Public Charities: Receiving and Projecting Financial Support

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Initial Questions:

- What is a public charity?
- How do I become/stay a public charity?
- As a public charity, how do I interact with the public?

Nonprofit Entity Formation, Step #1

The nonprofit corporation is the most typical legal entity used to form a charitable organization.

Drafting the Articles of Incorporation and Bylaws, and then incorporating the nonprofit corporation in your state is the first step to forming the charitable organization.

Nonprofit Entity Formation, Step #2

Once the nonprofit corporation has been formed according to the laws of your state, the next step is to ask the IRS for income tax exemption. Income tax exemption is also called 501(c) status.

You may think that all nonprofits are charitable organizations that "do good" in the community and offer a tax deduction to their donors. They are not. In general, only a small subset fit this description – 501(c)(3)s.

There are actually 29 different types of tax-exempt organizations under section 501(c) of the Internal Revenue Code: 501(c)(1) all the way to 501(c)(29), and additional miscellaneous types of tax-exempt organizations under other subsections of Internal Revenue Code section 501.

We can look at all of the different types of tax-exempt classifications a bit closer: http://www.irs.gov/publications/p557/ar02.html

Nonprofit Entity Formation, Step #2

501(c)(1)	Corporations Organized under Act of Congress (including Federal Credit Unions)	Instrumentalities of the United States	No Form	None	Yes, if made for exclusively public purposes
501(c)(2)	Title Holding Corporation For Exempt Organization	Holding title to property of an exempt organization	1024	990[1] or 990-EZ[8]	No[2]
501(c)(3)	Religious, Educational, Charitable, Scientific, Literary, Testing for Public Safety, to Foster National or International Amateur Sports Competition, or Prevention of Cruelty to Children or Animals Organizations	Activities of nature implied by description of class of organization	1023, 1023-EZ	990[1] or 990-EZ[8], or 990-PF	Yes, generally
501(c)(4)	Civic Leagues, Social Welfare Organizations, and Local Associations of Employees	Promotion of community welfare; charitable, educational, or recreational	May self-declare, 1024	990[1] or 990-EZ[8]	No, generally [2, 3]
501(c)(5)	Labor, Agricultural, and Horticultural Organizations	Educational or instructive, the purpose being to improve conditions of work, and to improve products of efficiency	May self-declare, 1024	990[1] or 990-EZ[8]	No[2]
501(c)(6)	Business Leagues, Chambers of Commerce, Real Estate Boards, etc.	Improvement of business conditions of one or more lines of business	May self-declare, 1024	990[1] or 990-EZ[8]	No[2]
501(c)(7)	Social and Recreational Clubs	Pleasure, recreation, social activities	May self-declare, 1024	990[1] or 990-EZ[8]	No[2]
501(c)(8)	Fraternal Beneficiary Societies and Associations	Lodge providing for payment of life, sickness, accident or other benefits to members	1024	990[1] or 990-EZ[8]	Yes, if for certain Sec. 501(c)(3) purposes
501(c)(9)	Voluntary Employees Beneficiary Associations	Providing for payment of life, sickness, accident, or other benefits to members	1024	990[1] or 990-EZ[8]	No[2]
501(c)(10)	Domestic Fraternal Societies and Associations	Lodge devoting its net earnings to charitable, fraternal, and other specified purposes. No life, sickness, or accident benefits to members	1024	990[1] or 990-EZ[8]	Yes, if for certain Sec. 501(c)(3) purposes
501(c)(11)	Teachers' Retirement Fund Associations	Teachers' association for payment of	Letter[6]	990[1] or 990-EZ[8]	No[2]

Nonprofit Entity Formation, Step #2

Asking the IRS for tax-exemption is like driving down a highway. There are many different types of cars you could theoretically drive down that highway in order to get to the desired final destination: income tax exemption.

However, we need to pick the "right" car that best describes how the organization will operate and what it will do. That is called classification.

Classification refers to which subsection of the Internal Revenue Code will govern the organization — which federal "rules of the road" the nonprofit must follow, and what type of tax-exempt organization the nonprofit will be.

You may find that the organization has aspects of more than one classification. Ultimately, the business model and how it operates will dictate which classification is appropriate. We need to choose our car, and then stay in our lane and follow the appropriate rules of the road.

Types of 501(c)(3)s

501(c)(3) - Organizations *organized and operated exclusively* for the following exempt purposes: charitable, religious, educational, scientific, literary, testing for public safety, amateur athletic organizations, and organizations that prevent cruelty to children or animals.

- 501(c)(3) private foundations
- 501(c)(3) public charities
- 501(c)(3) supporting organizations

Types of 501(c)(3)s – Which car?

- Every section 501(c)(3) organization is classified as either a private foundation or a public charity. Private foundations and public charities are distinguished primarily by the level of public involvement in their activities.
- Public charities generally receive a greater portion of their financial support from the general public or governmental units, and have greater interaction with the public. A private foundation, on the other hand, is typically controlled by members of a family or by a small group of individuals, and derives much of its support from a small number of sources and from investment income. Because they are less open to public scrutiny, private foundations are subject to various operating restrictions and to excise taxes for failure to comply with those restrictions.
- Under the tax law, a section 501(c)(3) organization is presumed to be a private foundation unless it requests, and qualifies for, a ruling or determination as a public charity. Organizations that qualify for public charity status include churches, schools, hospitals, medical research organizations, *publicly-supported* organizations (i.e., organizations that receive a specified portion of their total support from public sources), and certain supporting organizations.

Types of 501(c)(3)s – Which car?

501(c)(3) - Organizations *organized and operated exclusively* for the following exempt purposes: charitable, religious, educational, scientific, literary, testing for public safety, amateur athletic organizations, and organizations that prevent cruelty to children or animals.

- <u>501(c)(3) private foundations</u>
  - Every organization that qualifies for tax exemption as an organization described in section 501(c)(3), is a private foundation unless it falls into one of the categories specifically excluded from the definition of that term (referred to in section 509(a) – churches, schools, hospitals, governmental units, public charities, or supporting organizations).
  - There are several restrictions and strict requirements on private foundations.

Types of 501(c)(3)s – Which car?

501(c)(3) - Organizations *organized and operated exclusively* for the following exempt purposes: charitable, religious, educational, scientific, literary, testing for public safety, amateur athletic organizations, and organizations that prevent cruelty to children or animals.

- <u>501(c)(3) public charities</u> - These entities benefit the community at large, and, generally, receive funding from diverse public sources.
- Examples:
  - 509(a)(1) and 170(b)(1)(A)(i) – churches
  - 509(a)(1) and 170(b)(1)(A)(ii) – schools
  - 509(a)(1) and 170(b)(1)(A)(iii) – hospitals & medical research organizations
  - 509(a)(1) and 170(b)(1)(A)(iv) – "garden variety" organizations that normally receive a substantial part of its support from a governmental unit or from the general public (i.e., more than 33 1/3% of its support from gifts, grants, and contributions, and from diverse sources)
  - 509(a)(1) and 170(b)(1)(A)(v) – a federal, state, or local government or governmental unit
  - 509(a)(1) and 170(b)(1)(A)(ix) – an agricultural research organization
  - 509(a)(2) – "garden variety" organizations that normally receive: (1) more than 33 1/3% of its support from contributions, membership fees, and gross receipts from activities related to its exempt functions—subject to certain exceptions, and (2) no more than 33 1/3% of its support from gross investment income and unrelated business taxable income
    - Youth athletic organizations
    - Historical societies
    - Environmental groups with members

Types of 501(c)(3)s – Which car?

Public Support Test: The public support test is the mechanism by which the IRS determines if a charity has sufficient financial support from the correct sources.

- Under 509(a)(1): To be categorized as a public charity, the organization must demonstrate that it: 1.) either receives at least one-third of its financial support from the general public, other public charities, and the government (called the "33 1/3 test"); 2.) or that it receives at least 10% of its financial support from the general public, other public charities, and the government AND meets other criteria (called the "facts and circumstances test").
- Under 509(a)(2): To be categorized as a public charity, the organization must demonstrate that it receives more than one-third of its financial support from the general public or from gross receipts related to its exempt purposes (tuition, hospital charges, admissions), AND must receive no more than one-third of its support from gross investment income and unrelated business taxable income (UBIT). There is no "facts and circumstances test" under 509(a)(2).
- In both cases, the tests measure results over a five-year period, and substantial contributions (greater than $5,000 or more than 2% of all contributions received) from other than another public charity are "discounted" so that the charity demonstrates broad public support, not just a handful of major donors.
- This information will be spelled out in Schedule A of the Form 990.

Types of 501(c)(3)s – Which car?

501(c)(3) - Organizations *organized and operated exclusively* for the following exempt purposes: charitable, religious, educational, scientific, literary, testing for public safety, amateur athletic organizations, and organizations that prevent cruelty to children or animals.

- <u>501(c)(3) supporting organizations</u> –
  - These entities carry out their exempt purposes by supporting other nonprofits, usually other public charities. This type of classification is important because it allows 501(c)(3)s to avoid becoming private foundations if they are not meeting the public support test.
  - All supporting organizations must pass an organizational test, an operational test, a control test and a relationship test. Supporting organizations are classified as Type I, Type II or Type III supporting organizations based on how they satisfy the relationship test.
  - An example of a supporting organization is a separate foundation formed in order to support a specific church or camp (or category of churches/camps). The supporting organization raises money, holds real property, and/or controls major investments on behalf of that single church or camp.

SCHEDULE A
(Form 990 or 990-EZ)

Department of the Treasury
Internal Revenue Service

Public Charity Status and Public Support

Complete if the organization is a section 501(c)(3) organization or a section 4947(a)(1) nonexempt charitable trust.
▶ Attach to Form 990 or Form 990-EZ.
▶ Information about Schedule A (Form 990 or 990-EZ) and its instructions is at *www.irs.gov/form990*.

OMB No. 1545-0047
2016
Open to Public Inspection

Name of the organization | **Employer identification number**

Part I Reason for Public Charity Status (All organizations must complete this part.) See instructions.

The organization is not a private foundation because it is: (For lines 1 through 12, check only one box.)

1 ☐ A church, convention of churches, or association of churches described in **section 170(b)(1)(A)(i).**
2 ☐ A school described in **section 170(b)(1)(A)(ii).** (Attach Schedule E (Form 990 or 990-EZ).)
3 ☐ A hospital or a cooperative hospital service organization described in **section 170(b)(1)(A)(iii).**
4 ☐ A medical research organization operated in conjunction with a hospital described in **section 170(b)(1)(A)(iii).** Enter the hospital's name, city, and state: ______
5 ☐ An organization operated for the benefit of a college or university owned or operated by a governmental unit described in **section 170(b)(1)(A)(iv).** (Complete Part II.)
6 ☐ A federal, state, or local government or governmental unit described in **section 170(b)(1)(A)(v).**
7 ☐ An organization that normally receives a substantial part of its support from a governmental unit or from the general public described in **section 170(b)(1)(A)(vi).** (Complete Part II.)
8 ☐ A community trust described in **section 170(b)(1)(A)(vi).** (Complete Part II.)
9 ☐ An agricultural research organization described in **section 170(b)(1)(A)(ix)** operated in conjunction with a land-grant college or university or a non-land-grant college of agriculture (see instructions). Enter the name, city, and state of the college or university: ______
10 ☐ An organization that normally receives: (1) more than $33\frac{1}{3}$% of its support from contributions, membership fees, and gross receipts from activities related to its exempt functions—subject to certain exceptions, and (2) no more than $33\frac{1}{3}$% of its support from gross investment income and unrelated business taxable income (less section 511 tax) from businesses acquired by the organization after June 30, 1975. See **section 509(a)(2).** (Complete Part III.)
11 ☐ An organization organized and operated exclusively to test for public safety. See **section 509(a)(4).**
12 ☐ An organization organized and operated exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more publicly supported organizations described in **section 509(a)(1)** or **section 509(a)(2).** See **section 509(a)(3).** Check the box in lines 12a through 12d that describes the type of supporting organization and complete lines 12e, 12f, and 12g.

a ☐ **Type I.** A supporting organization operated, supervised, or controlled by its supported organization(s), typically by giving the supported organization(s) the power to regularly appoint or elect a majority of the directors or trustees of the supporting organization. **You must complete Part IV, Sections A and B.**

b ☐ **Type II.** A supporting organization supervised or controlled in connection with its supported organization(s), by having control or management of the supporting organization vested in the same persons that control or manage the supported organization(s). **You must complete Part IV, Sections A and C.**

Part II **Support Schedule for Organizations Described in Sections 170(b)(1)(A)(iv) and 170(b)(1)(A)(vi)**
(Complete only if you checked the box on line 5, 7, or 8 of Part I or if the organization failed to qualify under Part III. If the organization fails to qualify under the tests listed below, please complete Part III.)

Section A. Public Support

Calendar year (or fiscal year beginning in) ▶	(a) 2012	(b) 2013	(c) 2014	(d) 2015	(e) 2016	(f) Total
1 Gifts, grants, contributions, and membership fees received. (Do not include any "unusual grants.")						
2 Tax revenues levied for the organization's benefit and either paid to or expended on its behalf						
3 The value of services or facilities furnished by a governmental unit to the organization without charge						
4 **Total.** Add lines 1 through 3						
5 The portion of total contributions by each person (other than a governmental unit or publicly supported organization) included on line 1 that exceeds 2% of the amount shown on line 11, column (f)						
6 **Public support.** Subtract line 5 from line 4						

Section B. Total Support

Calendar year (or fiscal year beginning in) ▶	(a) 2012	(b) 2013	(c) 2014	(d) 2015	(e) 2016	(f) Total
7 Amounts from line 4						
8 Gross income from interest, dividends, payments received on securities loans, rents, royalties and income from similar sources						
9 Net income from unrelated business activities, whether or not the business is regularly carried on						
10 Other income. Do not include gain or loss from the sale of capital assets (Explain in Part VI.)						
11 **Total support.** Add lines 7 through 10						

12 Gross receipts from related activities, etc. (see instructions) . . . 12

13 **First five years.** If the Form 990 is for the organization's first, second, third, fourth, or fifth tax year as a section 501(c)(3) organization, check this box and **stop here** . . . ▶ ☐

Section C. Computation of Public Support Percentage

14 Public support percentage for 2016 (line 6, column (f) divided by line 11, column (f)) . . . 14 %

15 Public support percentage from 2015 Schedule A, Part II, line 14 . . . 15 %

16a **33 1/3% support test—2016.** If the organization did not check the box on line 13, and line 14 is 33 1/3% or more, check this box and **stop here.** The organization qualifies as a publicly supported organization . . . ▶ ☐

b **33 1/3% support test—2015.** If the organization did not check a box on line 13 or 16a, and line 15 is 33 1/3% or more, check this box and **stop here.** The organization qualifies as a publicly supported organization . . . ▶ ☐

17a **10%-facts-and-circumstances test—2016.** If the organization did not check a box on line 13, 16a, or 16b, and line 14 is 10% or more, and if the organization meets the "facts-and-circumstances" test, check this box and **stop here.** Explain in Part VI how the organization meets the "facts-and-circumstances" test. The organization qualifies as a publicly supported organization . . . ▶ ☐

b **10%-facts-and-circumstances test—2015.** If the organization did not check a box on line 13, 16a, 16b, or 17a, and line 15 is 10% or more, and if the organization meets the "facts-and-circumstances" test, check this box and **stop here.** Explain in Part VI how the organization meets the "facts-and-circumstances" test. The organization qualifies as a publicly supported organization . . . ▶ ☐

18 **Private foundation.** If the organization did not check a box on line 13, 16a, 16b, 17a, or 17b, check this box and see instructions . . . ▶ ☐

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Part III **Support Schedule for Organizations Described in Section 509(a)(2)**
(Complete only if you checked the box on line 10 of Part I or if the organization failed to qualify under Part II. If the organization fails to qualify under the tests listed below, please complete Part II.)

Section A. Public Support

Calendar year (or fiscal year beginning in) ▶	(a) 2012	(b) 2013	(c) 2014	(d) 2015	(e) 2016	(f) Total
1 Gifts, grants, contributions, and membership fees received. (Do not include any "unusual grants.")						
2 Gross receipts from admissions, merchandise sold or services performed, or facilities furnished in any activity that is related to the organization's tax-exempt purpose						
3 Gross receipts from activities that are not an unrelated trade or business under section 513						
4 Tax revenues levied for the organization's benefit and either paid to or expended on its behalf						
5 The value of services or facilities furnished by a governmental unit to the organization without charge						
6 **Total.** Add lines 1 through 5						
7a Amounts included on lines 1, 2, and 3 received from disqualified persons						
b Amounts included on lines 2 and 3 received from other than disqualified persons that exceed the greater of $5,000 or 1% of the amount on line 13 for the year						
c Add lines 7a and 7b						
8 **Public support.** (Subtract line 7c from line 6.)						

Section B. Total Support

Calendar year (or fiscal year beginning in) ▶	(a) 2012	(b) 2013	(c) 2014	(d) 2015	(e) 2016	(f) Total
9 Amounts from line 6						
10a Gross income from interest, dividends, payments received on securities loans, rents, royalties and income from similar sources						
b Unrelated business taxable income (less section 511 taxes) from businesses acquired after June 30, 1975						
c Add lines 10a and 10b						
11 Net income from unrelated business activities not included in line 10b, whether or not the business is regularly carried on						
12 Other income. Do not include gain or loss from the sale of capital assets (Explain in Part VI.)						
13 **Total support.** (Add lines 9, 10c, 11, and 12.)						

14 **First five years.** If the Form 990 is for the organization's first, second, third, fourth, or fifth tax year as a section 501(c)(3) organization, check this box and **stop here** ▶ ☐

Section C. Computation of Public Support Percentage

15 Public support percentage for 2016 (line 8, column (f) divided by line 13, column (f))	15	%
16 Public support percentage from 2015 Schedule A, Part III, line 15	16	%

Section D. Computation of Investment Income Percentage

17 Investment income percentage for **2016** (line 10c, column (f) divided by line 13, column (f))	17	%
18 Investment income percentage from **2015** Schedule A, Part III, line 17	18	%

19a **33 1/3% support tests—2016.** If the organization did not check the box on line 14, and line 15 is more than 33 1/3%, and line 17 is not more than 33 1/3%, check this box and **stop here.** The organization qualifies as a publicly supported organization ▶ ☐

b **33 1/3% support tests—2015.** If the organization did not check a box on line 14 or line 19a, and line 16 is more than 33 1/3%, and line 18 is not more than 33 1/3%, check this box and **stop here.** The organization qualifies as a publicly supported organization ▶ ☐

20 **Private foundation.** If the organization did not check a box on line 14, 19a, or 19b, check this box and see instructions ▶ ☐

Public Charity v. Private Foundation

- Public charities have greater freedom to pursue their mission and face far fewer restrictions than do private foundations. assumes that a charity depending on raising money, either directly or indirectly, from the general public has greater incentives toward transparency, competence, and good government (in other words, that the "market" for public donations will keep public charities honest) while a private foundation, with usually a small, interrelated governing board and no need for public engagement, requires closer regulation. Benefits of public charity status:
  - No tax on net investment income
  - No absolute self-dealing prohibition
  - No minimum distribution requirements
  - No excess business holding limitations
  - No jeopardizing investment limitations
  - Less restrictive taxable expenditure rules
  - No termination tax
  - Can engage in (limited) lobbying

Public Charity v. Private Foundation

- More benefits of public charity status:
  - Cash contributions to public charity deductible up to 60% of AGI; for private foundation, 30%
  - Contributions of long-term capital gain property capped at 30% of AGI for public charity; for private foundation, 20%

Public Charity v. Private Foundation

- Political Activity:
  - 501(c)(3) public charities organizations may only engage in “insubstantial” political activity – they may appeal directly to legislative bodies and representatives and may support issue-based legislation, but only on a very limited basis. No campaigning for specific candidates.
  - 501(c)(3) private foundations are prohibited from any form of political activity.

Public Interaction and Transparency: Following Laws, Rules, and Regs

Public Interaction and Transparency: Following Laws, Rules, and Regs

- Nonprofits have a legal and ethical obligation to their constituents and the public to conduct their activities with accountability and transparency. Nonprofits should regularly and openly convey information to the public about their mission, activities, finances, accomplishments and decision-making processes.
- Information from a nonprofit organization should be easily accessible to the public to provide its constituents with ongoing opportunities to interact with the organization. It should establish external visibility and build public understanding and trust in the organization.

Public Interaction and Transparency: Following Laws, Rules, and Regs

- IRS transparency requirements: Charitable organizations must make the following documents available to the public at large:
  - f1023EZ/f1023/f1024 application (including supplemental materials and schedules);
  - the three most recently filed annual f990 returns;
  - if applicable, any f990-T returns filed after August 17, 2006.

- State transparency requirements: Most states require a nonprofit corporation to disclose items to its members only:
  - Articles of Incorporation and Bylaws;
  - Accounting records including P&L and Balance Sheet
  - Voting agreements
  - Meeting minutes of membership meetings, Board of Director meetings, and committee meetings

Public Interaction and Transparency: Following Laws, Rules, and Regs

- Other items you may consider disclosing:
  - An explanation of the organization's mission, activities, results, and impact;
  - Information on how individuals can access programs and services;
  - A list of Board members, management, and staff;
  - Meeting minutes; and
  - Specific financial documents like an annual report and financial audit(s)

- What should NOT be disclosed publicly:
  - Planning documents
  - Confidential material
  - Budget
  - Executive session minutes
  - Donor list
  - Private addresses of Board members
  - Personnel files
  - If applicable, patient/client information

Charitable Solicitation: Rules and Regulations

The United States is the most generous country in the world:

- In May 2015, there were approximately 1,521,052 charitable organizations in the United States
- Approximately 91% of high net worth households give to charity. On average, high net worth donors gave $25,509 to charity in 2015. By comparison, general population households gave $2,520 on average. Charitable Giving Statistics, NPTrust, (2018) (http://www.nptrust.org/philanthropic-resources/charitable-giving-statistics).
- In 2017, the largest source of charitable giving came from individuals at $286.65 billion, or 70% of total giving; followed by foundations ($66.90 billion/16%), bequests ($35.70 billion/9%), and corporations ($20.77 billion/5%).
- In 2017, the majority of charitable dollars went to religion (31%), education (14%), human services (12%), grantmaking foundations (11%), and health (9%).

Overview

This generosity, however, has attracted criminals who profit from dishonest fundraising practices. To curb the exploitation of generous citizens, a patchwork of state-by-state fundraising regulations exist to protect consumers and nonprofits from deceptive and unscrupulous fundraising practices.

List of U.S. Charity Offices: https://www.nasconet.org/resources/state-government/

Solicitation

- The legal term for fundraising is "charitable solicitation."
- The definition of "charitable solicitation" is extremely broad. In most jurisdictions, a solicitation includes a direct or indirect request for a contribution with the understanding that it will be used for a charitable purpose, and likely includes all of the following methods:
  - Oral or written request.
  - The distribution, circulation, mailing, posting, or publishing of any advertisement or publication.
  - The making of any announcement to the press; over the radio; or by television, telephone or telegraph, concerning an event to which the public is requested to attend or make a contribution to.
  - The sale or attempted sale of any advertisement, advertising space, book, card, magazine, merchandise, subscription, ticket of admission or any other thing; the use of the name of any charitable person in any offer or sale as an inducement or reason to purchase such item; or the making of any statement in connection with any such sale, that the whole or any part of the proceeds from such sale will be used for any charitable purpose.

Solicitation

What about the internet?

- Charleston Principles:
  - Every nonprofit that raises funds using the internet and social media should be familiar with the Charleston Principles. The Charleston Principles are guidelines on charitable solicitations using the internet, and were approved by the National Association of State Charity Officials in March 2001. See: http://www.nasconet.org/wp-content/uploads/2018/04/Charleston-Principles.pdf
  - In general, if a charity has a website with a passive "donate here" button, that, alone, is not enough to require solicitation registration in multiple states. However, if the charity responds to a donation from that "donate here" button with an active request for further donations, such as "thank you for your donation, please consider another donation…," the charity has now solicited and is required to register.
- Be aware that that no matter what vehicle your nonprofit is using for fundraising (Twitter, Facebook, texting, phone calls, or old-fashioned snail mail and personal "asks") if the underlying activity is solicitation – defined as *asking for a donation* – that's regulated activity in most states.
- Crowdfunding and giving days can trigger registration requirements in multiple states.

Fundraising Regulations

Fundraising regulations generally come in 2 flavors:

- Charitable Solicitation Registration: To facilitate fundraising regulation, state authorities have traditionally required charities soliciting their residents for donations to register with its state charity office. https://www.nasconet.org/resources/state-government/. Registration allows the state to monitor who is soliciting within the jurisdiction, ensuring a responsible party can be contacted if complaints arise.
- Professional Fundraiser Registration: Many states also regulate the activity of paid fundraising consultants and require them to register with the designated state body. Paid fundraising consultants are usually called "Professional Fundraisers" or "Professional Solicitors."

#1: Charitable Solicitation

#1: <u>Fundraising by the Charity &</u>
<u>Disclosure of Charitable Contributions</u>

#1: Charitable Solicitation

Fundraising by the Charity:

- The general rule is: Charitable organizations must file a registration statement with the state's charity office (sometimes it's the Attorney General's Office; sometimes it's the Secretary of State's Office) prior to any charitable solicitation, and an annual return thereafter. Late fees apply so be sure to note renewal deadlines.
- Exceptions:
  - Certain jurisdictions have exemptions from this filing requirement for specific types of organizations.
  - Some jurisdictions do not have a filing requirement at all.

#1: Charitable Solicitation

Fundraising by the Charity:

- Common exemptions from charitable registration:
  - Charitable organizations that are composed ENTIRELY of volunteers (no paid staff) and receive less than $X in annual contributions from the public. (NOTE: Some jurisdictions say $25,000; some say $5,000; some say $50,000; some say "receive contributions from fewer than 10 people.")
  - Religious organizations exempt from filing Form 990s
  - Accredited educational institutions/schools
  - Organizations that solely solicit contributions from its voting members
- There are others, so check state-by-state where your charitable organization "does business."

#1: Charitable Solicitation

- Each state's system of fundraising regulation is different.
- Nonprofits have long agonized over the complexity of complying with the existing national patchwork of inconsistent and ever changing laws.
- These laws, although attempting to protect the public from deceptive fundraising practices, is costly and burdensome for charities.

#1: Charitable Solicitation

State-by-State Approach:

- Pros:
  - Allows you to be more targeted in your approach to registration, registering only in jurisdictions where it's absolutely necessary (saving $, and time in future years)
- Cons:
  - Each jurisdiction has its own form and its own laws
  - Requires a search for the forms, but now Google makes this easier and most jurisdictions have the forms on-line and/or an on-line registration process
  - Many state registration forms require signatures by more than one corporate officer, so allow time to collect the necessary signatures well in advance of filing deadlines
- Helpful resource: https://www.councilofnonprofits.org/tools-resources/charitable-solicitation-registration

State	Requirements for Exemption	Statutory Citation	Fee
Alabama	Contributions of $25,000 or less, and no hired fundraisers	Al. Code Sec. 13A-9-71,72	$25
Alaska	Contributions of $5,000 or less (excluding grants) OR contributions are from 10 persons or less, and no hired fundraisers. No paid officers.	AS 45.68.10,120 et seq. and AAC 12.010 et seq.	$40
Arizona	No registration required	ARS 44-6551 to 44-6561	
Arkansas	Nonprofits raising less than $25,000 per year with no paid staff or hired fundraisers	Ark. Code ann. 4-28-401	$0
California	Any charity organized in another state that is not "doing business" or holding property in California	Cal. Govt. Code 12580 to 12596; Cal Code of Reg., Title 11 300 to 310, 999.1 to 999.4; Bus. & Prof. Code Sec. 17510 to 17510.85, 22930; Cal. Corp. Code Sec. 5250.	sliding scale based on revenue/assets
Colorado	Charities that do not raise or receive gross revenue over $25,000 (excluding grants) OR contributions are from 10 persons or less.	Colo. Rev. Stat. 6-16-101	$10
Connecticut	Contributions of $50,000 or less, and no hired fundraisers	C.G.S. 21A-175, 190(d)	$50
Delaware	No registration required		
D.C.	Total gross receipts of less than $1,500, and no paid staff (including no paid fundraisers)	D.C. Code 44-1701, 1703	$70
Florida	Contributions of $25,000 or less, and no hired fundraisers.	F.S. 496.405, 406	sliding scale based on revenue
Georgia	Organizations with less than $25,000 in annual revenue	O.C.G.A. 43-17-1, 9	$35 initial; $20 renewal
Hawaii	Contributions of $25,000 or less, and no hired fundraisers	Hawaii Rev. Stat. 467B	$0
Idaho	No registration required		
Illinois	No applicable exemption	760 ILCS 55/1 and 225 ILCS 460/1	$15
Indiana	No registration required		
Iowa	No registration required		
Kansas	Contributions of $10,000 or less	KSA 17-1760	$35
Kentucky	No applicable exemption	K.R.S. 367.650	$0
Louisana	All organizations are exempt unless they hire fundraisers	La. R.S. 51: 1901 to 1904; La. Admin. Code, Title 16, Part III, Chpt. 5, Sec. 515	$25
Maine	Charities that do not raise over $10,000 OR contributions are from 10 persons or less, and no hired fundraisers. No paid officers.	9 M.R.S.A. Chpt. 385, Sec. 5001 to 5018	$50 initial; $25 renewal
Maryland	Contributions of $25,000 or less, and no hired fundraisers. BUT: Orgs exempt because they receive less than $25,000 in charitable contributions must file "Exempt Organization Fundraising Notice" Form SS-208.	Ann. Code, Bus. Reg. Art., Sec. 6-101	sliding scale based on revenue

Massachusetts	Contributions of $5,000 or less OR contributions are from 10 persons or less, and no hired fundraisers.	Mass. Gen. Law, Chpt 12 & 68	$50 initial
Michigan	Charities that receive $25,000 or less annually, the organization has no hired fundraisers, and its financial statements are available to the public.	MCLA 400.27, 283	$0
Minnesota	Contributions of $25,000 or less, and no paid staff.	Minn. Stat. Chpt. 309	$25
Mississippi	Contributions of $4,000 or less, and no hired fundraisers.	Miss. Code Ann. Sec. 79-11-501	$50
Missouri	All 501(c)(3) organizations are exempt	RSMo. Sec. 407.450	$15
Montana	No registration required		
Nebraska	No registration required		
Nevada	No applicable exemption	N.R.S. 82A.110	$0
New Hampshire	No applicable exemption	R.S.A. 7:19 to 7:32-I	$25 initial; $75 renewal
New Jersey	Contributions of $10,000 or less, and no paid staff (including no hired fundraisers)	NJSA 45:17A	sliding scale based on contributions
New Mexico	No applicable exemption	NMSA 22 Sec. 57-22-1	$0
New York	Contributions of $25,000 or less, and no hired fundraisers	NY EXEC § 172-a	$25
North Carolina	Contributions of $25,000 or less, and no hired fundraisers. No paid officers/trustees/directors.	Chapter 131 F	sliding scale based on contributions
North Dakota	No applicable exemption	N. Dak. Century Code, Chpt. 50-22	$25 initial; $10 renewal
Ohio	Contributions of $25,000 or less, and no hired fundraisers.	O.R.C. 1716	sliding scale based on contributions
Oklahoma	Organizations raising less than $10,000.	Title 18 O.S. Sec. 552	$65 initial; $15 renewal
Oregon	No applicable exemption	Ore. Rev. Stat. 128.610 to 129	sliding scale based on revenue
Pennsylvania	Contributions of $25,000 or less, and no paid staff.	10 P. S. 162.1	sliding scale based on contributions
Rhode Island	Contributions of $25,000 or less, and no hired fundraisers.	RI ST 5-53.1-3	$90
South Carolina	Contributions of $20,000 or less and no paid staff (including no hired fundraisers)	S. Carolina Code or Laws Sec. 33-56-50	$50
South Dakota	No registration required		
Tennessee	Contributions of $30,000 or less.	T.C.A. 48-101-502, 504, 506	$50 initial; renewal - sliding scale based on revenue
Texas	No registration required		
Utah	No applicable exemption	U.C.A. 13-22-8	$75
Vermont	No registration required		

Virginia	Contributions less than $5,000 over 3 preceding years, and no hired fundraisers.	Code of Virginia Sec. 57-48 to 57-69	$100 plus sliding scale based on contributions
Washington	Contributions of $25,000 or less, and no hired fundraisers, paid staff, or paid officers/trustees/directors.	RCW Chpt. 19.09	$60
West Virginia	Contributions of $25,000 or less, and no hired fundraisers.	Sec. 29-19-5	$15 or $50 based on revenue
Wisconsin	Contributions of $5,000 or less, and no paid staff (including no hired fundraisers).	Wis. Stat. 202.12	$54
Wyoming	No registration required		

#1: Charitable Solicitation

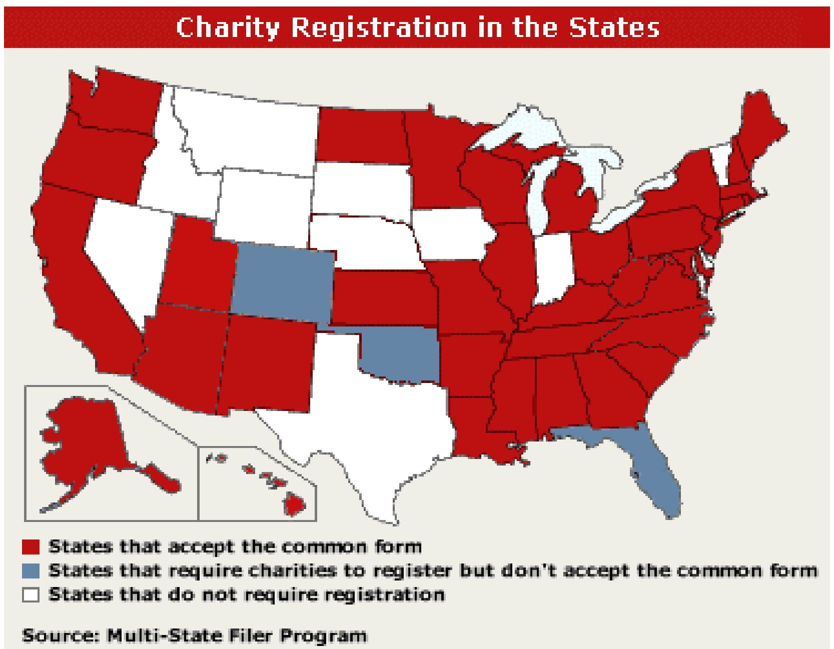
Unified Registration Statement:

- What is it?: The Unified Registration Statement (URS) represents an effort to consolidate the information and data requirements of all states that require registration of nonprofit organizations performing charitable solicitations within their jurisdictions. The effort is organized by the National Association of State Charities Officials and the National Association of Attorneys General, and is one part of the Standardized Reporting Project, whose aim is to standardize, simplify, and economize compliance under the states' solicitation laws.
- The URS is an *alternative* to filing all of the respective registration forms produced by each of the cooperating states. In those states, a registering nonprofit may use *either* the state form *or* the URS. Thus, the URS proves most useful to nonprofits soliciting regionally or nationally and, therefore, subject to the registration laws of *multiple* states. But the URS may be used by any nonprofit that is registering in a state accepting it.
- http://www.multistatefiling.org/

#1: Charitable Solicitation

Unified Registration Statement:

Which States Require Registration of Charitable Soliciting Organizations and Accept the URS?



Map by Jasmine Stewart, Courtesy of the Chronicle of Philanthropy

#1: Charitable Solicitation

Unified Registration Statement:

http://www.multistatefiling.org/

- Required Supplementary Forms
  - Arkansas
  - California
  - District of Columbia
  - Georgia
  - Maine
  - Minnesota
  - Mississippi
  - North Carolina
  - North Dakota
  - Tennessee
  - Utah
  - Washington
  - West Virginia
  - Wisconsin
- Appendix
  - Summary of Regulations for the Cooperating States
  - Other States that Require Registration
  - Annual Financial Reporting

#1: Charitable Solicitation

Unified Registration Statement:

- Pros:
  - One form
- Cons:
  - Not all jurisdictions accept it
  - Some of the jurisdictions that accept it still require supplemental forms with additional information
  - Does not provide you with information about whether your organization is specifically exempt from filing in each jurisdiction – and once you register, it's difficult to "unring the bell"

Disclosure Statements - State

- In addition to registration requirements, several states also require "disclosure statements" that alert potential donors that the nonprofit is registered in the state. The disclosure statements must be included in solicitation materials, such as annual appeal letters and letters confirming pledges.
- For state-by-state info on disclosure statements: http://www.perlmanandperlman.com/fundraising-compliance/charts-resources/

Disclosure Statements - State

Examples:

- Minnesota: Minn. Stat. § 309.556, Subd. 1
  The following information must be clearly disclosed in any written charitable solicitation:
  - the name and location by city and state of each charitable organization on behalf of which the solicitation is made;
  - the tax deductibility of the contribution; and
  - a description of the charitable program for which the solicitation campaign is being carried out; and, if different, a description of the programs and activities of the organization on whose behalf the solicitation campaign is being carried out.
- Ohio: O.R.C. § 1716.10
  Every charitable organization that directly solicits contributions in this state must make the following disclosures at the point of solicitation:
  – The name of the charitable organization and the city of the principal place of business of the charitable organization;
  – If the charitable organization has not received a determination letter from the Internal Revenue Service that is currently in effect, stating that the organization is exempt from federal income taxation under section 501(a) and described in section 501(c)(3) of the Internal Revenue Code, and the particular charitable purpose or purposes to be advanced with the funds raised.
- Illinois: 225 ILCS 460/15(b)
  If a charitable organization engages in any public solicitation and purports to relate the purpose or purposes for which the funds are solicited, such purposes must be fully and accurately identified to the prospective donor. If a charitable organization whose purposes include the rendering of noneducational program services intends to expend or budget more than 50% of its program service expenditures for informing or educating the public, and the funds being solicited will be used for such purpose, the donor at his or her request must be told that a primary use of the program funds will be for public education.

Disclosure Statements - State

Examples (continued):

- New York: McKinney's Executive Law § 174-b
  Any solicitation, by any means, including oral and written solicitations, by or on behalf of a registered charitable organization, must include:
  1. A statement that upon request, a person may obtain from the organization or from the attorney general, a copy of the last financial report filed by the organization with the attorney general. Such statement shall specify the address of the organization and the address of the attorney general, to which such request should be addressed and in the case of a written solicitation, must be placed conspicuously in the material with print no smaller than ten point bold face type or, alternatively, no smaller than the size print used for the most number of words in the statements.
  2. A clear description of the programs and activities for which it has requested contributions or a statement that, upon request, a person may obtain from the organization such a description.
  3. If any charitable organization makes contributions to another organization which is not its affiliate, the solicitation must include a statement that such contributions have been made and that a list of all organizations which have received contributions during the past twelve months from the soliciting organization may be obtained from that organization provided, however, a united way, federated fund or incorporated community appeal, by or through which a donation is merely transferred to a charity selected by the donor, need not include such donor selected organizations in the list. The term "affiliate" includes any chapter, branch, auxiliary, or other subordinate unit of any registered charitable organization, howsoever designated, whose policies, fund raising activities, and expenditures are supervised or controlled by such parent organization.

The written disclosure must be placed conspicuously in the materials with print no smaller than 10 point bold face type or, alternatively, no smaller than the size print used for the most number of words in the solicitation.

- California: No disclosure requirements for written solicitations by charities not using professional solicitors.

Disclosure Statements - Federal

- A nonprofit organization should provide a written disclosure (sometimes called a "donation acknowledgement") to a donor when the nonprofit organization receives contributions of $250 or more, and MUST provide a written disclosure when the donor makes a payment exceeding $75 partly as a contribution and partly as a compensation for goods and services provided by the organization (this is called a *quid pro quo* contribution). See: I.R.C. § 6115(a)(1)-(2)(2013); See also IRS Pub. 1771 at 11 (2013) (http://www.irs.gov/pub/irs-pdf/p1771.pdf).
- The written disclosure should contain the following:
  - Name of organization
  - Amount of cash contribution
  - Description (but not the value) of non-cash contribution)
  - Statement that no goods or services were provided by the organization in return for the contribution, if that was the case
  - Description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution
  - If it's a *quid pro quo* contribution, a notification to the donor that the amount of the contribution that is deductible for federal income tax purposes is limited to the excess of money (and the fair market value of property other than money) contributed by the donor over the value of goods or services provided by the organization

Disclosure Statements - Federal

A penalty is imposed on charities that do not meet the written disclosure requirement when receiving *quid pro quo* contributions. The penalty is $10 per contribution, not to exceed $5,000 per fundraising event or mailing. An organization may avoid the penalty if it can show that failure to meet the requirements was due to reasonable cause.

Disclosure Statements – Federal Contributions with Special Rules

NOTE: The IRS has separate, specific requirements for vehicles, land, buildings, and stock.

- Vehicles: See IRS Publication 4302 and Form 1098-C
- Land/Buildings: Beware of UBIT, Form 8283, and IRS Publications 526 & 561
- Stock: Beware of Rev. Rul. 78-197 (1978) (https://www.pgdc.com/pgdc/story/rev-rul-78-197), 2003 PLR (https://www.irs.gov/pub/irs-wd/0321010.pdf), and IRS Publication 526

Disclosure Statements - Federal

Beware of in-kind donations:

- An in-kind donation typically comes in the form of goods or services. Examples of in-kind donations include individuals providing school supplies to nonprofit organizations that serve at-risk youth, a gift card for a silent auction, or works of art given to a museum.
- Nonprofit organizations should provide donors who give in-kind donations a receipt similar to one provided to an individual who gives a cash donation. The only difference is that the nonprofit organization is not expected to list the actual value of the in-kind donation. However, it is important to describe what was donated.
- Example: "Thank you for your contribution of 5 gift cards with a face value of $100. Charity received this donation on [date]. No goods or services were provided in exchange for this contribution." or "Thank you for your contribution of a used oak baby crib and matching dresser…."
- The donor is responsible for valuing the goods or services provided in non-cash contributions and reporting that amount on their own tax return if they are seeking a charitable deduction.

Disclosure Statements – Federal Non-501(c)(3)

What if the nonprofit corporation doesn't have 501(c)(3) status??

- If the organization is not eligible to receive tax-deductible donations (i.e., is NOT a 501(c)(3)), solicitations on behalf of that organization must contain an express and easily recognizable statement that donations are not deductible as charitable contributions for federal income tax purposes. While a good faith effort to meet the foregoing will suffice, the IRS has provided safe harbor rules for complying with this requirement. See: IRS Notice 88-120 (1988) (https://www.irs.gov/charities-non-profits/notice-88-120-1988-2-cb-454); I.R.C. § 6113(a) (2013).
- To meet the safe harbor in a written solicitation, the statement must:
  - Be in at least the same size type as the primary message and readily visible.
  - Be on the same page, and in close proximity to, the request for donations.
  - Be the first sentence of a paragraph, or constitute the entire paragraph.
  - Be worded as one of the following:
    - ✓ "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions for Federal income tax purposes."
    - ✓ "Contributions or gifts to [name of organization] are not tax deductible."
    - ✓ "Contributions or gifts to [name of organization] are not tax deductible as charitable contributions."
- For oral solicitations, the same statement must be made in close proximity to the request for contributions (i.e., during the same telephone conversation and by the same solicitor).

Donors’ Recordkeeping and Substantiation Requirements

GENERAL RULE: Donors are allowed to deduct the difference between the value of the amount contributed and the value of the goods and services received in return from the nonprofit organization.

Exception 1

<u>Token Exception</u>:

- Insubstantial goods or services a charitable organization provides in exchange for contributions do not have to be described in the acknowledgment.
- Goods and services are considered to be insubstantial if the payment occurs in the context of a fundraising campaign in which a charitable organization informs the donor of the amount of the contribution that is a deductible contribution, and:
  - the fair market value of the benefits received does not exceed the lesser of 2 percent of the payment or $106; or
  - the payment is at least $53, the only items provided bear the organization’s name or logo (e.g., calendars, mugs, or posters), and the cost of these items is within the limit for “low-cost articles,” which is $10.60.
  - NOTE: These dollar amounts are for 2016. Guideline amounts are adjusted for inflation. Contact IRS Exempt Organizations Customer Account Services at (877) 829-5500 for annual inflation information.
- Example: If a charity gives a coffee mug bearing its logo and costing the organization $10.60 or less to a donor who contributes $53 or more, the organization may state that no goods or services were provided in return for the $53 contribution. The $53 is fully deductible.

Exception 2

<u>Membership Benefits Exception</u>:

- 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:
  - Free or discounted admissions to the charitable organization's facilities or events
  - Discounts on purchases from the organization's gift shop
  - Free or discounted parking
  - Free or discounted admission to member-only events sponsored by an organization, where a per-person cost (not including overhead) is within the "low-cost articles" limits
- Example: If a charity offers a $75 annual membership that allows free admission to all of its weekly events, plus a $20 poster, a written acknowledgement need only mention the $20 value of the poster, since the free admission would be considered insubstantial and, therefore, would be disregarded.

Exception 3

Intangible Religious Benefits Exception:

- If a religious organization provides only “intangible religious benefits” to a contributor, the acknowledgment does not need to describe or value those benefits. It can simply state that the organization provided intangible religious benefits to the contributor.
- “Intangible religious benefits” are benefits provided by a tax-exempt organization operated exclusively for religious purposes, and are not usually sold in commercial transactions outside a donative (gift) context.
- Examples include admission to a religious ceremony and a *de minimis* tangible benefit, such as wine used in a religious ceremony. Benefits that are not intangible religious benefits include education leading to a recognized degree, travel services, and consumer goods.

Donor Substantiation

- A separate acknowledgment may be provided for each single contribution exceeding the threshold, or one acknowledgment, such as an annual summary, may be used to substantiate several single contribution exceeding the threshold. There are no IRS forms for the acknowledgment. Letters, postcards, or computer-generated forms with the above information are acceptable.
- Recipient organizations typically send written acknowledgments to donors no later than January 31 of the year following the donation.

#2: Professional Fundraisers

#2: <u>Fundraising by a Professional</u>

#2: Professional Fundraisers

Fundraising by a Professional:

- Nonprofits hiring outside consultants to provide assistance with fundraising should be familiar with state laws that may require the registration with the state charity office prior to any solicitation activity.
- While registration of the consultant may not be the nonprofit's direct obligation, it is prudent to verify that your fundraising consultant is registered, if required by state law.

#2: Professional Fundraisers

Fundraising by a Professional:

- Fundraising professionals often go by the following names:
  - Professional Fundraiser
  - Professional Solicitor
  - Fundraising Counsel
  - Grant Professional
- The general rule: If a person is a.) soliciting b.) on behalf of a charity c.) and being paid to do so, he/she is a fundraising professional and must register with the state charity office prior to any solicitation activity. This rule generally applies to independent contractors/consultants, not employees.

#2: Professional Fundraisers

<u>Fundraising by a Professional</u>:

- This general rule applies to grant writers as much as it applies to phone solicitors in call-centers.
- What commonly needs to be filed:
  - Registration Statement
  - Solicitation Notice
  - Written authorization from the charity, usually in the form of a contract
  - Surety bond (usually in the amount of $25,000) – some jurisdictions waive this requirement if the professional is not going to have custody and/or control of the charitable contributions
  - Solicitation Campaign Report Form within 90-days of the close of the fundraising “campaign”
  - Fee

#2: Professional Fundraisers

Fundraising by a Professional: Be sure you hire a reputable professional

- Federal Trade Commission: https://www.ftc.gov/tips-advice/business-center/guidance/raising-funds-what-you-should-know-about-hiring-professional
- Fundraising Fables: Retaining Fund Development Professionals: http://fundraisinggoodtimes.com/2014/07/21/fundraising-fables-retaining-fund-development-professionals/
- Check with your state's charity office to get more information about the fundraising professional and to determine if he/she is properly registered. http://www.nasconet.org/resources/state-government/

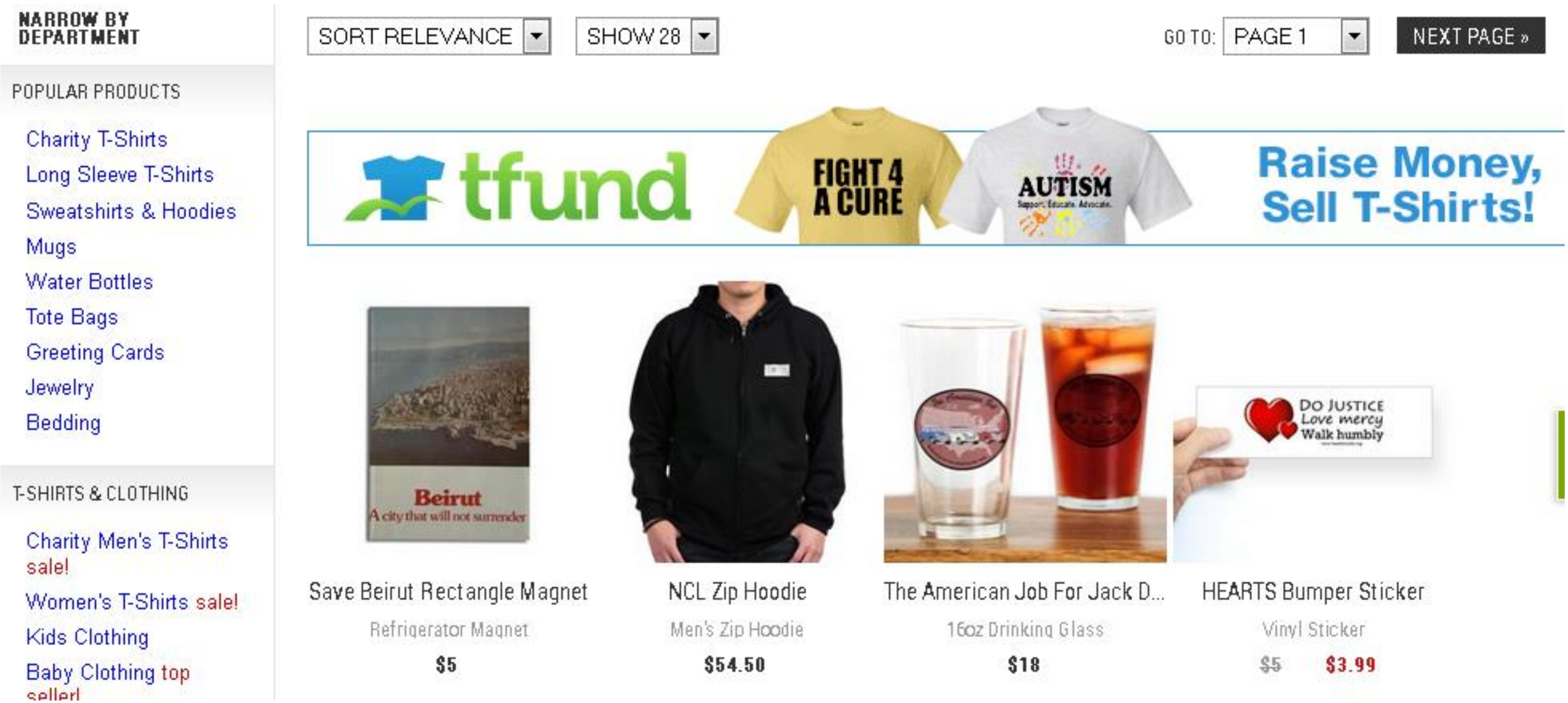
#2: Professional Fundraisers

Fundraising by a Professional:

- It is not considered ethical to compensate fundraising professionals with a commission, or a percentage of contributions, or funds raised.
- See:
  - Association of Fundraising Professionals: http://www.afpnet.org/Ethics/EthicsArticleDetail.cfm?ItemNumber=734
  - Council for Advancement and Support of Education: http://www.case.org/Samples_Research_and_Tools/Principles_of_Practice/CASE_Statements_on_Compensation_for_Fundraising_Performance.html

#2: Professional Fundraisers

Watch out for "inadvertent" professional fundraising: Cafepress



Watch out for "bad" professional fundraising: Savers

Savers under the scrutiny of Attorney General

Storefront of the E. Lake St. Savers, one of 330 stores owned by conglomerate Savers LLC. Their operations in Minnesota are under scrutiny by the Minnesota Attorney General. (Photo by Margie O'Loughlin)

By MARGIE O'LOUGHLIN

On Nov. 24, Minnesota Attorney General Lori Swanson issued a compliance report questioning the relationship between Savers retail stores and the local non-profits they partner with. These include Vietnam Veterans of America, Disabled Veterans of America, Epilepsy Foundation of Minnesota, Lupus Foundation of Minnesota, Courage Kenney Foundation and True Friends.

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PHILANTHROPY

NEWS AND ANALYSIS
DECEMBER 12, 2014

Comment (0)

Report Slamming Savers LLC Prompts Pivot in Handling of Donated Goods

By Michael Anft

Several nonprofits that use for-profit companies to collect donated goods say that they will look more closely at such arrangements, following a Minnesota decision that called for Savers LLC to change its business practices.

Minnesota's Attorney General's Office filed a compliance report in November stating that "Savers mixes its identity with that of the charities and fails to disclose the amount of a donor's donation that is received by the charity versus the amount that is retained by Savers, a for-profit corporation."

The Seattle-based company earns more than $1-billion annually from sales of donated

#2: Professional Fundraisers

Watch out for “bad” professional fundraising: Integral Resources

Phone solicitor Integral Resources to pay $105,000 to Ohio over charity calls

A Massachusetts-based professional phone solicitor will pay $105,000 to settle a suit by Ohio's attorney general that it mislead Ohioans about calls it made for nonprofits.

Ohio Attorney General Mike DeWine

Plain Dealer file

Ohio Attorney General Mike DeWine announced the settlement today with Integral Resources Inc.

DeWine said Integral's employees mislead Ohioans into believing they were being called by a volunteer from the charity, rather than a professional solicitor, and mislead them about the percentage of collected dollars that would go to the cause.

Accepting Money/Property – Pitfalls to Avoid: When Contributions Create Taxable Income for the Organization

UBIT

Unrelated Business Income and Taxing it:

Definition. There are three pillars to identifying a business activity as generating unrelated business income. An "unrelated trade or business" is any activity that:

- (i) constitutes a trade or business or a facet of a trade or business,
- (ii) is regularly carried on, and
- (iii) is not substantially related to an organization's exempt purposes.

UBI can result in income tax payable to the IRS by the charity.

UBIT

Unrelated Business Income and Taxing it:

What is a "Trade or Business?":

- Under Section 513, a "trade or business" includes any activity that is carried on for the production of income from the sale of goods or the performance of services.
- A trade or business activity must be operated for profit or at least have a profit motive.
- A trade or business activity does not lose that characterization simply because it is carried on as part of a larger activity or complex of activities that may be related to the EO's exempt purpose.
- Policy of preventing unfair competition between exempt and non-exempt organizations carrying on the same business.

UBIT

Unrelated Business Income and Taxing it:

What is a "Regularly Carried On?":

- Not surprisingly, this term refers to the frequency and continuity of an activity. Treas. Reg. § 1.513-1(c).
- If the activity is carried on with the frequency and continuity of a commercial enterprise, it will be considered "regularly carried on." Again, the policy of preventing unfair competition is cited.
- The regulations also examine the time span in which activities are carried out. Treas. Reg. § 1.513-1(c)(1).
    - Year round?
    - Sporadic?
    - Compared to commercial business – is it also seasonal/intermittent?

UBIT

Unrelated Business Income and Taxing it:

What is "Substantially Related?":

- A trade or business is related to an exempt purpose if it has a causal relationship with the accomplishment of the EO's exempt purpose. To avoid UBIT treatment, the causal relationship must be substantial and "important." Whether this relationship exists depends on the facts and circumstances of each case.
- If activities are inherently non-charitable, or if they are activities normally carried on by for-profit businesses, the activity may be considered as related if it is carried on at below-market costs and or is provided to other charities or individuals who are proper objects of charity.
- The scale of the activity can also matter. Assume that an EO carries out an activity that is seemingly related to the EO's purpose. If the activity is conducted on a significantly larger scale than is necessary to accomplish the EO's exempt purposes, then the portion the activity that is not necessary for accomplish those exempt purposes will generate UBTI. Treas. Reg. § 1.513-1(d)(3).

UBIT

Unrelated Business Income and Taxing it:

Statutory Exceptions. Some activities are statutorily excepted from the definition of an unrelated trade or business. Treas. Reg. § 1.513-1(e). A sample of these activities are (see IRS Publication 598 for a more detailed description):

- Volunteer workforce: A trade or business in which substantially all the work is performed for the organization without compensation.
- Convenience of members: As to 501(c)(3) organizations and state colleges and universities, an activity that is carried on primarily for the convenience of the organization's members.
- Selling donated merchandise: The selling of merchandise, substantially all of which was received by the EO as contributions or gifts.
- Certain bingo games.
- Qualified trade show activity.
- Qualified public entertainment activity (i.e., a fair or exposition promoting agriculture and education)
- Qualified sponsorship activities

UBIT

Unrelated Business Income and Taxing it:

Other Important Rules and Exceptions:

- S Corporation Income. All income from ownership of S corporation stock is UBIT, regardless if the S corporation business is related or unrelated. Code § 512(e).
- Section 512(b)(1): UBIT does not include dividends, interest, payments with respect to securities loans (as defined in subsection (a)(5)), amounts received or accrued under a loan agreement, annuities, and deductions with respect to all such amounts.
- Section 512(b)(2): UBIT does not include royalties, however measured, and all deductions with respect to royalties.

UBIT

<u>Unrelated Business Income and Taxing it:</u>

Other Important Rules and Exceptions:

- Section 512(b)(3): UBIT does not include rents from real property or rents from personal property leased in connection with the real property if the rents attributable to the personal property are <u>incidental</u> to the total rents under the lease.
- Note: there are exceptions, and exceptions to the exceptions.
- Example: Debt Financed Income is NOT UBIT even though, by definition, debt financed income is a passive investment held to produce income. See materials, IRC Section 514, and IRS Publication 598.

UBIT

Unrelated Business Income and Taxing it: **Why do we even care?**

- Too much UBIT can jeopardize an EO's tax-exempt status.
- It can require tax-exempt organizations to pay tax. But, incurring UBIT liability isn't inherently bad:
  - If you generate "unrelated business income" per the IRS rules, you should report this income and directly connected expenses on IRS Form 990-T. Subsequently, you may owe some taxes on that income.
  - However, since you only pay taxes on the activity's net income after you subtract allowed expenses ("directly connected expenses") from the gross reported income, in many cases, generating unrelated business income results in no tax liability.
  - Many nonprofits that have been at this for a long time simply consider the tax liability on their UBI as a cost of doing business. If your nonprofit incurs unrelated business income, you're in good company. In 1995, more than 36,000 exempt organizations reported gross unrelated business income. This number has no doubt risen in the past five years.
- A nonprofit that expects to incur $500 or more in UBIT liability must make estimated tax payments on a quarterly basis. Large nonprofits that generate substantial unrelated business income may be subject to the Electronic Federal Tax Payment System (EFTPS).

Accepting Money/Property – Pitfalls to Avoid:

Restricted Gifts, Endowments, Donor Advised Funds, and Planned Giving Programs

Donor Imposed Restrictions

Restricted gifts

Donor Imposed Restrictions

Restricted gifts:

- What are they?
  - Restricted gifts: Donors may designate or "restrict" the use of their donations by the charity to a particular purpose or project. An example is a gift to a special scholarship fund at a university.
  - Unrestricted gifts: "Unrestricted" contributions are donations the nonprofit may use for any purpose. Unrestricted funds usually go toward the operating expenses of the organization, including wages.
- Why do they matter? Restricted donations can be spent only for purposes as designated by the donor; unrestricted donations can be spent on anything from programs to toilet paper.

Donor Imposed Restrictions

Restricted gifts:

- How do you know if a gift is restricted? Look at the “gift instrument”
  - Only the donor can determine if a donation is restricted or not. The designation can be made by a letter from the donor or through an explicit agreement with the nonprofit.
  - Often grants from foundations are restricted to a particular program or purpose, and that restriction is set out in the documentation that accompanies the award.
- Nonprofits must be clear when asking for gifts:
  - Some charities have experienced donor backlash when it appeared that donors were donating for a particular purpose only to find out that the charity used their gift in an unrestricted way.
  - In addition to the moral obligation to the donor, most state laws prohibit “false and misleading” solicitations and require donations be used in accordance with the intended charitable purpose.
  - If a donor restricts a donation to a particular purpose and the nonprofit does not comply, the donor can demand a refund. The donor can take legal action if needed and report the charity to the Office of the Attorney General in the state where the charity resides.

Donor Imposed Restrictions

Restricted gifts:

- Types of restricted funds:
  - Temporarily Restricted: Donors sometimes impose time-limited restrictions. Time-restricted means that the donation can be used for a particular purpose for a specified period, or it must support a specific program or campaign. When the time is up, or the project is done, the funds become unrestricted or stopped. Examples include a grant, graduation of a scholarship recipient, or the completion of a building project.
  - Permanently Restricted: Permanently restricted funds never expire. Usually, this means that the charity invests the gift and then uses the interest and investment returns in perpetuity. Permanently restricted funds often go into an endowment that supports a particular activity or the organization in general.
- Whatever type of restricted fund is set up, the nonprofit must keep track of it and report it appropriately in its financial statements. Consult the Accepted Accounting Principles (GAAP) at the Financial Accounting Standards Board (FASB) for detailed information.
- Can a charity "un-restrict" a gift? Restricted gifts can be unrestricted only by the donor or a court.

Donor Imposed Restrictions

Endowments

Donor Imposed Restrictions

Endowments:

- What are they? Permanently restricted funds. Only the interest from an endowment can be spent, not the principal that anchors the endowment. Professional money managers often oversee endowment funds, investing the money in stocks, bonds, and other investments.
- Why do they matter? They serve as an "insurance policy" for the future of an organization. With an endowment, facing the ups and downs of the economy and fundraising becomes easier.
- Your Board should set up the rules of the endowment in an investment policy. For instance, you will want to name the endowment, restrict its use, and provide guidelines for how much of the interest can be employed yearly and when the endowment principal can be tapped if needed under extraordinary circumstances.
- The endowment can be set up within your existing nonprofit corporation, or it can be spun off into a separate 501(c)(3) organization or foundation.

Donor Imposed Restrictions

Donor-Advised Funds

Donor Imposed Restrictions

Donor-Advised Funds:

- What is it? A donor-advised fund, or DAF, is a giving vehicle established at a sponsoring public charity.
- How does it work?
  - It allows individual donors to make a charitable contribution (an irrevocable contribution of personal assets, including cash, stock, real estate, etc.), or multiple contributions over time
  - The individual donor immediately receives the maximum tax deduction allowable by the IRS, but the contribution is placed into a DAF account where it can be invested by the public charity sponsor and grow tax-free
  - At any time, the individual donor can recommend usually with strong persuasive authority to the public charity sponsor that it make grants from the DAF to qualifying charities (generally public charities)
  - The individual donor can remain anonymous and still enjoy his/her charitable deduction. Since the individual donor's contribution was made through an intermediary DAF, the sponsoring public charity can execute the contribution anonymously on behalf of the individual donor.
- The first DAFs were created in the 1930s, but regulatory recognition did not exist until the Tax Reform Act of 1969. In the 1990s, DAFs began to grow in visibility and popularity, and today they are philanthropy's fastest-growing vehicles.

Donor Imposed Restrictions

Donor-Advised Funds:

- Benefits:
  - Donations to a DAF qualify for the more favorable charitable deduction treatment of a gift to a public charity than donations to a private foundation.
  - DAFs are not subject to the self-dealing and payout rules applicable to private foundations.
  - Unlike private foundations that require a minimum annual distribution, a DAF has no distribution requirements and can allow investment funds within the account to build up for years or even decades.
  - DAF contributions do not count negatively toward the recipient's public support test.
- Pitfalls:
  - There are restrictions, rules, and laws that make DAFs difficult to do correctly, including excise tax penalties.
  - Because of their popularity and controversiality, the IRS is scrutinizing DAFs more carefully than in the past.

Donor Imposed Restrictions

Donor-Advised Funds – Requirements and Restrictions:

- The public charity serving as the sponsor of the DAF must retain expenditure responsibility over the funds. This means the sponsoring public charity must develop procedures, demonstrate ownership and control over the DAF, and provide the individual donor with mere advisory privileges.
- DAFs cannot make distributions to only a single identified organization or government entity.
- DAFs cannot make contributions:
  - to natural persons and private foundations (other than private operating foundations)
  - for purposes unrelated to the recipient's mission
  - where the original donor receives more than an "incidental benefit," either directly or indirectly, from the distribution

Donor Imposed Restrictions

Planned Giving Programs

Planned Giving Program Basics

Planned Giving Program:

- What is it?
  - Planned giving is the solicitation of major gifts by a nonprofit, often contributed by an individual donor who commits to give a major gift, over time or at death, as a part of the donor's overall financial and estate planning. A planned gift is a contribution that is arranged in the present, usually through a will, bequest, or trust, and is distributed at a future date, traditionally when the donor passes away.
  - Planned giving vehicles can get quite exotic. Planned gifts can range from the relatively simple bequest made in a will, to gifts like charitable gift annuities and charitable remainder trusts that provide major gifts to a non-profit while at the same time returning income to the donor.
- Why does it matter? Planned gifts can be game-changing for your organization. Even relatively smaller planned gifts can be used to sustain certain programs or facilities, add capacity, establish endowments, or launch major new initiatives. Simply put, every non-profit should be focused (in part) on finding benefactors to leave them planned gifts because there is no better way to plan for the future growth and strength of your organization.
- Establishing a Planned Giving Program: See https://philanthropy.iupui.edu/files/course_resources/establishing_a_planned_giving_program_regenovich.pdf

Accepting Money/Property – Pitfalls to Avoid:
Unusual Grants

Unusual Grants

Unusual Grants:

- What are they?
  - Substantial grants, contributions, or bequests from a donor that are:
    - attracted because of the organization's publicly supported nature,
    - unusual and unexpected because of the amount, and
    - large enough to endanger the organization's status as a publicly supported organization if taken into account.
  - A grant that meets these requirements may be treated as an unusual grant that is entirely excluded from the publicly support test even if the organization receives the funds over a period of years.
- Why do they matter? If not categorized properly, large grants from private foundations can "tip" a charity from a public charity to a private foundation.

Accepting Money/Property – Pitfalls to Avoid:

Have a Gift Acceptance Policy
and an Investment Policy

Policies and Procedures

Gift Acceptance Policy:

- Intended to minimize financial risk to organization
- Protect against donor discontent or litigation
- Policy should:
  - Require evaluation of gift on organizational mission, finances, and ethics
  - Place a premium on ability to comply with donor's intent
  - Require determination of how potential gifts fit into the organization's portfolio and investment strategy

https://www.councilofnonprofits.org/tools-resources/gift-acceptance-policies

Policies and Procedures

Investment Policy:

- Meant to reduce risk while providing return
- Identify duties of Board v. investment management committee v. officers with investment responsibility v. investment advisors
- Can rely on advice of advisory committee, but decision-making rests with board
- Provide a procedure for hiring advisors and evaluating performance
  - Review fees and effect on return
  - Review whether advisors comply with policy and guidelines
- Determination of investment objectives
  - Needs and timing
  - Risk tolerance
  - Asset allocation
  - Diversification requirements
- Identify permissible investments and provide for review of other investments

https://www.councilofnonprofits.org/tools-resources/investment-policies-nonprofits

Thank you!!!

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