

Corporate and Governance Compliance

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CORPORATE AND GOVERNANCE COMPLIANCE

Congratulations, your organization is now incorporated and received its determination letter from the Internal Revenue Service (IRS) confirming the organization's tax-exempt status under Internal Revenue Code ("Code") Section 501(a). Many organizations believe that the hard work is now done, but doing so could jeopardize the continued operations of the organization.

A. Annual Action Items and Key Policies

Most nonprofit organizations are incorporated as a nonprofit corporation under state law. As such, the organization may have annual filing requirements with the state in which it is incorporated in addition to any filings with the IRS.

Organizations that are charitable may also have filing requirements relating to charitable solicitation activities.

State Corporate Annual Filings

Many states require nonprofit corporations to file periodic reports with the state to maintain corporate "good standing." Failure to maintain good standing could result in the corporation being administratively dissolved by the jurisdiction. Therefore, it is important to keep the state informed regarding any address or e-mail changes to ensure the organization receives notification of required filings. Examples of annual corporate filings include:

https://corp.delaware.gov/paytaxes.shtml
http://www.sos.ca.gov/business/corp/pdf/so/corp_so100.pdf
http://www.sec.state.ma.us/cor/corpdf/c156ds1622950c11357.pdf
https://quickstart.sos.nh.gov/online/Account
http://sos.ri.gov/documents/business/forms/631.pdf
http://www.sos.state.co.us/biz/FileDocSearchCriteria.do http://www.sos.state.co.us/pubs/business/helpFiles/REPORT_HELP.html

IRS Filings

Many nonprofit organizations also seek recognition of tax-exempt status under the Code. All tax-exempt organizations, even small organizations, now have annual filing requirements with the IRS. These filings requirements are included in the determination letter that the organization receives from the IRS. A summary of the annual Form 990 filing requirements is noted below.

What to File	Due Date	Summary
Form 990/ 990-EZ*	15 th day of the 5 th month after end of fiscal year (for calendar filers— May 15 th)	Required for organizations with gross receipts more than \$50,000 annually. Due date may be extended for three months, without showing cause, by filing Form 8868 with the IRS before the due date. An additional three-month extension may be requested on Form 8868, for reasonable cause why the return cannot be filed by the extended due date.
Form 990-N (e-postcard)	15 th day of the 5 th month after end of fiscal year (for calendar filers— May 15 th)	Required for organizations with gross receipts less than \$50,000 annually. Must be filed electronically at the IRS website at www.irs.gov . Organizations classified as supporting organizations under Code Section 509(a)(3) must file a Form 990 or 990-EZ regardless of revenue unless it supports a religious organization (filing threshold is then \$5,000 in annual gross revenues).
Form 990-T	15 th day of the 5 th month after end of fiscal year (for calendar filers— May 15 th)	Organizations that have gross receipts of \$1,000 or more from unrelated trade or business during any given year. <i>Note: Estimated quarterly tax on unrelated business income must be made if the organization expects its tax for the year to be \$500 or more.</i>

What to File	Due Date	Summary
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***Failure to file Form 990/990-EZ or 990-N for three (3) consecutive years will result in the automatic revocation of the organization's tax-exempt status.**

Annual Board/Member Requirements

Good governance is also an important aspect of nonprofit operations. Regular board meetings as well as at least an annual meeting of members (if applicable) is required under most state laws. Annual action items include, but are not limited to, the following:

- Review and approval of minutes from the last meeting of the board/members
- Completion of conflict of interest disclosure forms
- Review of financial statements (audited if required)
- Selection of auditors (if required)
- Election of directors and officers
- Presentation of annual report; note that some states (e.g., New York) require an annual report be presented and that the report include specific information
- General ratification of past acts

Policies

Having good, clear policies and procedures in place is critical for any organization and nonprofit organizations are no exception. In fact, because of the additional legal requirements and restrictions placed on nonprofit organizations, policies become even more critical. Key policies to consider include:

Policy	Recommendation
Board of Directors Code of Conduct	All organizations adopt.
Reasonable Compensation Policy	All organizations adopt (may be included in by-laws).
Conflict of Interest Policy	All organizations adopt (may be included in by-laws).
Annual Disclosure Form	All organizations adopt and use in

Policy	Recommendation
	accordance with its Conflict of Interest Policy. Form may also collect information required to be disclosed on the annual Form 990.
Whistle-Blower Code of Conduct Policy	All organizations adopt. The Sarbanes Oxley Act, which was adopted to govern public companies, has two sections which arguably also apply to nonprofit organizations. This policy complies with the requirements of this act.
Expense Reimbursement Policy and Reimbursement Form	All organizations adopt.
General Signatory and Banking Authority Policy	All organizations adopt.
Contract Approval Policy	All organizations adopt.
Policy on External Communications, Political Activities and Government Relations	All organizations adopt, especially important for organizations that have restrictions or limitations on lobbying or political activity.
Record Retention Policy	All organizations adopt.
Gift Substantiation and Disclosure	All organizations adopt.
Gift Acceptance Policy with Real Property Gift Procedures	Organizations that will accept gifts other than cash, checks or marketable securities should adopt.
Statement of Investment Objectives, Goals and Policy Guidelines	Organizations that have funds that are or will be invested should adopt.
Telecommunications Policy	Organizations that have employees or provide cell phones to directors, officers or employees should adopt.
Joint Venture Policy	Organizations that plan to enter into joint

Policy	Recommendation
	venture (i.e., joint ownership) with other organizations
Employee Use of Corporate Credit Cards	Organizations that have corporate credit cards should adopt. Note that we generally do not recommend that an organization have an ATM or debit card under any circumstances.
Committee Charters	The organization should consider adopting charters for committees with board delegated authority to ensure that the mission and objectives of the committee are clearly communicated.
Grant Policies and Procedures	Organizations that will make grants to individuals or other organizations adopt.
Grant Letter Agreement	Organizations that make grants to other organizations should adopt and require all grant recipients to execute this agreement. Note that additional requirements may apply if an organization that is tax-exempt under Code Section 501(c)(3) makes a grant to an organization that is not also tax-exempt under Code Section 501(c)(3).
International Grant Policies and Procedures	Organizations that engage in any international grant-making activities should adopt.
Expenditure Responsibility Procedures	All private foundations that will make grants to organizations that do not have recognition of tax-exempt status under Code Section 501(c)(3) should adopt.
Affidavit Procedures for Grants	All private foundations that will make grants to organizations that do not have recognition of tax-exempt status under Code Section 501(c)(3) should adopt.

B. Lobbying/Electioneering

Conducting lobbying or electioneering activities raises concerns for nonprofit organizations because some of these activities are allowed and others are not. So, as an initial matter, it is important that an organization understand the difference between these activities.

Lobbying

Lobbying includes activities conducted at the federal, state or local levels for the purpose of influencing the outcome of legislation such as direct communication with legislators and political officials. It does not include public education efforts that are objective, nonpartisan and present alternative points of view.

Communications regarding legislation that will directly affect the existence, nature, powers or tax-exempt status of a charity are not considered lobbying activities.

Lack of funding (i.e., lobbying concerning a budget) is not considered part of this “self-defense” exception. Lobbying also includes lobbying efforts directed at attempting to effect the opinions of the general public (e.g., grassroots lobbying).

Legislation can include actions by Congress, state legislatures, city councils or other elected bodies with respect to bills or resolutions; confirmation of an individual for office; and ballot initiatives.

To be considered lobbying, a communication must refer to and reflect a view on a specific legislative proposal or legislation that has been introduced before a legislative body. If the communication does not refer to specific legislation, it may be considered issue advocacy.

Electioneering

Organizations that are tax-exempt under Code Section 501(c)(3) are absolutely prohibited from participating or intervening in (including the publishing or distributing of statements) any political campaign on behalf of (or in opposition to) any candidate for public office. Therefore, these organizations cannot support or oppose any candidate for public office (international, federal, state or local). This includes endorsing a candidate or making a donation to the candidate. It also includes general statements of support or opposition to a candidate, as well as the use of the organization’s resources (staff, volunteers, office space, communication platforms such as a newsletter or Twitter feed, etc.) to support or oppose a particular candidate or party.

Note that even if a statement does not expressly state a request to vote for a specific candidate, the organization's statement may still be considered campaign intervention if the message favors or opposes a certain candidate. A statement may also identify a candidate by providing identifying information (other than a name) such as referring to his or her political party, showing a picture of the candidate or describing other distinctive features of the candidate's campaign or biography.

Nonpartisan voter education activities or activities encouraging people to vote, such as organizing a public forum, publishing voter education guides or conducting get-out-the-vote drives, are not considered campaign intervention. However, organizations must be careful not to show any favoritism to any candidate or party while conducting such activities.

For more information about political activities, see IRS Revenue Ruling 2007-41 and IRS Revenue Ruling 78-248.

C. Intermediate Sanctions

Members of governing boards of organizations described in Code Sections 501(c)(3) and 501(c)(4) have a duty to assure that the organization does not provide certain inside parties (i.e., directors and officers) more than an arm's length, fair market value compensation, contract terms and/or fringe benefits. The IRS imposes severe penalties on the recipient of excessive compensation, and may also impose personal financial penalties on directors or trustees when it finds an "excess benefit" transaction.

Any paid contracts, salary or benefit adjustments or bonus decisions may expose a board to these penalties. Therefore, a board will want to consider steps to assure that the compensation and benefit levels for insiders are well within allowable ranges and contain no excess benefits. By having a board follow certain procedures in setting any insider compensation and approving the contract, it can largely eliminate a board members' personal penalty exposure.

Overview

Excise taxes are imposed on certain "disqualified persons" who improperly benefit from an "excess benefit transaction" involving the organization. Excise taxes are also imposed on "organization managers" who participate in an excess benefit transaction knowing that it is such a transaction, unless the participation is not willful and is due to reasonable cause.

These penalties are commonly referred to as “intermediate sanctions.” Before these provisions became effective in 1995, the IRS’s only tool when it encountered excess benefit transactions was to revoke the tax exempt status of a Code Section 501(c)(3) or 501(c)(4) organization. It had no available sanction other than what was considered to be tantamount to the “death penalty” for a charity. The scandal involving the compensation and benefits of William Aramony, President of United Way of America, and the unwillingness of the IRS to revoke United Way’s exempt status because of the Aramony transactions, persuaded Congress that intermediate sanctions were needed. Accordingly, it enacted what is now Code Section 4958, entitled “Taxes On Excess Benefit Transactions.”

Taxes on Disqualified Persons

An initial tax is imposed, for each excess benefit transaction, on the disqualified persons. The tax is equal to 25% of the “excess benefit” from the transaction. An additional tax is imposed in any case in which an initial 25% tax is imposed and the excess benefit involved in the transaction is not corrected within the correction period. The additional tax is equal to 200% of the excess benefit involved.

What Organizations Are Subject to Code Section 4958?

Organizations that are tax-exempt under Code Sections 501(c)(3) and 501(c)(4) at any time in a five-year period before the excess benefit transaction occurred are referred to as “*applicable tax exempt organizations*.” However, the following are **not** considered applicable tax-exempt organizations:

- A private foundation
- A governmental entity that is not subject to taxation
- A foreign organization tax-exempt under Code Section 501(c)(3) or 501(c)(4) that receives substantially all of its support from sources outside the United States
- An organization tax-exempt under Code Section 501(c)(3) or 501(c)(4) whose exemption was never recognized or was revoked **unless** the revocation was based on the presence of private inurement or impermissible private benefit. If this occurs, then the organization would be considered an applicable tax-exempt organization during the revocation period. And, the five-year look back rule would also apply.
- Disqualified persons as defined under Regulations Section 53.4958-3T

Who Are Disqualified Persons?

A “*disqualified person*,” with respect to any transaction, is any person who was in a position to exercise substantial influence over the affairs of the organization at any time during the five-year period ending on the date of the excess benefit transaction. A disqualified person would include, among others, any of the following:

- any board member;
- any person who, regardless of title, has ultimate responsibility for implementing the decisions of a board or for supervising the management, administration or operation of the organization, such as the organization’s president, chief executive officer (CEO) or chief operating officer (COO);
- any person who, regardless of title, has ultimate responsibility for managing the organization’s finances, such as the organization’s treasurer or chief financial officer (CFO);
- any other person in a position to exercise substantial influence during the applicable period, unless such person is an employee of the organization who:
 - receives economic benefits from the organization of less than \$90,000;
 - is not defined in 1, 2 or 3 above; and
 - is not a substantial contributor to the organization;
- any member of the family of a person who is a disqualified person; and
- any entity in which a disqualified person holds a 35% or greater interest.

What Is An Excess Benefit Transaction?

An “*excess benefit transaction*” is any transaction in which an economic benefit is provided by the organization directly or indirectly to or for the use of any disqualified person, if the value of the economic benefit provided exceeds the value of the consideration (including the performance of services) that the organization received for providing the benefit. An “*excess benefit*” is the excess referred to in the above definition of excess benefit transaction. The most common form of an excess benefit transaction occurs when an organization pays a

disqualified person unreasonable compensation with respect to the services rendered.

Compensation is reasonable if it is in an amount that would ordinarily be paid for like services by like enterprises under similar circumstances. With respect to excess or unreasonable compensation, the most critical concept is that all of the consideration for performance of services given to an individual needs to be included in determining whether the compensation is reasonable. Compensation includes all forms of cash and non-cash compensation, including salary, fees, bonuses and severance payments. Compensation includes all other compensatory benefits, whether or not included in gross income for income tax purposes, including payments to welfare benefit plans, such as plans providing medical, dental, life insurance, severance pay and disability benefits, and most taxable and nontaxable fringe benefits.

Taxes on Organization Managers

In cases where an initial 25% tax has been imposed on disqualified persons, a tax is also imposed with respect to an excess benefit transaction on the organization managers who “participate” in the transaction “knowing” it to be an excess benefit transaction. The tax is equal to 10% of the excess benefit. However, the tax is not imposed where the organization manager’s participation was not “willful” and was due to “reasonable cause.”

An “*organization manager*” is:

- any officer, director or trustee of the organization; or
- any individual having powers similar to those of officers, directors or trustees of the organization, regardless of the individual’s title.

Under a special rule for certain committee members, an individual who is not an officer, director or trustee, yet serves on a committee of a board that is attempting to invoke the rebuttable presumption of reasonableness based on the committee’s actions, is an organization manager for purposes of the 10% tax imposed on organization managers.

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