

# Transparency in Your Nonprofit Organization

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NON-PROFIT  
ORGANIZATION

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## I. Tax Exempt Organizations<sup>1</sup>

A. General---Associations are generally considered by the IRS to be “business leagues” as defined by Section 501(c)(6) of the IRS Code.

1. Things to look at relative to determine whether an association qualifies as tax exempt are the following:

- a. that it not be organized for profit.
- b. that no part of its earnings inure to the benefit of any private shareholder or individual (except as payment for services rendered to the association)
- c. that the organization be an association of persons or firms having a common business interest.
- d. that its activities be directed to the improvement of conditions in one or more lines of business.
- e. that it not be engaged regularly in a business of a kind ordinarily carried on for profit.
- f. that its activities not be confined to the performance of particular services for individual members.
- g. that it be a business league and in the same general class as a chamber of commerce or board of trade.

### B. IRS Tests for Determination of Tax-Exempt Status

1. The organizational test examines whether the organization was formed according to IRS Code Section 501(c)(6) and regulations under the Code as a non-profit organization or a business league and whether, therefore, any portion of its earnings or surplus will inure to individual members.

2. The operational test examines whether the association’s activities are consistent with Section 501(c)(6) and the

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<sup>1</sup> A less common type of tax exempt organization is a 501(c)(4), which includes civic leagues, social welfare organizations, or local associations of employees. These are often a “cause-based” association focused exclusively on issue advocacy.

regulations so that it promotes business interests, does not provide particular services, and is engaged in exempt activities.

### C. Taxation of Tax-Exempt Organizations

1. All associations must annually file IRS Form 990.
  - a. Form 990 is filed for informational purposes only.
  - b. Form 990 is filed by the fifteenth day of the fifth month following the end of the organization's tax year. (May 15 for calendar year organizations). Extensions may be obtained.
  - c. New Form 990 includes Part VI questions on governance, management, and disclosure.<sup>2</sup>
2. Chambers of commerce or associations with unrelated trade or business gross income that exceeds \$1000 must file IRS Form 990-T.
3. To be taxable, unrelated business income
  - (1) must be derived from the conduct of a trade or business.
  - (2) the income must be from a trade or business which is carried on regularly.
  - (3) the trade or business from which the income is derived must not be substantially related to the purpose for which the organization was granted an exemption.

Statutory exceptions to UBIT are

- (1) dividends
- (2) rent (from debt-free property)
- (3) royalties---get a license (i.e., this is common in association affinity programs where the association endorses a product/service for members but does not conduct the marketing of the endorsed product/service.)

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<sup>2</sup> One question asks about the number of independent board directors. This is defined as someone not compensated as an officer or employee, not compensated more than \$10,000 as an independent contractor (not including reasonable reimbursement of expenses and reasonable director compensation), neither the director of family members is in a reportable transaction with the association. This means a member can be a donor to association's affiliated foundation at any level and still be considered an independent director.

- (4) interest
- (5) annuities
- (6) gains from the sale of property to customers in the ordinary course of business
- (7) income from governmental research
- (8) income from work performed by volunteers who receive no compensation

Publication advertising is probably the greatest source of UBIT for tax-exempt organizations. Advertising in magazines, newsletters and directories is subject to UBIT.

4. Corporate Sponsorship of Events
  - a. Contributions from sponsors may be taxable income if the promotional services rendered by the sponsor are deemed to be “excessive” by the IRS.
  - b. The following sponsor material will be considered advertising: price preparation, endorsements, inducements to purchase and qualitative or corporate language.
  - c. Distribution of a sponsor’s product at a sponsored event will not make sponsorship income taxable, whether it is free or sold and an “exclusive” sponsorship will not make payments under the sponsorship taxable.

## II. **Not-For-Profit Corporate Law**

Associations are generally incorporated under the state not-for-profit corporation laws.

1. State Not-For-Profit Corporation Law
2. Articles of Incorporation
3. Bylaws---most important. Typically contain:
  - a. Membership criteria

- b. Powers, manner of selection, and terms of office of officers and directors
  - c. General information about committees.
  - d. Indemnification and insurance provisions
  - e. Procedures for member termination
  - f. Required notifications, including quorum, for board meetings and actions, and membership meetings and actions
  - g. Financial management
  - h. Procedures for amending the Bylaws.
4. Policies and Procedures- Details on day-to-day association operational procedures can be maintained in this document e.g., how much per diem does a director receive for attending a meeting, do association members speaking at its annual session receive an honorarium, under what circumstances can a member use the association's logo, etc.).

### III. Antitrust Law<sup>3</sup>

- A. Unreasonable Restraints of Trade - Federal and state government agencies, as well as private plaintiffs, enforce the antitrust laws, which generally prohibit unreasonable restraints of trade. Not-for-profit membership organizations, because they bring competitors together, are natural targets.
- B. Size - Corporations, big or small, including associations, are subject to the antitrust laws to the same degree, although size is often relevant to substantive antitrust liability. Association activities pose a risk because their members are often competitors in the marketplace.

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<sup>3</sup> The U.S. Department of Justice has an entire division devoted to such matters: <http://www.justice.gov/atr/>

- C. Penalties - Penalties for antitrust violations can be severe, including treble damage payments, and prison terms for individuals convicted of criminal violations. More likely exposure for associations or chambers is cost of legal defense and injunctive relief.
- D. Best practice- Adopt a formal antitrust compliance policy, distribute regularly to officer, directors, committee members, employees and read a summary at the beginning of each board or committee meeting.
- E. Discussions to avoid:
  - a. Prices to be charged to customers by members
  - b. Division or allocation of markets or customers
  - c. Coordination of bids or requests for bids
  - d. Terms and conditions of sales, including credit or discount terms
  - e. Terms for distribution of products
  - f. Targets for production of products or the level of production
  - g. What constitutes a fair profit or margin levels
  - h. Basis upon which prices are determined
  - i. Exchange of price information as to specific customers
  - j. Boycott of or a refusal to deal with a customer or supplier
  - k. Compilation of approved lists of customers or suppliers
- F. Discussion that are permissible:
  - a. Reporting on general industry or profession trends
  - b. Describing advances or problems in technology or research
  - c. Demonstrating methods for an individual or firm to be more profitable via better knowledge of costs
  - d. Summarizing effective methods of purchasing, production, marketing
  - e. Education about science and art of management
  - f. Considering professional relations to governments
  - g. Product improvement strategies
  - h. Developing responses to consumer or environmental issues
- G. Statistical studies are acceptable when:

- a. Only gross sales or average prices are reported
  - b. Individual transactions or data are NOT reported
  - c. Only past information is surveyed
  - d. There is no agreement to adhere to the reported information in any way
  - e. Reports are available to sellers, buyers, and association nonmembers
- H. Safe harbor: As long as an association is making an independent business decision, it should not have exposure (*e.g. association is dissatisfied with an outside vendor and elects not to do business with them for the foreseeable future*). Antitrust concerns arise when organizations or individuals coordinate or agree on certain conduct.

#### IV. Membership Requirements

- A. Black-Balling - No black-balling by competitors is allowed, but a board vote on admission to membership is permissible, as is a requirement that new members be sponsored by existing members, unless such votes and sponsorship requirements are actually used to implement an unreasonable anticompetitive scheme.
- B. Geographic Limitations - Geographic limitations on membership that do not discriminate between competitors - for example, that a business must be doing business in a certain city or state - are permissible.
- C. Types of Business Limitations - Reasonable functional definitions of eligibility for membership are permissible (for example, only businesses allowed -no not-for-profits, government bodies, those in the same profession, trade, or particular functional level in the profession or trade, etc.).
- D. Financial Condition Limitations - Exclusions based on financial condition (cannot pay dues), length of time in business (one or two years may be required), and a record of serious criminal conduct can be enforced if properly defined. Good reputation requirements and other

exclusions based on ethical considerations may not be legally justifiable, but practical considerations may permit their use.

E. Guidelines -

1. *Suspension* - Suspension of action on membership application pending resolution of a criminal prosecution is permissible once a charge has been filed.
2. *Voluntary* - Do not force membership in an association or chamber or participation in chamber or association activities; make it voluntary.
3. *Exclusivity* - Associations or chambers may choose to do business only with members. Encouraging members to deal with other members is acceptable; encouraging them not to deal with nonmembers (or to deal only with members) is not.
4. *Nonmember Fees* - Charging nonmembers higher fees than members for services (including publications) rendered by a chamber or association is acceptable. In some cases, association or chamber services must be provided to nonmembers (just about any service that provides a significant competitive advantage and cannot be readily obtained elsewhere).

*Caveat: so long as the charge is not so high as to effectively compel the non-member to join the association.*

5. *Unethical Behavior*- Failure to comply with reasonable association rules unrelated to competition among members is a legitimate reason for involuntary termination. This may include failure to comply with business or professional ethics codes.
6. *Due Process*- The is the key best practice is due process to avoid an allegation of arbitrarily membership termination:
  - a. Have formal procedures for receiving and acting on requests for expulsion and strictly adhere to them.
  - b. Provide a written notice stating the reason for expulsion.

- c. Allow an opportunity for the member to appear in person or be represented before a board or committee.
- d. Allow an appeal to the board of directors or highest governing body.

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