques, other art objects, jewelry and gems, or collectibles). For donations of used "related or similar" items (ex. computer, monitor and printer which are considered a

single unit) over $250, we recommend asking an independent business to provide a written estimate of the value of the items being contributed. For individual items, or several related or similar items worth $5,000 or more, the donor must have the items appraised by a qualified professional appraiser, and that appraiser must sign the IRS Form 8283). It is important for nonprofit groups to insist that the donor not assign an unreasonably high value to non-cash contributions, because the nonprofit organization itself must sign an acknowledgement of the contribution, and of the value claimed by the donor.

6 THE "QUID-PRO-QUO" RULES STATE THAT NO ONE MAY TAKE A DEDUCTION FOR THE FULL AMOUNT OF A CONTRIBUTION FOR WHICH THEY RECEIVED ANYTHING OF TANGIBLE VALUE IN RETURN. The "Quid Pro Quo" rules apply to any donation in which the donor receives anything of value in return for the donation. Money paid for admission to fundraising events that provide a dinner, concert, or other entertainment are treated as "quid-pro-quo" donations because the donors receive something of value in return for their donations. The IRS allows donors to take a deduction only for the amount they give which is in excess of the FAIR MARKET VALUE of the goods or services they receive. For example, if a nonprofit group holds a fundraising event which includes dinner and music, even if the nonprofit group uses only volunteer labor and donated goods so there are no costs at all for the group itself, the donor must subtract the fair market value of the dinner and entertainment from his or her contribution to calculate the amount which can be claimed as a deduction.

7 NO ONE MAY TAKE A TAX DEDUCTION FOR THE PRICE OF ADMISSION TO A DINNER OR AN ENTERTAINMENT EVENT JUST BECAUSE THEY CHOSE NOT TO ATTEND THE EVENT. The IRS Quid Pro Quo rules state that donors are buying the right to attend, and cannot take a deduction simply because they choose not to exercise that right. Therefore, if donors say they to want buy tickets to support your organization even though they cannot attend, you should encourage them, instead, to make a contribution for the amount they were planning to spend without actually purchasing a ticket. If they make a contribution rather than purchase a ticket they can take a deduction for the full amount.

8 CALLING A PAYMENT A "VOLUNTARY CONTRIBUTION" DOES NOT AUTOMATICALLY MAKE IT TAX DEDUCTIBLE. If the donor received something of value in return for the donation, it is generally treated as a "quid-pro-quo" donation even if the payment was called a "voluntary contribution" and the donor could have received the goods or services without making the donation.

9 NO ONE CAN TAKE A DEDUCTION FOR THE PRICE OF PURCHASING A RAFFLE TICKET. Raffle tickets are a special kind of quid-pro-quo donation in which no tax deduction may be taken. The IRS rules state that the opportunity to

win a prize in a raffle is always worth the price paid. This rule means that the price of buying raffle tickets are never a tax deductible donation.

10 DONORS CANNOT CLAIM TAX DEDUCTIONS FOR THE DONATIONS THEY MAKE UNLESS THEY ITEMIZE DEDUCTIONS ON THEIR FEDERAL TAX RETURNS. If a person simply takes the "standard deduction" allowed for federal tax returns, instead of itemizing deductions, then they cannot claim a deduction for charitable contributions. Many people who work for nonprofit organizations promise that all donors can take a deduction, whereas, in fact, many people who give money very generously compared to their income and assets, in reality, cannot claim that deduction. This is why you should only say that "your contribution may be deducted to the full extent allowed by law." Because mortgage interest is an allowable personal deduction, almost everyone who is paying for the purchase of a house itemizes their tax return and therefore will be able to take a deduction for their charitable contribution. Conversely, most people who are not in the process of buying a house do not itemize their deductions and cannot claim a charitable deduction.