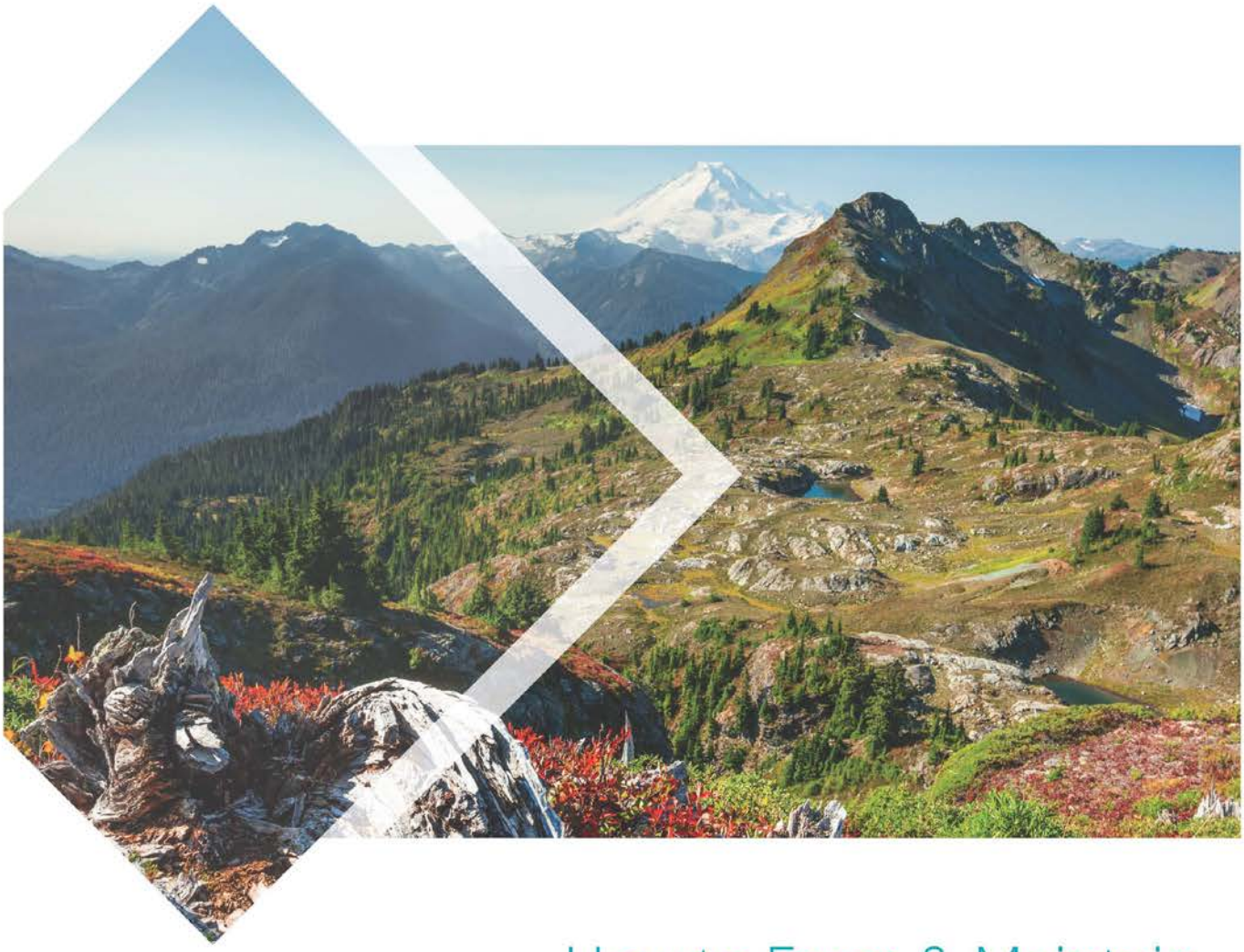
WASHINGTON
NONPROFIT HANDBOOK

2018 Edition



How to Form & Maintain a Nonprofit Corporation in Washington State

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WASHINGTON NONPROFIT HANDBOOK:

How to Form and Maintain a Nonprofit Corporation in Washington State

July 2018 Edition

Published by Wayfind

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with
Washington Nonprofits
and
Washington State Office of the Secretary of State

Acknowledgements

We wish to express our gratitude to the Advisory Committee, authors and editors of the July 2018 Edition of the Washington Nonprofit Handbook. This book was a collaborative project that could not have been accomplished without the good work of all its contributors.

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We would like to thank Document Processing at Foster Pepper PLLC for their extensive editorial and word processing support.

We would also like to thank Lisa Durant for her graphic design skills in designing the Washington Nonprofit Handbook cover and Lane Powell PC for donating Lisa's time.

Finally, thank you to Washington Nonprofits and the Washington Office of the Secretary of State for their editorial and financial support.

Judith Andrews
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Washington Nonprofit Handbook, July 2018 Edition

Publisher's Note

Wayfind would like to give special thanks to lead editors, Judy Andrews and Joanna Plichta Boisen, for partnering with Wayfind on the revision of the Washington Nonprofit Handbook (July 2018 edition). Content, integrity and writing quality were ensured because of Judy and Joanna's knowledge and dedication to this project. We would also like to thank Willa Osborn, Pro Bono Fellow at Foster Pepper for her time and editing skills to make sure that all of the chapter references and links were accurate.

Wayfind would also like to acknowledge Washington Nonprofits for their on-going partnership with Wayfind to develop high quality learning tools, including the Washington Nonprofit Handbook. The Introduction to the Handbook, was based on the *Starting a Nonprofit* toolkit, authored by Nancy Bacon, Director of Learning and Engagement at Washington Nonprofits. Along with Nancy, Laura Pierce, Executive Director, provided critical input to the Washington Nonprofit Handbook. We are grateful for their ongoing support and commitment to the nonprofit sector.

Finally, Wayfind would like to thank the Washington Office of the Secretary of State, Corporations and Charities Division, for its support in developing educational tools like the Handbook and for its commitment to creating a thriving environment for nonprofit organizations in our state. Resources like this one make a meaningful difference in the nonprofit sector and beyond.

Jodi Nishioka
Executive Director
Wayfind

Cautionary Note

This handbook contains information about the laws impacting nonprofit organizations in Washington. Legal information is not the same as legal advice (which involves applying laws to particular individuals and organizations and their unique circumstances). It is always a good idea to consult with an attorney to obtain advice as to how the law should be interpreted in light of the particularities of you, your organization and your situation. You should be aware that the laws impacting nonprofit organizations change over time. The information contained in this handbook may become out of date.

This handbook is only partially revised. All chapters involving the Washington Nonprofit Corporation Act (RCW 24.03) have not been materially revised because the statute has not changed since the 2009 edition. We do expect the Washington Nonprofit Corporation Act to be revised by the Washington State Legislature in the near future and we will revise those chapters at that time. All other chapters have been revised.

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Washington State has a thriving nonprofit sector comprising more than 52,000 active domestic nonprofit corporations and 16,000 registered charities. These organizations touch every aspect of life in Washington, from veterans' advocacy to environmental stewardship, performing arts to education, elder care to economic development. These organizations leverage hundreds of thousands of volunteer hours and hundreds of millions of dollars in donations to improve the lives of Washingtonians, and drive a significant part of Washington's thriving economy.

For those seeking guidance in how to start and manage a Washington non-profit, Wayfind's Nonprofit Handbook provides valuable insight. This book is a practical resource for those just thinking about forming an organization that will benefit their neighbors, to those looking to wind down the affairs of a non-profit corporation. It outlines management standards and offers tips for how non-profit leaders can stay in compliance with the laws and develop their organizations.

The Office of Secretary of State maintains state registrations for non-profit corporations and charitable organizations. In addition to the ability to file required documentation and reports by mail or in person, OSOS has recently launched a new on-line service called the Corporations and Charities Filing System (CCFS). CCFS not only enables customers to file a wide range of corporate and charitable reports on-line, but also now provides full access to the public to all corporate and charitable records filed with OSOS. These records can be viewed on-line, and downloaded for free, saving customers time and money when obtaining this information.

As overseer of this program, I commend the handbook's authors for the care and knowledge they have contributed to assist those who care about Washington non-profits.

For more information about registering a non-profit with my office, please contact the specialists in our Corporations Division at (360) 725-0377 or our Charities Program at (800) 332-GIVE.

Thank you for your interest in these very important organizations.

Sincerely

Kim Wyman
Secretary of State

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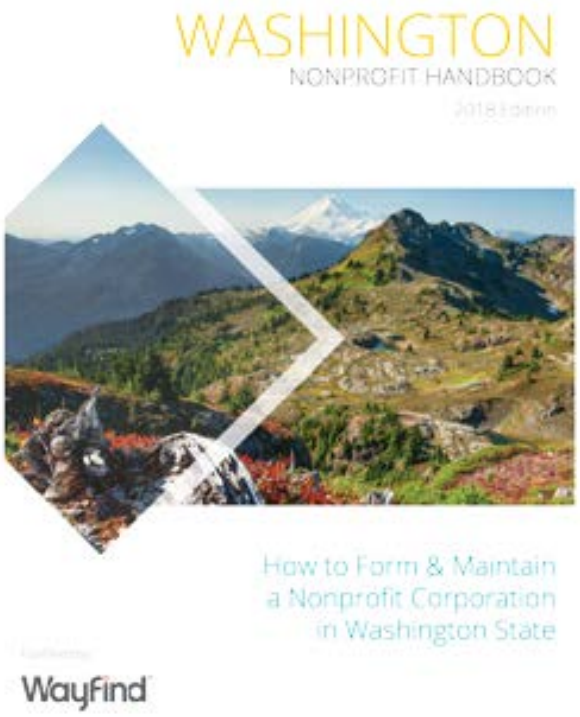


Part 1 There are Many Ways to do Good in the World

Chapter 1 What is a Nonprofit?
Chapter 2 Are You Sure You Want to Do This?
Chapter 3 Alternatives to Incorporating
Chapter 4 Importance of Formality
Chapter 5 Early Decisions

PART 1. THERE ARE MANY WAYS TO DO GOOD IN THE WORLD

CHAPTER 1. What is a Nonprofit?

Before we get started, let's define the word nonprofit. A **nonprofit** is a type of **corporation** that is created to accomplish a public benefit. It does not have owners. It has no shareholders. It cannot be set up to generate an income or profit for the organizers. Some organizations apply for **tax-exempt status** from the Internal Revenue Service (IRS) so that donations can be tax-deductible to the donor, and so that the organization will qualify for grants from private foundations and governments and can avoid federal corporate income tax. There are different classifications of different types of nonprofit organizations under Washington State law (see Part 2 of this Handbook for more information) and different types of tax-exempt organizations, one of which is for charitable organizations exempt under section 501(c)(3) of the Internal Revenue Code of 1986, amended (also referred to in this Handbook as "501(c)(3) organizations").

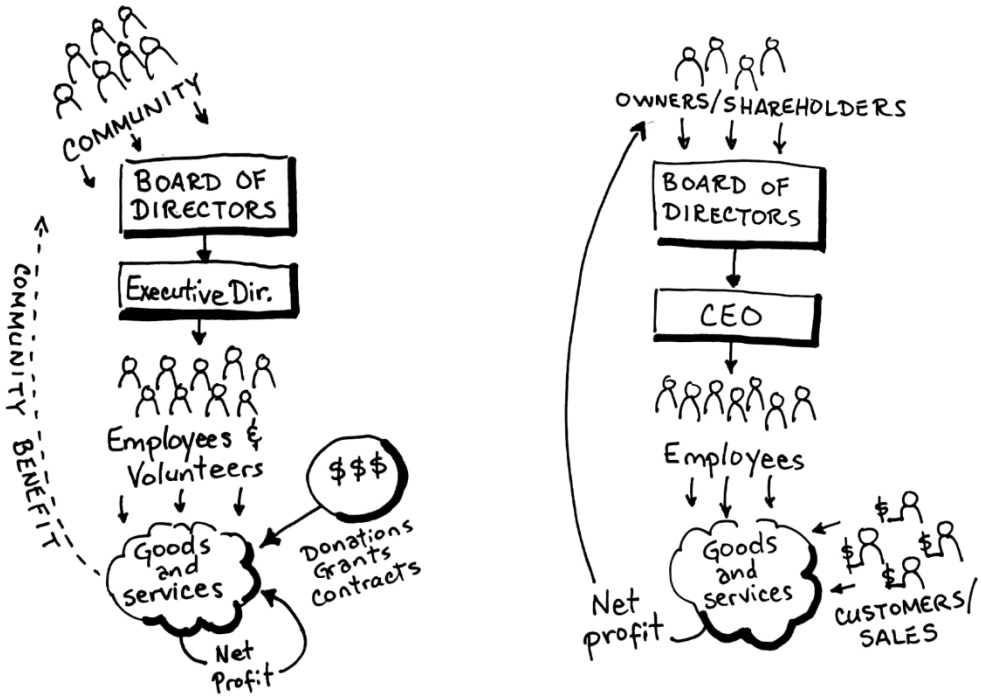
There are important differences between a nonprofit and a for-profit organization. The main differences are:

Owners: A nonprofit does not have any owners. Assets are held in trust for charitable or other purposes that benefit the community.

Profits: A nonprofit does not share profits with owners or shareholders. Any money left over at the end of the year goes back into furthering the organization's mission.

Volunteers: Most nonprofits have volunteers. A for-profit does not.

Control: No one person owns or controls a nonprofit. A nonprofit is governed by a board of directors. The board of directors may hire an executive director to implement its strategy, who may in turn manage employees and/or volunteers. A for-profit can be owned by one person or group of people who make all strategic decisions and have control of the company.



CHAPTER 2. Are You Sure You Want to Do This?

The rest of this book explains what how to form and maintain a nonprofit organization. The goal is to persuade you to think twice before you start down this path. There are many reasons for creating a nonprofit, but there are also simpler and less demanding ways to get up and running. It makes sense to consider those possibilities first.

> **TIP:**
>
> For more on exploring whether a nonprofit is the best fit, check out the *Starting A Nonprofit* tool kit, to determine if starting a nonprofit is right for you. *Starting A Nonprofit* is a collaboration between Washington Nonprofits, Office of the Secretary of State, 501 Commons, and Wayfind.

Like many start-up businesses, most new nonprofits exist only a short period of time. The reasons they close down vary widely, but the implication is clear: a nonprofit might not be the right structure, organizers might not be ready to create a nonprofit corporation, and starting a new organization is hard work that takes time and resources. Surviving beyond the start-up phase depends on good fortune, dedication, significant planning, community support, and the ability to execute on the organization's business plan.

The traditions of community service and mutual support that characterize the role of nonprofits in American life have been historically a vital—even an essential—part of our communities. There are hundreds of thousands of recognized nonprofit organizations at work across the country today. Each of them had its start in the same way: a small dedicated group committed to bringing a new organization into existence. Some started small and have remained small. They meet some specific need in some continuing way. Others have grown to be such familiar features of our communities that it is hard for us today to imagine the moment when they were nothing more than a shared vision.

Whatever the future holds for the idea that brings you to read these pages, the authors of this book wish you the best of luck and great success in your efforts to benefit the community. If these pages smooth the way for you to meet those goals, then the work of putting this book together will have been well worth it.

CHAPTER 3. Alternatives to Incorporating

Many groups who want to do good in the community may not have the resources, time or capacity to create and run a new nonprofit corporation. There are alternatives to creating a new nonprofit corporation which allow organizers to focus on their work in the community while getting help from another nonprofit or foundation with back-office support, legal compliance and other support services. It is common for community groups to get support through fiscal sponsorship for the first year(s) and then incorporate and obtain their own tax-exempt status later, when they have enough community support and internal capacity to run the organization.

a. Fiscal Sponsorship

There are several alternatives to creating a 501(c)(3) nonprofit corporation. The two most common are both fiscal sponsorship options: 1) partner with a nonprofit exempt under section 501(c)(3) and have the work you hope to do become a project of that nonprofit, or 2) incorporate as a nonprofit and enter into a fiscal sponsorship agreement, in which another tax-exempt organization becomes your organization's fiscal sponsor.

Both of these options allow a new project or entity to do good work in the community, without having to manage and oversee governance, legal compliance and back office work. These options allow for the new organization to benefit from the fiscal sponsor's 501(c)(3) status, allowing the organization to receive tax-deductible donations and grants from private foundations, and have its revenues

be exempt from federal income tax through the fiscal sponsorship of a 501(c)(3) organization. For more on fiscal sponsorships, see Chapter 59.

b. Informal Community Project

It is also possible to do community work as volunteers without a formal structure. This option works well if there is no money involved and volunteer tasks are simple, like gathering school supplies and donating them to a school. Once there is money flowing through the entity, there needs to be greater formality.

c. Work with a Community Foundation

Another option is to work with an established community foundation to put in place a program and procedures for achieving the charitable purposes that will be executed under the foundation's auspices. This option is worth considering, for example, if the planned purposes are focused on granting scholarships, responding to the needs of people suffering from disease, or fostering research. Discussing plans with one or several community foundations may offer practical solutions for achieving charitable goals without incurring the costs and administrative burdens of establishing a new nonprofit organization.

CHAPTER 4. Importance of Formality

Having a nonprofit corporation legal structure or going under the fiscal sponsorship of another nonprofit corporation, is important for two main reasons: 1) accounting of money and 2) avoiding personal liability.

1) Accounting: If there is any money flowing into and out of the entity, it is important to have structure and formality. If the entity is accepting money for a particular purpose, a donor relationship and an implied legal obligation to use the funds for that particular purpose is created. With this obligation comes the responsibility to account for the care and expenditure of funds. It is necessary to open a separate bank account so that the money is not commingled with personal money. To open a checking account for the new nonprofit a bank will ask for a banking resolution adopted by a board of directors. Using a personal checking account for an organization's business invites suspicion from others involved and might complicate an individual's personal tax situation.

2) Avoiding Personal Liability: Having a separate corporate entity, such as a nonprofit corporation, provides protection to individuals from personal liability. This means that if something goes wrong and someone makes a claim that they suffered some injury in the course of the work of the project, the claim will be against the nonprofit corporation and not the individual volunteer or employee. If there is no corporate entity and there is an accident in the course of the work, those involved can be sued personally.

CHAPTER 5. Early Decisions

If a nonprofit is the best fit for your objectives, there are some fundamental decisions that you will need to consider, including the following:

a. What is the Organization's Mission?

The organization's mission is a brief statement encompassing what the organization hopes to accomplish. The specific mission should be determined by the organizers or founding board of directors. If the organization is going to apply for tax-exemption as a 501(c)(3) organization, the mission must fall within certain categories of "charitable" purposes identified by the IRS. *See* Part 4 on Obtaining Recognition As A Code Section 501(c)(3) Organization.

b. Who will be the Founding Board Members?

The founding board members should be individuals who are committed to the mission of the organization, who are willing to provide financial support to the organization, and who have time and capacity to govern the organization. The founding board members will draft the mission and bylaws of the organization. If the organization plans to apply for 501(c)(3) tax exemption, the IRS prefers at least 3 board members who are not related by blood or marriage.

c. Will the Organization Have Members?

Typically, a nonprofit organization has members if the organization provides certain benefits to defined group of people. If a nonprofit has members, there are many rules regarding membership that need to be thought through. For example, the organizers will need to think through who qualifies to be a member, what benefits members have, what decision-making powers the members have, and if

the members will elect the board of directors. *See* Chapter 13 for more on membership.

d. Will the Organization Seek to Have Tax-Exemption as a 501(c)(3) Organization?

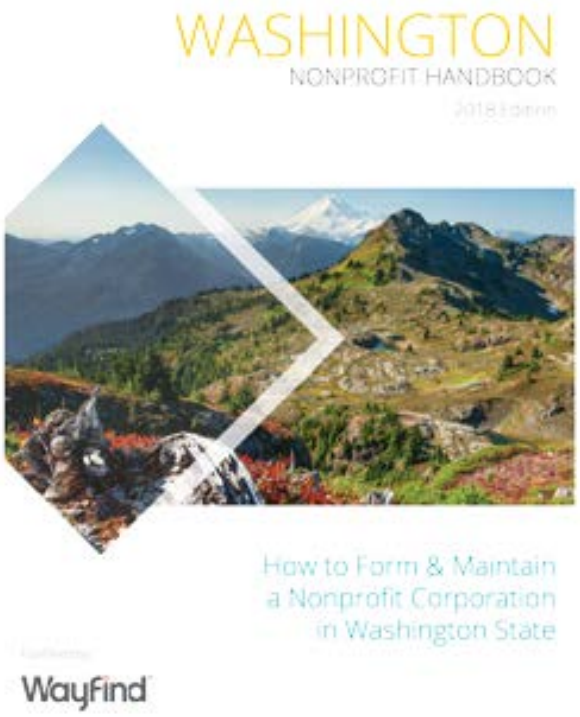
Tax-exemption under section 501(c)(3) of the Internal Revenue Code of 1986, as amended, is a tax status for which charitable nonprofit organizations can qualify. To obtain such tax-exempt status, the nonprofit organization must apply to the IRS. There are many issues and requirements to address when you are applying for this tax-exemption and it is a relatively complicated process. *See* Part 4 on Obtaining Recognition As A Code Section 501(c)(3) Organization.

The 3 main reasons for obtaining tax-exemption as a 501(c)(3) organization are:

(a) Donations can be tax-deductible to the donor,

(b) The ability to qualify for grants from private foundations and governments, and

(c) The organization is "exempt" from federal corporate income tax.



Part 2 How To Form A Nonprofit

Chapter 6	Common Nonprofit Organizational Structures
Chapter 7	The Washington Nonprofit Corporation Act (RCW 24.03)
Chapter 8	Pre-Incorporation Issues
Chapter 9	Nuts and Bolts of Incorporating
Chapter 10	The Organizational Meeting and Post-Incorporation Tasks

Note: *Part 2. How To Form A Nonprofit* has not been revised since 2009. The information contained in the following chapters is accurate. *Part 2* will be updated when the Washington State Legislature revises the Washington Nonprofit Corporation Act.

PART 2. HOW TO FORM A NONPROFIT

CHAPTER 6. Common Nonprofit Organizational Structures

a. Types of Nonprofit Corporations

Historically, Washington has had a number of statutes permitting the formation of nonprofit corporations. When the Washington Legislature adopted the Nonprofit Corporation Act in 1967, it repealed a number of different types of nonprofit corporations. However, several options still remain. The best option will depend on the purposes and activities of the corporation to be established. The types of nonprofit corporations include:

(i) The Washington Nonprofit Corporation Act (RCW 24.03)

Most nonprofit corporations, particularly those that qualify as exempt from federal taxation under section 501(c)(3) of the Code, are incorporated under the Washington Nonprofit Corporation Act (the "Act"). A fuller description of the Act appears in Chapter 7.

(ii) Nonprofit Miscellaneous and Mutual Corporation Act (RCW 24.06)

Organizations can be incorporated under RCW 24.06, the Nonprofit Miscellaneous and Mutual Corporation Act, for any lawful purpose including, but not limited to, mutual, social, cooperative, fraternal, beneficial, service, and labor organization. Mutual benefit organizations, such as business leagues, homeowners' associations, and social and recreational clubs, may incorporate under this statute. Corporations may not be organized under this RCW 24.06 for any purposes which by law are restricted to corporations organized under other statutes. These include insurance companies, banks, savings and loan associations and credit unions.

While this statute is very similar to the Act, RCW 24.06 does not contain the limitations on activities or protections contained in the Act that serve to protect charitable assets. This indicates that the intent of the Legislature was that charitable organizations be organized under the Act rather than RCW 24.06. Additionally, unlike a corporation organized under the Act, a corporation organized under RCW 24.06 may issue shares to shareholders and may distribute surplus funds to members or shareholders. RCW 24.06.025, .070.

RCW 24.06 specifically prohibits a corporation from engaging in any business, trade, vocation or profession for profit. A corporation may accumulate reserves, equity, surplus or other funds through subscriptions, fees, dues or assessments or from charges made to its members or other persons for services rendered or supplies or benefits furnished or from distributing surplus funds to its members, stockholders or other persons in accordance with the provisions of the corporation's articles of incorporation. RCW 24.06.035.

(iii) Corporations Sole (RCW 24.12)

RCW 24.12 permits a bishop, overseer or presiding elder of a church or religious denomination in the state to incorporate for church purposes. This allows recognized churches, particularly those with a hierarchical structure, to conduct their affairs in corporate form.

(iv) Fraternal Societies (RCW 24.20) and Building Corporations Composed of Fraternal Society Members (RCW 24.24)

Under RCW 24.20, fraternal societies, lodges or chapters may incorporate by filing articles of incorporation with the Secretary of State in accordance with RCW 24.20.10. Members of fraternal societies (there must be at least ten) and fraternal societies themselves may form a separate corporation under RCW 24.24 to construct, maintain and operate a building for fraternal and social purposes.

(v) Employee Cooperative Corporations (RCW 23.78)

This statute facilitates the ownership and control of a business by its employees. Under RCW 23.78, a corporation can engage in any business in which it could otherwise engage in under the Washington Business Corporation Act, Title 23B RCW. A corporation organized under RCW 23.78 is governed in large part by provisions of the Washington Business Corporation Act.

(vi) Cooperative Associations (RCW 23.86)

Under RCW 23.86, any number of persons may associate together as a cooperative association to operate any lawful business on the cooperative plan. Although the chapter does not define the "cooperative plan," an agricultural cooperative probably presents the best example of such a corporation.

(vii) Other Nonprofit Corporations

Washington law provides for a number of other kinds of nonprofit corporations, many for particular kinds of activities. For example, RCW 24.28 provides for the formation of granges, RCW 24.36 permits the formation of a corporation to market fishery products, and RCW 48.09 provides for the incorporation of mutual insurance companies.

b. Charitable Trusts

A charitable trust may also be recognized as exempt from federal income tax under section 501(c)(3) of the Code. The law covering trusts, which differs in some significant ways from corporate law, will not be covered in this Handbook.

CHAPTER 7. The Washington Nonprofit Corporation Act (RCW 24.03)

Most nonprofit corporations in Washington, particularly those that also qualify as exempt from federal taxation, incorporate under the Act. The Act provides the legal framework for the formation and operation of a nonprofit corporation in Washington State. As with for-profit corporations formed under the Washington Business Corporation Act, governmental control of the activities of nonprofit corporations is accomplished through other statutes, regulations and ordinances.

The Act gives nonprofit corporations a broad range of powers. A corporation's articles of incorporation and bylaws may not grant powers in addition to those granted by the Act, although they may limit such powers. Within certain limitations described below, the powers described in the Act are as broad as those conferred on for-profit corporations. Powers include the power to purchase, own, lease, sell, convey, mortgage and otherwise deal in real and personal property, lend money or credit (except to officers and directors), make contracts, incur liabilities and borrow money, lend money for corporate purposes and invest funds, be involved in legal actions and make donations for the public welfare or for charitable, scientific or educational purposes.

The Act places several significant limitations upon nonprofit corporations. Under the Act, a nonprofit corporation may not:

- Have or issue shares of stock;
- Make any disbursement of income to its members, directors or officers; or

- Loan any money or credit to its directors or officers.

In addition, at dissolution or final liquidation, assets must be appropriately distributed. This will be described in more detail in Chapter 9 under the discussion of the articles of incorporation.

Nonprofit corporations may be organized under the Act for any lawful purpose or purposes, including, but not limited to, charitable, benevolent, eleemosynary, educational, civic, patriotic, political, religious, social, fraternal, literary, cultural, athletic, scientific, agricultural, horticultural, animal husbandry, and professional, commercial, industrial or trade purposes. The Act prohibits certain organizations from being organized under it. These include labor unions, cooperative organizations and organizations subject to any of the provisions of the banking or insurance laws of the state.

CHAPTER 8. Pre-Incorporation Issues

Before moving into the practical legal discussion of how to draft legal documents and incorporate, it is important to understand several organizational issues that frequently arise during the early stages of forming a nonprofit organization. It will be beneficial to the organization to address and resolve these issues in the planning stage of forming your organization. These issues fall into four categories: membership, board of directors, decision-making style and mission.

a. Membership

Under the Act, a nonprofit organization may have members or it may be a "non-membership" corporation. Members may be persons or entities, such as corporations or limited liability companies. Under the Act, unless otherwise provided in the organization's articles of incorporation or bylaws, members have certain voting rights. Members have the right to vote on issues including the election of directors to the board of directors, amendments to the articles of incorporation, and the merger or dissolution of the corporation. Proper provisions in an organization's documents may give members the right to vote for all or only some of these purposes, or may give members no voting rights at all.

The decision whether to have members or not and what rights to give members relates to the nature and purpose of the corporation. Membership is often considered when an organization plans to raise funds from its supporters or seeks active participation by a large group of people. Membership may help

encourage supporters to volunteer for the organization because they feel a greater sense of belonging. However, some organizations may find that the burden of obtaining a membership vote to carry out certain organizational actions, such as electing directors, outweighs any benefit to having members. This problem can be particularly burdensome as an organization grows larger.

It is also important to consider the procedures under which membership rights are granted. Such considerations include the amount of notice to give members for meetings, the number of members needed to constitute a quorum, and whether voting by proxy will be permitted.

b. Board of Directors

Under the Act, the governing body of a nonprofit corporation is called the "board of directors," and the individuals who serve on the board are referred to as "directors." Sometimes nonprofit organizations call their board a "board of trustees" and refer to the members of the board as "trustees." Either form of terminology is permitted in Washington. For purposes of this Handbook, the terms "board of directors" and "directors" will be used.

The board of directors manages the business affairs of the corporation. Usually, this means that the board sets policy, adopts and oversees the budget, hires the executive director and makes other major decisions for the organization. Sometimes, particularly as organizations are just starting up, the board of directors is involved in the day-to-day management of the organization.

Before recruiting a board of directors for an organization, it is important to think about the ideal size of the board, the length of a term of board service, and the qualities of individuals you want to have as directors. Factors in making these decisions include:

- Whether the board is intended to represent the community the organization will serve or the community in which the organization will be active.

- What role the board will take in fundraising. Will individual directors be asked to make a contribution, and is the contribution a significant one? Do you intend to rely upon board members for connections into resources such as businesses or foundations? Will the board be planning and putting on fundraisers for the organization?

- Whether the organization will need particular skills, such as legal or financial expertise.

- Whether the board will be setting policies on substantive issues that will become important to the organization's mission or function in its community.

- Whether there is a particularly long "learning curve" to become involved in the organization.

c. Decision-Making Style

While focusing on the role of members and directors in an organization, it is important to consider how these bodies will make decisions. This issue involves factors such as quorum (the number of persons needed to hold a meeting in which action can be taken) and numbers of votes of those present needed to take action.

Select a decision-making style that considers whether process and consensus decision making is important to the organizers, the level of formality that will be expected in meetings and the numbers of persons expected to participate in membership and/or board meetings. For example, if larger numbers of persons are involved, it may be beneficial to have a lower quorum number to make it easier to hold a meeting and take action. If participation by members or directors is important, a higher quorum number will ensure that a few active members do not make decisions. If more formality and larger numbers of persons are involved, adoption of Robert's Rules of Order or similar rules are recommended to keep the meetings running smoothly.

d. Mission Statement

If you have not done so, it is important to develop a mission statement for the organization. A clear, succinct mission statement becomes the basis for developing purposes of the organization, as well as a necessary tool for raising funds, recruiting directors and volunteers and planning activities and programs of the organization.

CHAPTER 9. Nuts and Bolts of Incorporating

The actual creation of a nonprofit corporation under Washington law is a fairly straightforward process. The basic steps discussed below will give you information on both the legal requirements and the practical tasks involved. The

Nonprofit Formation Checklist (https://wayfindlegal.org/) is a helpful resource to refer to throughout the process.

a. Name

Choose a name for the corporation that signifies a message. The organization's name should convey a message consistent with its mission. Your corporate name should suggest what your organization is about and should arouse interest in your organization. Sometimes both the name and its abbreviation or acronym can convey a message. For example, both "Progressive Animal Welfare Society" and the abbreviation "PAWS" express the organization's mission to protect animals.

Once you have chosen a name for the organization, you must determine whether some other organization already has used the name or a name similar to it. If no other organization has chosen the name, it is available for your organization's use.

To determine whether the name is available in Washington State, you must check with the Corporations Division of the Secretary of State. It is now possible to conduct a search on the Secretary of State's website. At the same time, you may reserve the exclusive right to use the corporate name so that it will still be available when you file your articles of incorporation.

Legal Requirements for a Name

While your chosen corporate name may be creative and catchy, there are certain things it cannot be under the Act. The organization's name:

- CANNOT be the "same as or deceptively similar to" an existing or reserved corporate name, or limited partnership or limited liability company name.
- CANNOT include or end with "incorporated," "corporation," "company," "incorporated," "limited partnership," "Ltd.," or any other corporate designation.
- CANNOT describe the purpose of your organization in a misleading way. Any word or phrase that indicates that the corporation is organized for any purpose other than the purpose contained in the Articles of Incorporation is not permitted. For example, if your organization plans to work on AIDS, you cannot call it "The Cancer Foundation."
- CANNOT be in a foreign language unless the name is spelled with letters from the English alphabet. For example, "El Centro de la Raza" is permitted because it is spelled with English letters.

Your organization's name can include words such as "club," "league," "association," "services," "committee," "fund," "society," "foundation," or "[your corporate name], a nonprofit corporation." See Chapter 59 for further discussion of fiscal sponsorship.

To confirm that a name is available and reserve an available name, you can submit (on-line, by mail or in person) a reservation request form or a letter of request to the Corporations Division with the reservation fee. You can submit up to three different names. Upon receipt of the request, the Corporations Division checks the request against its master files. The first available name is reserved for you for 180 days. The reservation can be extended once more for another 180 days. If none of the proposed names can be used or reserved, your reservation fee is returned.

Finally, Chapters 70, 71 and 72 of this Handbook discuss intellectual property issues that you may wish to consider regarding your organization's name.

TIP:

DO NOT order letterhead, stationary, business cards or any other printed materials with the organization's name until you have reserved the name.

b. Articles of Incorporation

(i) Generally

The articles of incorporation and the bylaws constitute the organizational and governing documents of a nonprofit corporation. The articles of incorporation create the corporation under state law. The bylaws provide the rules under which the corporation operates. The articles and bylaws should not have provisions that conflict with one another and should interrelate with one another. Except with respect to the number of directors, provisions of the articles will have control over provisions of the bylaws where such provisions are inconsistent.

Sample articles of incorporation can be found online at https://wayfindlegal.org/. The Secretary of State's office provides a template of articles of incorporation in which information can be written onto the form directly and the form itself filed with the Secretary of State as the corporation's articles of incorporation. This form meets state requirements for incorporation, but does not contain provisions required under federal tax law to qualify the corporation as tax-exempt under section 501(c)(3) of the Code. Therefore, if you plan to apply for tax-exempt status for your organization, do not use this form without ensuring that provisions meeting the requirements of federal tax law are attached.

(ii) Required Provisions

The Act requires that articles of incorporation include the provisions described below:

- **Name**. The name of the corporation must be listed. See the discussion above regarding the legal requirements of a corporate name.

- **Period of Existence**. You must list the period of duration of the corporation. The period is usually perpetual, but it may be limited to a specific number of years.

- **Purpose of Organization**. You must describe the purpose or purposes of the organization. Under the Act, a nonprofit corporation may be organized for any lawful purpose, including, but not limited to, charitable, benevolent, eleemosynary, educational, civic, patriotic, political, religious, social, fraternal, literary, cultural, athletic, scientific, agricultural, horticultural, animal husbandry, and professional, commercial, industrial or trade purposes. The Act prohibits certain organizations from being organized under it. These include labor unions, cooperative organizations and organizations subject to any of the provisions of the banking or insurance laws of Washington State.

  Additionally, if you plan to seek tax-exempt status for your organization, you must ensure that the purposes you choose are consistent with requirements of federal tax law. A discussion of charitable and other permissible purposes for federal tax exemption appears in Chapter 22. If your purposes involve international activities, it is important to review the issues discussed in Chapters 37-44.

- **Registered Agent and Office**. You must give the name of the initial registered agent and the address of the initial registered office. The registered agent may be (i) an individual who is a Washington resident, or (ii) a nonprofit or for-profit corporation or a limited liability company. If the registered agent is a corporation or a limited liability company, it must be incorporated or formed in Washington or, if incorporated or formed in another state, it must be authorized to do business in Washington. The business office of the registered agent is the registered office of the nonprofit organization. It must be at a

specific geographic location in Washington State. A post office box is permitted only if the geographic address of the registered office also is provided.

In addition, a consent form should be attached to the articles of incorporation in which the registered agent agrees to serve as registered agent of the corporation. This consent must be filed with the Secretary of State along with the articles of incorporation. An example of such consent appears at the end of the sample articles of incorporation that are available online at https://wayfindlegal.org/. The form of articles of incorporation available on the Washington Secretary of State's website also contains a consent form.

- **Directors**. The board of directors serves as the governing body of the corporation and is responsible for its management and administration. The board has the ultimate responsibility of running the organization.

  The Act requires that you provide the number of directors constituting the initial board of directors and the names and addresses of the persons who will serve as the initial directors. Under the Act you must have at least one individual on the initial board of directors, and you may have as many additional initial directors as you wish.

  The Act requires that a board of directors be composed of one or more individuals. A corporation or other entity may not serve as a director of a nonprofit corporation under the Act. The number of directors constituting the board of directors can be provided in either the articles or bylaws. Often the articles of incorporation state that the bylaws will provide the number of directors on the board, because the bylaws are more easily amended to accommodate the changes an organization may make in the number of directors on its board over time. The number of directors is often expressed as a range between a minimum and maximum number of directors.

- **Incorporators**. The incorporators are the organizers of the nonprofit corporation. They sign and file the articles of incorporation. A nonprofit corporation may have one or more incorporators. An individual or an entity may act as an incorporator. If the incorporator is an individual, the individual must be at least 18 years of age. You

must list the names and addresses of the incorporators of the corporation in the articles of incorporation.

Until the corporation is formed, any incorporator may act on behalf of the organization. Such incorporator may be personally responsible for any expenses or liabilities incurred prior to the date of incorporation if the nonprofit corporation is never formed or if the acts of the incorporator are not ratified by the board of directors. Therefore, if an incorporator makes any expenditures on behalf of the organization before it is incorporated and wishes to be reimbursed by the corporation, the incorporator must keep accurate records and receipts of any and all expenses for which he or she will seek reimbursement.

Finally, an incorporator must file accurate information with the Secretary of State. If an incorporator files documents that he or she knows contain false information, the incorporator will be guilty of a gross misdemeanor.

- **Dissolution**. You must provide the name of any person or corporation to whom net assets are to be distributed in the event the corporation is dissolved. "Net assets" are the funds and other property remaining after payment of all the debts and other liabilities of the corporation and the appropriate distribution of charitable assets.

  If your organization plans to apply for status as a tax-exempt organization, there are additional requirements that apply to this provision under federal law. Federal tax law requires that upon dissolution of a 501(c)(3) organization, any remaining assets be distributed to another 501(c)(3) organization for one or more exempt purposes. The IRS requires that these requirements be stated in the articles of incorporation of a 501(c)(3) organization. See sample articles of incorporation for language that satisfies the federal requirements. Sample articles of incorporation are available online at https://wayfindlegal.org/.

(iii) Recommended Additional Provisions

In addition to the required provisions, your organization may want to include one or more of the following provisions in its articles of incorporation:

- **Director Liability Limitations**. This provision eliminates or limits the personal liability of directors of the corporation for monetary damages to the corporation for conduct as a director. The sample provision in the form of articles of incorporation limits the liability of directors to the extent permitted in Washington law. The Act forbids eliminating or limiting liability for acts or omissions that involve intentional misconduct by a director or a knowing violation of law by such director or for any transaction from which the director will personally receive a benefit of money, property or services to which such person is not legally entitled.

- **Indemnification**. Under an indemnification provision, the corporation promises to pay expenses, liabilities and losses incurred by a director of the corporation in defending such director in any legal action in which such person becomes involved because of actions taken in his or her official capacity as a director of the corporation. A nonprofit corporation may not indemnify a director found by a court to be liable to the corporation. A sample indemnification provision is included in the sample form of articles of incorporation.

- **501(c)(3) Requirements**. An organization seeking federal tax-exempt status under section 501(c)(3) of the Code must satisfy several additional requirements in its articles. In addition to ensuring that the purposes and dissolution provisions meet federal tax law requirements, the articles must prohibit the distribution of any net earnings to members, directors, officers or other private persons and prohibit the organization from carrying on noncharitable activities. It is also recommended that the articles contain appropriate language with respect to political action and lobbying activities. The form of articles contains examples of such provisions. Again, the form articles of incorporation available through the Secretary of State's office do not contain these provisions and, therefore, should not be used if you intend to seek 501(c)(3) status for your organization, or if used should attach these provisions. In addition, a fuller discussion of these requirements is contained in Chapters 22 and 27-36.

c. Bylaws

(i) Generally

While it is not required that bylaws be prepared prior to filing the articles of incorporation with the Secretary of State, it is recommended that bylaws be drafted at the same time as the articles to ensure that the documents are consistent with each other and that the particular purposes, mission and manner of acting are reflected in both of the organization's governing documents.

Bylaws contain the rules adopted for the regulation and management of your organization. The Act requires that the board of directors of a nonprofit corporation adopt bylaws for the corporation. Provisions in the bylaws may not be illegal or inconsistent with the articles. Bylaws are not filed with the Secretary of State, but are provided to the IRS with the application for 501(c)(3) status. Most bylaws outline the duties and powers of directors and officers and provide for notice, time and place of meetings. If the corporation has members, the bylaws contain rules for admission, voting rights and meetings of members. If the corporation requires members to pay dues, then the amount, method of calculation and payment dates may be stated in the bylaws or established in a separate resolution of the board of directors.

There are two forms of sample bylaws to serve as a guide in developing your organization's bylaws—a sample of bylaws for a corporation with voting members and a sample of bylaws for a corporation without members. The sample bylaws can be found online at https://wayfindlegal.org/.

Bylaws can differ greatly among nonprofit organizations, reflecting the different types of nonprofit organizations and organizations' different governing structures and styles. However, when drafting bylaws, you need to pay attention to requirements in Washington law. The Act provides rules on such topics as time and place of members' and directors' meetings, voting rights, quorum, qualifications and duties of directors and removal of directors and officers. These statutory provisions act as default provisions and will govern the corporation in the absence of such provisions in the bylaws (or articles). In addition, the Act contains certain requirements that must be met by all corporations subject to the Act. These requirements will govern over any inconsistent provisions on the same subject in the bylaws or articles. Therefore, it is recommended that organizers take care to develop bylaws that will suit the purposes, activities and governing structure of the organization and meet statutory requirements.

To assist in drafting bylaws, the following information provides a description of the provisions in the Act that will govern an organization unless otherwise specified in the organization's bylaws (or articles of incorporation). That is, these are the "fallback" or "default" provisions, which are used in the event that an organization's bylaws do not address a particular topic. For example, if your organization's bylaws do not contain a provision stating the number of members needed to call a special meeting, then the number will be the number specified in the Act. Therefore, if you would like a different rule for your corporation than any of the following, you must include the rule you want in the corporation's bylaws or, in some cases, its articles.

(ii) Members

Unless otherwise provided:

- An individual, for-profit or nonprofit corporation, a general or limited partnership, an association or other entity may be a member of the organization.

- Meetings of members must be held at the registered office of the corporation in Washington State.

- A special meeting of members may be called by members having one-twentieth of the votes entitled to be cast at such meeting.

- Members of the organization may participate in a meeting of members by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other at the same time.

- Members of the organization may take any action that may be taken at a meeting of the members without a meeting if a consent, setting forth the action so taken, is executed by all of the members entitled to vote with respect to the subject matter thereof. This unanimous consent may be carried out using mail, fax or electronic mail. The written resolution (usually the consent is written as a resolution) with the signatures of the members (or return email consents) is filed with the corporate minutes.

- Notice of regular meetings other than the annual meeting need only be made by providing each member with the adopted schedule of

regular meetings for the coming year at any time after the annual meeting and ten days prior to the next succeeding regular meeting and at any time when requested by a member.

- Each member has one vote on each matter submitted to members for a vote.

- Members must vote in person (proxy votes are only permitted if provided for in the bylaws).

- Members holding one-tenth of the votes entitled to be cast represented in person or by proxy (proxies are only permitted if provided for in the bylaws) shall constitute a quorum.

- A vote of the majority of the votes entitled to be cast by members present, or represented by proxy at a meeting at which a quorum is present, is necessary for any matter voted upon by the members to be legally adopted. (Note: A greater proportion may be required by the bylaws or articles and is required by the Act for certain actions.)

- Electronic communication may not be used to give notices, consents or waivers to a member unless the organization has received consent from the member.

- Elections of directors cannot be conducted by mail or electronic transmission unless provided for in the bylaws.

(iii) Board of Directors

Unless otherwise specified:

- Directors need not be residents of Washington or members of the corporation.

- Initial directors named in the articles of incorporation hold office until the first annual election of directors.

- If the articles or bylaws provide for the election of any director or directors by members, then any directors elected by members may be removed, with or without cause, by two-thirds of the votes cast by members having voting rights with regard to the election of any director, represented in person or by proxy (if permitted by the

bylaws) at a meeting of members at which a quorum is present. (Note: There are some special rules with respect to cumulative voting that should be reviewed if the organization is considering cumulative voting to elect directors.)

- A vacancy in the board and any directorship to be filled by reason of an increase in the number of directors may be filled by the affirmative vote of a majority of the remaining directors even though less than a quorum is present.

- A majority of directors constitutes a quorum. (Note: While the bylaws or articles may fix another number for a quorum, it can never be less than one-third of the number of directors.)

- The act of a majority of directors present at a meeting at which a quorum is present shall be the act of the board. (Note: (1) the bylaws or articles may provide for a greater percentage or number than a majority, and (2) the Act requires a vote of a greater number of directors for certain actions, such as a merger of the organization.)

- Directors may participate in board meetings by means of conference telephone or similar communications equipment by means of which all persons participating in the meeting can hear each other at the same time. (Note: This right is also permitted to committee members for committee meetings.)

- Directors may take action without a meeting if a consent, setting forth the action so taken, is executed by all of the directors. This unanimous consent may be carried out using mail, fax or electronic mail. The written resolution (usually the consent is written as a resolution) with the signatures of the directors (or return email consents if permitted) is filed with the corporate minutes.

- Electronic communication may not be used to give notices, consents or waivers to a director unless the organization has received consent from the director.

TIP:

In order to qualify for an exemption from state business and occupation and/or sales taxes, an organization may be required to have a minimum number of directors and meet other requirements (*See* Chapter 52).

(iv) Committees

Unless specified in the bylaws (or articles), the board does not have authority to create committees of the corporation to which it may delegate its authority to manage the corporation. Additionally, in order for the delegation of authority to be effective, the committee must have at least two directors as committee members. The Act contains several statutory prohibitions related to committees that cannot be changed in the bylaws or articles:

- No committee shall have the authority of the board in reference to amending, altering or repealing the bylaws; electing, appointing or removing any member of any such committee or any director or officer of the corporation; amending the articles of incorporation; adopting a plan of merger or consolidation with another organization; authorizing the sale, lease, or exchange of all or substantially all of the property and assets of the corporation not in the ordinary course of business; authorizing the voluntary dissolution of the corporation or revoking proceedings therefore; adopting a plan for the distribution of the corporation's assets; or amending, altering or repealing any resolution of the board which by its terms provides that it shall not be amended, altered or repealed by such committee.

- The designation or appointment of any committee and delegation to it of authority shall not operate to relieve the board or any director of any responsibility imposed by law.

(v) Officers

Unless otherwise specified:

- The officers of a corporation consist of a president, one or more vice-presidents, a secretary and a treasurer.

- Officers are elected or appointed annually by the board.

- Any officer elected or appointed may be removed by the persons authorized to elect or appoint such officer whenever in their judgment the best interests of the corporation will be served thereby.

- No person may hold two or more offices.

(vi) Other Bylaw Provisions

There are several topics for which the Act does not specifically provide and which should probably be covered in your corporation's bylaws:

- There is no procedure for the removal of directors if the organization is a non-membership corporation or does not have voting members.

- There are no required specifications for notices to directors for regular or special board meetings.

- There is no requirement of an annual meeting if the organization is a non-membership corporation or does not have voting members.

- The board has no authority to create committees to which the board may delegate the authority of the board in the management of the corporation.

- The creation of committees and their formation, composition and operation are not provided for.

- There is no specified manner or timing of attaining office for officers.

- There is no day and time fixed for the annual meetings of directors and members (this matter should be addressed in the bylaws, if applicable).

d. Conflict of Interest Policy

Pursuant to the fiduciary duty called the duty of loyalty, a director of a nonprofit corporation is required to put the interests of the corporation before personal interests. A conflict of interest policy adopted by the board of directors serves to put in place procedures that will prevent a director with a conflict of interest from personally benefiting from a decision that he or she would make or participate in making. *See* Chapter 13 for additional discussion regarding conflicts of interest and fiduciary duties of directors. A sample conflict of interest policy is

available online at https://wayfindlegal.org/. Alternatively, a conflict of interest policy could be included in the organization's bylaws rather than a separate policy.

e. File Articles with Secretary of State

When the articles are completed, the original of the articles of incorporation must be filed with the Secretary of State. Each of the incorporators must sign the articles, and the registered agent must sign the consent form. The filing fee required by the Secretary of State must accompany the articles. You may mail in documents, file them in person at the Secretary of State's office in Olympia, have a records or messenger service file them for you, or file them online at the Secretary of State's website. If you wish to have the filing effective on the day in which the articles are delivered to the Secretary of State, you must pay an additional fee for expedited filing. A schedule of fees is provided on the Secretary of State's website.

If the Secretary of State finds that the articles of incorporation conform to law, the Secretary shall, when all fees have been paid:

- Endorse on the articles the word "filed" and the effective day of the filing;
- File the articles;
- Issue a certificate of incorporation to which a conformed copy shall be affixed; and
- Return the certificate of incorporation and a conformed copy affixed to it to the incorporators or their representative.

Corporate existence of a nonprofit corporation begins upon the filing of the articles. The date stamped on the articles by the Secretary of State is the effective date of incorporation.

CHAPTER 10. The Organizational Meeting and Post-Incorporation Tasks

a. The Organizational Meeting

After the issuance of the certificate of incorporation, a majority of the initial directors of the corporation must call an organizational meeting of the board of directors by giving at least three days' notice to the initial directors named in the articles of incorporation. The notice must state the time and place of the meeting.

This notice may be waived by all the directors; if it is waived, that fact should be stated in the minutes to the organizational meeting.

You should prepare an agenda for the organizational meeting. The initial board of directors should cover the following business items, at a minimum, at the organizational meeting:

- **Adopt Bylaws**. It is helpful to the initial directors and increases the efficiency of the meeting if draft bylaws are provided to the directors well in advance of the meeting for review and comment. Many groups have found it helpful to hold a study session prior to the organizational meeting to collect comments and discuss draft documents.

- **Elect Officers**. The officer positions established in the corporation's bylaws should then be filled in the manner provided in the bylaws. Pursuant to Washington law, the officers of a nonprofit corporation consist of a president, one or more vice-presidents, a secretary and a treasurer. If permitted by the bylaws, the same person may hold one or more offices, except the offices of president and secretary.

- **Adopt a Conflict of Interest Policy**. A draft of this policy should be provided to directors prior to the meeting for review and comment. *See* Chapter 9.

- **Decide on a Fiscal Year**. Generally, this will coincide with the calendar year, but it is not required to do so. Often the bylaws contain a provision designating a fiscal year.

- **Select a Bank**. Choose a bank for the corporation's bank account and authorize signatories for the account. It is helpful to prepare for this by obtaining forms from the bank in advance of the meeting. The board of directors must adopt a resolution authorizing the opening of the account and signatories for the account. The bank usually will have a form resolution that you can use. The organization will need a federal employer identification number, commonly abbreviated as "EIN" or "EIN" in order to open an account. Information with respect to obtaining an EIN is provided below in subsection (b) of this Chapter.

- **Approve Any Legal Documents**. Approve initial leases and contracts, if any. Approve application for 501(c)(3) status, if prepared, and authorize execution of the form and payment of the application fee.

- **Ratify Organizers' Actions; Approve Reimbursement of Expenses**. Adopt a resolution ratifying all of the organizers' and/or incorporators' actions taken on behalf of the corporation prior to the date of incorporation and approve reimbursement of expenses, if any, upon review of the documentation of the expenses.

The secretary of the board or another designated individual should take notes during the meeting and prepare minutes for approval of the board. Upon approval of the board (usually received by motion adopted at the next meeting of the board), the minutes should be kept among the permanent records of the corporation.

The organizational meeting can occur by unanimous written consent. Unanimous written consent is a record of the resolutions made by the board of directors and signed and dated by each director or consented by a director by email. The resolutions become effective on the date on which the last signature is obtained. A copy of the executed unanimous consent should be kept among the permanent corporate records of the corporation. A sample form for a unanimous written consent for the initial meeting of the board of directors can be found online at https://wayfindlegal.org/.

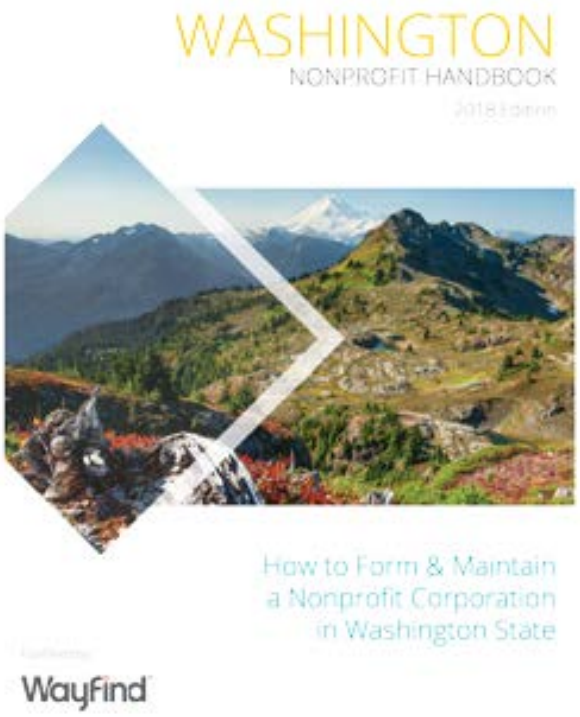
b. Other Organizational Tasks

Several steps need to be completed after the incorporation of your organization.

- **Federal Employer Identification Number**. A federal employer identification number ("EIN") is required for the application for tax-exempt status as a 501(c)(3) organization, as well as by most banks in order to open bank accounts in the name of the corporation. The assignment of an EIN to your corporation is a fairly straightforward process. To obtain an EIN, IRS Form SS-4 must be completed and filed with the IRS. The IRS permits filing of completed forms online, by mail or fax. An EIN may also be obtained by a phone call to the IRS. The phone number is in the instructions to the Form SS-4. No filing fee is currently required to obtain an EIN. If the organization has a return

fax number, the IRS will fax an EIN back to the organization. The Form SS-4 and instructions are available on the IRS' website.

- **Master Business Application**. Upon the filing of the articles of incorporation with the Secretary of State, the Secretary of State's office provides a packet of information regarding new corporations in Washington State, including a Master Business Application form. You may also obtain Master Business Application forms from the Department of Licensing. Completion and filing of the Master Business Application will provide your organization with its basic state tax registration and employer registration. Basic state tax registration (registration with the Washington State Department of Revenue) is required if the organization plans to engage in any business activity (which is broadly defined and may include a charitable activity that generates a stream of revenue). The Master Business Application form will also register the corporation for payment of certain state employment taxes. These include registration with the Department of Labor and Industries and establishment of an Industrial Insurance Account and registration with the Employment Security Department for purposes of unemployment insurance.



Part 3 Governance And Operations

Chapter 11 Importance of Acting Like a Corporation
Chapter 12 Function and Authority of the Board of Directors
Chapter 13 Duties and Obligations of Board Members to the Corporation
Chapter 14 The Role of the Executive Director
Chapter 15 Board Development
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Chapter 20 Exposure and Risks of Directors and Officers
Chapter 21 Directors' and Officers' Insurance

PART 3. GOVERNANCE AND OPERATIONS

CHAPTER 11. Importance of Acting Like a Corporation

a. Limited Liability

Notes on Terminology for Part III

The terms "director" and "board member" are used interchangeably; the terms "corporation" and "organization" are also used interchangeably; the term "officer" is used when referring to a director that has been elected to a leadership position on the board; and the term "member" is used in reference to those organizations with a membership group that has voting rights.

A nonprofit corporation is a legal entity separate and distinct from its directors, officers and employees. As such, liabilities and obligations incurred by the corporation, in the absence of unusual circumstances, must be satisfied out of the assets of the corporation and do not "pass through" to its directors, officers or employees. Put another way, a corporation provides a limited shield to its directors, officers and employees against payment of liabilities and obligations incurred by the corporation.

b. Personal Liability

In certain circumstances, a director, officer or member of a corporation may become personally liable for the corporation's liabilities and obligations. This may occur if the corporation's officers, directors or members fail to maintain the corporation's separate legal identity by confusing their individual identity with that of the corporation. This confusion of identities generally occurs when one or more of the directors, officers or members of the corporation mix their personal, individual interests with the corporation's business, often for personal gain. In such cases, a court may choose to disregard the corporate entity created and hold the individuals acting on behalf of the corporation (i.e., the directors, officers or members) personally responsible for the corporation's liabilities and obligations. A court may choose to impose personal liability in this manner even though articles of incorporation creating the corporation, which limit an individual's liability, have been filed.

Courts and the Internal Revenue Service ("IRS") give particular scrutiny to cases involving a small number of individuals who fill multiple roles within the corporation, which is very common for a new nonprofit corporation. In deciding whether liabilities and obligations of a corporation will "pass through" to officers or directors, courts and the IRS scrutinize the corporation and its operation to decide if the corporation meets certain minimum standards for consideration as a

separate entity. For instance, courts examine whether the corporation has adequate funds to pay its creditors, whether the individuals commingled corporate and personal funds on a regular basis, whether the individuals failed to keep proper corporate records and whether the corporation generally failed to act like a corporation. The IRS may assess taxes and penalties personally against the corporation's principals if it concludes the corporation is not a valid separate entity.

A principal of a corporation (usually an officer or director) may also become personally liable for the liabilities of the corporation if the individual fails to make clear to persons with whom he or she is dealing that he or she is in fact acting as an agent of the corporation and not as an individual. All business transactions of a corporation should clearly indicate that they are corporate transactions, and the representative capacity of the officers or directors acting on behalf of the corporation should always be disclosed.

c. Preventative Action

To ensure that a nonprofit corporation is considered a separate entity, regular meetings for both the board of directors and members (if it is a membership organization) should be held meticulously. The board should also ensure that written minutes of these meetings are prepared and placed in the corporate record book. Nonprofit corporations should also be especially diligent in maintaining sufficient funds to pay their debts and in segregating corporate funds from the personal funds of the corporation's officers and directors. A failure to segregate funds could also result in loss of tax-exempt status. See the discussion in Chapter 29 on private inurement.

In all dealings on behalf of a nonprofit corporation, a director or officer should clarify the capacity in which he or she is acting. In addition, all signatory lines for contracts and other documents should identify the corporation by its full legal name together with the title of the officer or director signing the document. If the name of the corporation and the title of the signatory are not written above or under the signature line, the officer or director should add these by hand under his or her signature.

The following chapters illuminate the importance of explicit and robust policies, systems, and procedures for a nonprofit corporation; clearly defined roles and responsibilities for directors, officers, staff, and volunteers; and open and trusting relationships among all individuals and stakeholder groups. These

practices will preserve the corporate entity and enable it to work more effectively to accomplish your organization's mission.

CHAPTER 12. Function and Authority of the Board of Directors

Operating a nonprofit organization is a complex undertaking that involves multiple stakeholders, including board members, the executive director and other staff, volunteers, persons being served, and funders. The board of directors is responsible for setting overall priorities and ensuring that resources are used wisely in pursuit of the organization's mission.

Under the Act, a nonprofit corporation's board of directors is the governing body of the corporation and is responsible for managing the affairs of the corporation. The board may delegate certain of its responsibilities to committees and officers of the corporation, but the board retains ultimate responsibility for the corporation. A corporation exercises its powers through resolutions and acts of the board. Generally, the board delegates the day-to-day responsibilities of operating the corporation to paid or volunteer staff members.

a. Election, Number of Directors, and Board Terms

Under the Act, a corporation's board of directors must be composed of at least one individual. The articles of incorporation ("articles") or bylaws establish the number of and election method of the directors. The number of directors may be a range (e.g., "not less than seven or more than 15") and may be increased or decreased by amending the document that specifies the number. An amendment that decreases the number of directors cannot shorten the term of any current director. The articles or bylaws may provide that directors will be elected by the corporation's members or by the corporation's directors; in some circumstances, directors may be appointed.

The articles or bylaws specify the directors' terms of office. Terms can be for one year or several years. Nonprofit corporations typically choose terms of two or three years for their directors. Each director holds office until his or her successor has been selected and qualified. The term of the directors may be staggered by providing that only some portion of the board seats are up for election at the same time. Staggering the directors' terms can provide valuable continuity on the board.

If the corporation has a membership with voting rights, the articles or bylaws may require that directors be elected by a majority vote of the corporation's members. Alternatively, the articles or bylaws may provide for a more complex

manner of electing directors known as "cumulative voting." Cumulative voting permits each member or director entitled to vote to add all of the votes to which he or she is entitled and apply them toward one candidate's election or distribute the votes among several candidates.

b. Action by the Board

To be a valid act of the corporation, the act must be approved by a majority of the directors at a board meeting in which a quorum is present. Unless the corporation's articles or bylaws state otherwise, a majority of the directors constitutes a quorum. A quorum may not be less than one-third of the total number of directors. The articles or bylaws may require a greater proportion of votes for certain acts by the board, such as the removal of a director or modification of the corporation's purpose.

A director may vote against (i.e., dissent) or not vote on (i.e., abstain) an action taken by the board. However, if the director is present at the meeting where the action is taken, it is assumed that the director consented to the action unless the director's dissent or abstention is recorded in the minutes or filed in writing with the secretary of the corporation.

Directors cannot appear by proxy or give their proxies to another director. Directors must be present to listen to the discussion, consider each resolution, and vote based on their judgment.

c. Removing Directors and Vacancies on the Board

A corporation's articles or bylaws may contain a procedure for removing directors. If the articles or bylaws provide for the election of any directors by members, yet fail to specify a procedure for removal, the Act specifies the following:

- Any director elected by members may be removed by two-thirds of the votes cast by members having voting rights with regard to director elections, at a meeting where a quorum is present. Note that members may be represented in person or by proxy, if permitted by the bylaws (even though this option is not available to directors).

- If a corporation has cumulative voting, a director may be removed if the number of votes cast for removal would have elected the director at an election.

- If a corporation has no members and no removal procedure is specified in the bylaws, the corporation must go to court to effect the removal of a director.

- If the articles or bylaws do not specify a procedure to fill a vacancy on the board, then a majority of the remaining directors may elect a new director. The new director that is elected or appointed completes the unexpired term of the vacant position.

d. Committees

The board may designate and appoint committees to perform certain activities of the corporation, if the articles or bylaws allow for the creation of such committees. However, even if the board appoints a committee and delegates duties to the committee, the board and individual directors remain ultimately responsible for duties imposed by law. Additionally, in order for a committee to have delegated authority, it must have at least two directors as committee members.

The Act prohibits the board from delegating certain powers or responsibilities to committees. Committees cannot:

- Amend, alter, or repeal the corporation's articles or bylaws;

- Elect, appoint, or remove any member of the committee, nor any director or officer of the corporation;

- Adopt a plan of merger with another corporation;

- Authorize the sale, lease, or exchange of substantially all of the corporation's assets;

- Authorize the dissolution of the corporation;

- Adopt a plan for distribution of the corporation's assets; or

- Amend, alter, or repeal any board resolution that by its terms may not be amended, altered, or repealed by a committee.

e. Meetings

Nonprofit corporations with members must hold at least one annual meeting for members and one annual meeting for directors. Although corporations without

members are not required to hold an annual board meeting, it is recommended that one be held. The annual member meeting is typically held for the purpose of electing directors for the next year and for discussion of general business matters. The annual board meeting is typically held for the purpose of electing directors (unless directors are elected by members), electing or appointing officers for the coming year, adopting the corporation's budget, approving programs/activities, and forming plans and strategies. Holding an annual meeting ensures that elections necessary to elect directors and officers take place.

The corporation must give notice of the annual meeting to members using one of the methods approved in the bylaws no less than 10 or more than 50 days prior to the meeting. The corporation's bylaws establish the date of the annual meeting of members and directors for membership corporations and of directors for nonmembership corporations. Failure to hold an annual meeting at the designated time required under the corporation's bylaws will not bring about a dissolution of the corporation, but it does put the corporation out of compliance with its bylaws and, as such, should be remedied as soon as possible by the board.

Beyond the annual board meeting, most boards will establish a schedule of monthly or quarterly meetings. The bylaws may permit regularly scheduled board meetings to be held with or without notice as long as the schedule of board meetings is approved at a board meeting. Board meetings may be held in or out of Washington State.

Special board meetings require that notice be sent to the directors. The procedure and timing for giving notice should be stated in the bylaws. If a director attends a meeting, the director waives the notice requirement, unless he or she attends the meeting solely to object to lack of notice. The bylaws should state whether the notice should include specific information about the business to be conducted at the special meeting.

Regular and special meetings may be conducted by conference calls or similar methods of communication that allow comment and response by all directors at the same time. If all directors sign or email a written consent to a corporate action and a record of such consents are kept in the corporate minutes book, a meeting is not required to validate the action. The Act does not currently permit "online" meetings of any kind.

f. Officers

Under the Act, the officers of a corporation consist of a president, one or more vice-presidents, a secretary, and a treasurer. The articles and bylaws may provide for the time and manner of the election or appointment of the officers; otherwise, the officers are elected or appointed annually by the board. The articles or bylaws may allow any two or more offices to be held by the same person except for the offices of president and secretary. Generally, the articles or bylaws list the specific duties and responsibilities of the officers.

Typical responsibilities of officers include the following:

- The president is responsible for facilitating the effective action of the board in governing and supporting the organization. The president sets the agenda for board meetings (in partnership with the chief executive, if one exists) and leads board meetings. Often, the president appoints the chairs of all standing and ad hoc committees of the board.

- The primary role of the vice-president is to assume the responsibilities of the president in the event of her/his absence. Often, the vice-president also carries out special assignments as requested by the president or the executive committee. If an organization has multiple vice-presidents, each is typically charged with a set of unique responsibilities.

- The secretary is responsible for maintaining corporate records. The secretary ensures that accurate meeting minutes are recorded and retained, and that notices are duly given in accordance with the provisions of the bylaws.

- The treasurer is responsible for managing the board's review of, and action related to, the organization's financial health. The treasurer ensures that comprehensive financial reports are made available to the board on a frequent basis (at least quarterly), and identifies opportunities to strengthen the board's ability to carry out its fiscal responsibilities. The treasurer is accountable for maintaining accounts and appropriate fiscal controls.

g. Minutes and Other Corporate Records

A nonprofit corporation should keep a written record of all members (if the corporation has members), board, and committee meetings. Such record is kept in the form of minutes. Minutes to a meeting should include the following:

- Identification of the group that is meeting;
- Date of the meeting;
- List of those individuals present;
- Description of items discussed and action taken on each item (including the wording of the motion or resolution adopted). If there is a conflict of interest with respect to an item, the procedure for a conflict of interest should be followed and recorded. *See* Chapter 9 for a discussion of a conflict of interest policy.

Optional items include a list of those absent and/or excused; a summary of the discussion that occurred with respect to each item; information regarding a vote on an item (number in favor, opposed, abstentions), identification of the individuals making and seconding motions or resolutions, and copies of motions and resolutions that failed to pass.

After the meeting, the minutes should be prepared from the notes or recordings taken at the meeting. The draft minutes are then presented at the next meeting of the group for review and approval at the meeting. Some organizations send draft minutes out to the group prior to the meeting for review. Any corrections or revisions to the minutes made by the group at the meeting should be reflected in the minutes as adopted by the group.

h. The Corporate Record Book

Each nonprofit corporation should keep a corporate record book or series of books containing all of its organizational and corporate documents. These documents include the articles and bylaws, any amendments to the articles or bylaws, minutes of all board and committee meetings, waivers of notice or notice of all meetings, tax-exemption application and determination letters, annual reports, membership certificates, all insurance policies, warranties, contracts, leases and other legal documents, and copies of all communications with board members, officers, members and contributors. Corporate records should be kept at the principal office of the corporation.

i. Public Documents

Certain corporate documents are part of the public record. In Washington, all public corporate records are kept in Olympia by the Corporations Division of the Secretary of State. The public corporate documents include the articles of incorporation and any amendments, articles of merger or consolidation, articles of dissolution, the name of the registered agent and the addresses of the registered office and registered agent, the corporate annual report forms that disclose the names and addresses of the corporation's directors and officers, and certain other information such as the Unified Business Identifier (UBI), the license expiration date, the type of corporation (nonprofit), and, with respect to corporations incorporated in other states that are qualified to do business in Washington, their states of incorporation. The annual reports filed under the Charitable Solicitations Act and the Charitable Trust Act are also part of the public record.

Chapter 35 discusses which documents are subject to disclosure under federal law for section 501(c)(3) organizations.

CHAPTER 13. Duties and Obligations of Board Members to the Corporation

a. Duty of Care

A director of a nonprofit corporation should take seriously the responsibility of managing the affairs of the corporation. The Act requires a director to perform his or her duties "in good faith, in a manner such director believes to be in the best interests of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances."

A director must stay informed about the general affairs and finances of the corporation. Directors should examine financial statements regularly—at least quarterly—to ensure that the corporation has adequate funds to pay its debts, and that those funds are being used to further the corporation's mission and goals. An annual budget for the corporation should be approved prior to or at the beginning of each fiscal year.

The Act does not require directors to attend board meetings (though bylaws often include such a requirement). However, a director who is frequently absent from meetings will find it difficult to contribute in a meaningful way and to fulfill his or her duty of care. Organizations that are especially concerned about absenteeism can include a provision in their bylaws specifying that a director who is absent a certain number of times shall be deemed to have resigned from the board.

Directors are expected to use common sense and practical judgment; they are not expected to be experts in every matter the board considers. In performing his or her duties, a director may rely on information, opinions, reports, or statements—including financial statements and other financial data—prepared or presented by an officer or employee of the corporation whom the director believes to be competent and reliable in the matter presented; professionals such as attorneys, accountants, or others, if the matter is within that person's expertise; or a committee on which the director does not serve, if the matters are within the committee's designated authority. However, if a board member has a particular expertise (e.g., accounting), he or she is expected to utilize this deeper knowledge.

Because the board is typically comprised of outsiders who do not participate in the daily management and operation of the corporation, directors often rely on staff or volunteers to provide them with information about the corporation's operations. Directors must carefully evaluate this information to ensure that problems or potential risks or liabilities are not being withheld from or misrepresented to the board.

b. Duty of Loyalty

A director must act with the best interest of the corporation in mind, and not for his or her own personal benefit or the benefit of another person or organization. Conflicts of interest, or potential conflicts of interest, should be avoided. In the event that a conflict of interest is unavoidable, the conflict should be disclosed to the board and the director with the conflict should abstain from the discussion and the vote.

It is useful and is widely considered to be a "best practice" for a nonprofit corporation to have a written conflict of interest policy. *See* Chapter 9. In addition to providing a procedure for disclosing and resolving conflicts of interest, the policy should require that each officer, director and key employee submit an annual disclosure statement specifying such individual's (and his or her family members'):

- Business relationships with any entity that contracts with the corporation;
- Investments in companies from which the corporation obtains goods or services, to which the corporation sells goods or services, or that provides goods or services in competition with the corporation;

- Outside activities involving board, advisory board, or managerial or consulting services for any outside business, government agency, or individual that does business or competes with the corporation;

- Specific transactions with the corporation related to the sale, exchange, or lease of property; lending of money or other extension of credit; furnishing of goods, services, or facilities; payment of compensation, or payment/reimbursement of expenses in excess of $1,000; and the transfer of income or assets; and

- Other activities that might be regarded as a potential or actual conflict of interest in connection with his or her position with the corporation.

Directors are prohibited from entering into any transaction that involves the flow or transfer of income or assets through or away from the corporation for the benefit of anyone associated with the corporation. Additionally, the Act prohibits the corporation from lending money or extending credit to any of its directors. Any director engaging in such a transaction and any director participating in the making of such a loan or extension of credit is liable to the corporation for the amount of the loan until it is paid.

Confidential matters of the corporation should be respected by all directors. Questions related to whether or not something is confidential should be discussed with the board and/or legal counsel.

c. Other Obligations

Directors must act lawfully when conducting business on behalf of the corporation. Directors must also act within the scope of authority and purpose of the corporation as specified in the corporation's governing documents. Finally, directors should ensure that the corporation is in compliance with laws and other regulations.

A board of directors functions as a group. A director cannot speak on behalf of the board or act for the board outside a meeting, unless authorized by the board as a whole. Any director attempting to act on behalf of the board without explicit authorization is exceeding his or her authority. However, officers and some committee chairs may have implicit authority to perform certain routine tasks associated with their jobs.

d. Models of Governance

In an effort to clarify the roles and responsibilities of nonprofit boards, several organizations and academic researchers have developed "models of governance" for nonprofit corporations. Most of these models go beyond simply restating the legal duties of boards and directors, aiming to set forth critical functions and processes of nonprofit boards.

One widely used model is The CompassPoint Board Model for Governance and Support (CompassPoint, 2003, http://www.compasspoint.org). As the name implies, the CompassPoint Model suggests that boards and directors fulfill two roles: governance and support. The objective of governance functions is to represent the community's interest within the organization, asking, "Is our organization using public and private resources to benefit the community?" The objective of support functions is to represent the organization's interest in the community, posing the question, "How can I, as a member of the board, best represent the organization in the community?"

The entire board acts as a unit when fulfilling governance functions. Board members generally act individually or through committees when fulfilling support functions.

Governance responsibilities include the following:

- *Direction*—determine mission/purpose and vision
- *Legal Affairs*—ensure compliance with laws and regulations and fulfillment of contractual obligations; manage risk; obtain adequate insurance coverage
- *Finances*—approve annual budget; review financial statements; safeguard assets from waste and misuse; review audit (if applicable); manage investments (if applicable)
- *Human Resources*—hire/fire, support, evaluate, and set compensation for the executive director; ensure that the organization has appropriate personnel policies
- *Fundraising*—approve fundraising strategy and monitor progress
- *Planning*—determine overall priorities/objectives (and related strategies)

- *Programs*—approve new programs; support the use of program evaluation to measure impact

- Impact/Efficiency—maximize the use of resources

Support responsibilities include the following:

- *Fundraising*—contribute to the organization's resource development efforts (e.g., make a contribution according to one's own means; plan and volunteer at fundraising events; solicit cash and noncash contributions; share contacts)

- *Public Relations*—act as an ambassador on behalf of the organization and its clients/customers

- *Volunteerism*—recruit and encourage volunteers (including new board members)

- *Advice*—serve as a sounding board; advise staff in areas of expertise

- *Reputation*—lend name and personal credibility to the organization for use in brochures, grant proposals, and the like

It is important to note that, when fulfilling support functions, directors will typically be taking direction from staff. Board members should be cognizant of this important distinction.

Various factors—organizational culture, size of the corporation and board, stage of organizational growth, financial resources (and constraints), and many others—will dictate the amount of time that directors will spend on governance versus support functions.

e. Board Member Job Description

Clarifying expectations for individual board members is critical, especially in relation to both time and financial commitments. Many organizations have found it useful to create a "job description" or "contract" for directors. Examples can be obtained from a number of organizations, including BoardSource (http://www.boardsource.org) and CompassPoint (http://www.compasspoint.org).

Directors are not usually compensated for their board service. However, some organizations provide reimbursement of expenses incurred during the

performance of board duties, including attendance at board-authorized meetings and conferences.

CHAPTER 14. The Role of the Executive Director

a. Typical Responsibilities

The executive director (or chief executive officer) reports to the board of directors and is responsible for the overall management of the organization. The executive director should receive a formal evaluation from the board on an annual basis.

Working in collaboration with the board, the executive director assumes responsibility for overall organizational leadership, visioning, and long-range planning, as well as board development.

Depending on the size and structure of the organization, the executive director either assumes direct responsibility for or oversees the following:

- Financial management, including budgeting, financial forecasting, and fiscal oversight;
- Fundraising and resource development;
- Program development, implementation, and evaluation;
- Community relations, including outreach, marketing, communications, and advocacy;
- Human resources management, including the development of sound personnel policies and practices;
- Staff and volunteer recruitment, selection, evaluation, and development; and
- Compliance with federal, state, and local regulations.

Compensation among executive directors varies considerably—based on budget size, number of staff, interest area, cost of living, and a host of other factors. One source for salary data is the *Nonprofit Wage and Benefit Survey of King, Pierce, and Snohomish County*, published every two years by United Way of King County (http://www.uwkc.org).

b. Words of Wisdom for New Executive Directors

In "The Nonprofit ED's First 100 Days," *The Nonprofit Quarterly* offers advice and guidance for new executive directors. In general, the authors suggest that these critical days should be focused on gathering information, expressing curiosity and interest about the details of the work of new colleagues, and preparing to lead the organization toward the future in light of the goals and commitments expressed during the hiring process.

The article proposes "Eleven Questions for a New Leader." They are:

(a) How should I sequence these first 100 days?

(b) Am I confident that I understand the organization's current situation?

(c) What are this organization's top three opportunities and challenges? To what extent is there agreement, dissent, or indecision about priorities?

(d) Which relationships are most critical for me to sustain? Who would expect to hear from me early in my tenure?

(e) How should I allocate my time among internal and external relationships? How do others view this distribution?

(f) What information and sources of information do I need to master to understand the field and environment of this organization?

(g) Does my newness open avenues for changed relationships, new support, or repaired bridges?

(h) What symbolic moves could I take to denote a new era?

(i) Who else applied for this position whom I should now call on?

(j) What might I later regret that I didn't do early on?

(k) What weaknesses in my own personality or style do I need to compensate for?

Oliver Tessier & Ruth McCambridge, *The Nonprofit ED's First 100 Days*, Nonprofit Q., Spring 2008, at 38-43.

c. The Executive Director/Board Partnership

An effective partnership between the board and the executive director can, among other things, enhance the prospects of success for the executive director and increase levels of satisfaction and retention among board members. Suggestions for enhancing this partnership include:

- Take time to establish relationships (and renegotiate "ground rules") with each change in board president or executive director;
- Clarify and respect roles;
- Minimize surprises;
- Communicate regularly between board meetings;
- Work together to develop board meeting agendas;
- Collaborate on board orientation, training, evaluation, and leadership development; and
- Show appreciation for one another's contributions to the organization.

d. Serving on the Board

When the executive director serves on the board, it is typically in a nonvoting role. If the executive director has a voting position on the board, he or she will need to abstain on all matters related to the board's personnel functions (e.g., setting the compensation for the executive director) as well as other matters where a potential conflict of interest may exist.

Regardless of whether the executive director serves on the board, he or she should help set agendas for board meetings, and attend and actively participate in these meetings.

CHAPTER 15. Board Development

a. Recruitment of Directors

Every nonprofit desires and deserves a committed, knowledgeable, and effective board of directors. A nonprofit corporation should choose its directors carefully, in light of the needs of the corporation as well as the talents and characteristics of current and prospective board members. Areas to consider include:

- *Personal qualities* such as enthusiasm, creativity, passion for the cause(s) of the organization, and interpersonal skills;
- *Skills and knowledge* in areas such as marketing, evaluation, human resources, legal affairs, finance, fundraising, management, leadership, and the organization's service area(s); and
- *Demographics* such as age, gender, and race/ethnicity.

It is also important to ensure that the board is exposed to the perspectives of those being served by the organization. To this end, some nonprofit organizations make an effort to recruit former clients or customers to serve on the board (it is generally not advisable to have current clients serving on the board). Other options include establishing a "client advisory board" or developing a system for gathering input from clients on a regular basis.

b. Orientation and Training

The foundation of an effective board of directors is orientation and education. A board orientation program should be provided for all new board members, and the orientation should include time for socializing and relationship building. Potential topics for an orientation program include:

- Organizational history;
- Vision, mission, values;
- Current programs;
- Organizational priorities and significant issues/challenges;
- Budget, including an overview of major sources of funding;

- Expectations of board members;
- Parliamentary procedure (if followed); and
- An overview of board manual contents.

All directors should receive a board manual, and the contents of the manual should be updated on a regular basis. The board manual is typically developed by staff in consultation with board officers or the board development committee. For new board members, the manual serves as an orientation handbook that provides useful information about the organization. For the remainder of a director's term, the manual becomes a central resource about the organization and the activities of the board. Contents may include:

- Vision, mission, and values statements;
- Brief written history of the organization and/or an organizational fact sheet;
- Brochures, newsletters, or other publications;
- Articles of incorporation, bylaws, and IRS determination letter;
- Key policies (e.g., conflict of interest, investment, travel/meeting expense reimbursement);
- Most recent annual report;
- Most recent audited financial statements and form 990;
- Current strategic plan and/or other long-range planning documents;
- Current annual budget;
- Board meeting minutes;
- Written expectations/responsibilities of board members (both individually and collectively);
- Committee descriptions;
- Directors' and officers' insurance coverage summary;

- List of current directors and officers (with titles and affiliations and contact information);
- Brief biographies of the ED/CEO and other management staff; and
- Organizational chart.

Nonprofit organizations should make a commitment to the on-going education of board members. Training can be offered to the board as a whole (e.g., as part of an annual board retreat) or individual board members can be given the opportunity to attend conferences and trainings in the community. Common training topics for board members include:

- Financial management (understanding financial statements);
- Board roles and responsibilities;
- Cultural competency;
- Parliamentary procedure (if applicable);
- Fundraising (especially individual donor cultivation); and
- Strategic thinking and planning.

c. Evaluation

Boards have a responsibility to assess the effectiveness of both individual directors and the board as a whole. This is commonly handled through an annual board self-evaluation process. Areas to review include board composition, board recruitment, committee structure, meetings, decision-making processes, relationships with staff and other key stakeholders, and overall strengths and weaknesses.

CHAPTER 16. Annual Reporting Requirements

Each year, the Washington Secretary of State sends an annual corporate report form to every Washington nonprofit corporation. The corporation must return the report with the required fee to the Secretary of State by the due date to preserve its corporate status. Generally, the Secretary of State sends the report to the corporation's registered office at least 30 days prior to the required filing date. The report requests a list of the corporation's officers and directors, any change to the address of the corporation's registered office or agent and other basic

information. A corporation's failure to file the report within the required time period results in automatic dissolution of the corporation by the Secretary of State. A nonprofit corporation may also be required to file annual reports pursuant to the Charitable Trust Act (see Chapter 17) or the Charitable Solicitations Act (see Chapter 45). Finally, the corporation may be required by federal tax law to file a Form 990. *See* Chapter 35 for a discussion of this form.

CHAPTER 17. Entities to Report as Charitable Trusts

The Charitable Trust Act ("CTA"), codified in RCW 11.110, applies to all entities, including corporations that meet the definition of a "trustee." A nonprofit corporation meets this definition if it is either (1) formed for the administration of a charitable trust or (2) holds assets that can only be used for charitable, religious, eleemosynary, benevolent, educational or similar purposes.

a. Significance of the CTA

(i) Attorney General Enforcement Powers

The CTA empowers the attorney general to enforce the terms of the trust as the statutory representative of its public beneficiaries. Trustees are required to give the attorney general notice of all judicial proceedings affecting the trust or its administration in which the attorney general is a necessary party. The attorney general is authorized to investigate transactions and relationships involving the trust. This includes the authority to issue administrative orders requiring any person to appear to answer questions regarding trust administration.

(ii) Registration Requirement

Perhaps of greater day-to-day importance, some trustees are also required to register and report annually to the Secretary of State concerning the trustees' affairs. While the law defines "trustee" for purposes of the attorney general enforcement powers very broadly, it requires only some trustees to register with the Secretary. The registration requirement applies when:

- The trustee holds assets that are invested for income-producing purposes. Even though assets are invested, all or part of the principal or income of the trust must be presently available for charitable purposes. A trustee is not required to register if the trust's terms require that the assets be entirely expended for a charitable purpose within one year; and

- The assets have a value of at least $250,000.

b. How to Register and Report Under the CTA

To register under the CTA, the trustee must file with the Secretary of State a copy of the instrument establishing the trust, an inventory of assets, and a registration form provided by the Secretary.

The annual reporting requirement is satisfied by filing with the Secretary a copy of the corporation's publicly available United States tax or information return, such as a Form 990 or 990 PF. A corporation that is not required to file either of these returns can instead file a separate form provided by the Secretary, describing the corporation's financial affairs.

CHAPTER 18. Amending Governing Documents

a. Generally

It is advisable for the board of directors of a nonprofit corporation to review its articles of incorporation and bylaws on a regular basis to ensure that the provisions in these documents are still accurate and not out of date. For example, the board will want to confirm that all of the activities conducted by the organization fall within the organization's purposes set forth in the articles. The procedures set forth in the bylaws should be confirmed as current practices of the organization.

b. Amending Articles; Restatement

A nonprofit corporation may need to amend its articles of incorporation at some time after its formation. The most common reasons for an amendment to the articles include (a) a change of name, (b) addition of or a revision to one or more of its purposes, or (c) addition of one or more of the provisions required by federal tax law to satisfy the organizational test necessary to qualify as a 501(c)(3) organization. *See* Chapter 22 for a description of the requirements of the organizational test.

The Washington Nonprofit Corporation Act sets forth the statutory procedure for amending articles of incorporation. In addition, the corporation's bylaws and articles should be checked for any additional requirements, such as more stringent notice or additional approval requirements. A document containing the revised or additional language, called "Articles of Amendment" must be drafted. A form for Articles of Amendment can be found online at https://wayfindlegal.org/.

The procedure for a nonprofit corporation to adopt the Articles of Amendment differs for corporations with voting members and corporations with no members or no voting members:

- For corporations with voting members, the board of directors first passes a resolution approving the proposed Articles of Amendment and directing a vote of the members. The board may also need to call a special meeting of the members for the vote. The members of the corporation then vote on the proposed Articles of Amendment at a regular or special membership meeting duly called in accordance with the bylaws or by mail-in or electronic ballot if permitted in the bylaws. The proposed Articles of Amendment must receive a vote of two-thirds of the members present at a meeting in which there is a quorum of members.

- For corporations with no members or no voting members, the board approves the proposed Articles of Amendment at a regular or special meeting of the board held in accordance with the bylaws. The vote to approve the Articles of Amendment must be by a majority of directors in office at a meeting in which a quorum is present. Such vote can also be held by unanimous consent resolution.

After receiving the required corporate approval, the Articles of Amendment, signed by an officer of the corporation, are filed with the Secretary of State with the appropriate filing fee. A closing paragraph of the Articles of Amendment recites the corporate approval obtained, including the date such approval was received. The Secretary of State's website contains a helpful form reciting the required information. The Articles of Amendment become effective on the date of filing with the Secretary of State or on such later date as stated in the Articles of Amendment.

If a corporation has amended its articles of incorporation several times or has significantly revised the articles, it may prepare and file restated articles, which integrate all of the amendments into a single document. The restated articles must be approved using the process described above and filed with the Secretary of State with the appropriate filing fee.

c. Bylaws

Nonprofit corporations amend their bylaws more frequently than they amend their articles of incorporation. The bylaws are amended in accordance with the procedure set forth in the bylaws themselves or in the articles of incorporation.

If there is a procedure for amending the bylaws in both the articles and the bylaws, the procedure in the articles must be followed. Generally, amendments to the bylaws are effective with board approval alone. However, it is common for nonprofit corporations with voting members to require approval of bylaw amendments by the members. Even if a membership vote is not required, it is not unusual for the procedure for amending bylaws to call for a supermajority vote of the board or for special notice or meeting requirements. In addition to amending the bylaws, the board may also repeal one or more of the bylaws or adopt new bylaws. Once adopted, the bylaws continue to govern the affairs of the corporation until the bylaws are either amended or repealed.

CHAPTER 19. Sarbanes-Oxley – Document Retention and Protections for Whistleblowers

With the passage of the Public Company Accounting Reform and Investor Protection Act of 2002 (often referred to by the names of its principal sponsors as "Sarbanes-Oxley," or "SOX" for short), corporate America was prompted to give more attention to governance and financial accountability. This law focuses primarily on the financial affairs of publicly traded corporations. Two of the provisions of Sarbanes-Oxley have very broad application, though, and directly pertain to the operations of most nonprofit organizations.

Preservation of Records

Title VIII of the Sarbanes-Oxley Act (SOX) extends criminal penalties to anyone who "knowingly alters…any record…with the intent to…obstruct…the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States." (section 802). Destroying or altering documents related to an IRS investigation of a nonprofit organization's Form 990 (see Chapter 35) is an example of the kind of behavior this section is designed to punish. Nonprofit organizations may frequently be required to file other reports with federal agencies that fall within the scope of this section. Adopting policies that guard against violating SOX is good business practice for any organization that files reports with the federal government.

Every nonprofit organization should preserve the documentation used to prepare any reports and, in particular, make clear to all volunteers and employees that documents cannot be destroyed or altered in any way if an investigation of the organization's affairs are on the horizon or underway.

Protections for Whistleblowers

Title XI of SOX establishes penalties for anyone who "knowingly, with the intent to retaliate, takes any action harmful to any person…for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense." (section 1107). Policies and procedures that protect whistleblowers and prevent retaliation are important and guard against potential violations.

If it is easy for clients, volunteers, employees, and vendors to bring attention to suspicious behavior in ways that avoid embarrassment and risk of retaliation, they are much more likely to do so. In turn, the risks that an organization's assets will be misused, misappropriated, or misreported is greatly reduced. There are firms that operate confidential whistleblower reporting systems using toll-free telephone numbers. It is also possible to ask volunteers to collect confidential tips and reports. Compliance with SOX requires assurances that reporting in good faith, even if it turns out to be a mistake, will not expose the whistleblower to adverse consequences.

Financial Reporting and Charitable Solicitations

The Washington Charitable Solicitations Act (RCW 19.09) requires most organizations that solicit contributions from the public for charitable purposes to register and report on their activities annually to the Charities Program in the Office of the Secretary of State; there are penalties for false or misleading reports. (*See* Chapter 45 for a description of the requirements of this Act.) Section 541 of the Act requires all soliciting organizations to follow certain financial reporting requirements (specified in RCW 19.09.075). Those with amounts over $1 million in gross receipts (averaged over three years) are required to provide specific financial information – which may include the Form 990 the organization has filed with the IRS – to the public either in response to inquiries or on a publicly available website. Soliciting organizations with more than $3 million in revenue are required to have an independent, third-party audit performed annually and to make the resulting report readily available. (*See* more on Washington's charitable solicitations law online at http://app.leg.wa.gov/RCW/default.aspx?cite=19.09.)

CHAPTER 20. Exposure and Risks of Directors and Officers

a. Directors' and Officers' Liability and Exposure

A director or officer is not automatically liable simply because the corporation is sued. Rather, liability arises because the director or officer is charged with some breach of a duty owed either to the corporation or to a specific party. Suits against directors or officers typically are brought in one of three ways:

- An outside party may sue a director or officer directly, claiming some injury by the corporation.
- A party may assert some right of the corporation against a director or officer, suing to enforce the right of the corporation. This type of suit is referred to as a "derivative action." In effect, the corporation is suing the director or officer to enforce the corporation's rights, typically because of an alleged breach of the director's or officer's duty of care or duty of loyalty to the corporation.
- A director or officer may be held independently liable under various statutory provisions concerning issues such as employment practice claims, environmental claims, tax delinquencies or antitrust claims.

Another source of possible liability arises in the context of corporate loans. Washington law prohibits nonprofit corporations from making loans to directors or officers. Any director who votes for or assents to such a loan and any officer who participates in making such a loan will be jointly and severally liable to the corporation for the loan amount until the loan is repaid.

b. Indemnification

Directors and officers of a nonprofit corporation typically will want the corporation to have a program of indemnification to the maximum extent permitted by applicable law. In Washington, a nonprofit corporation may indemnify its officers and directors to the same extent as a for-profit.

A corporation may indemnify its directors and officers whether or not they successfully defend against a suit, so long as the director or officer acted in good faith and reasonably believed that actions taken on behalf of the corporation were in the corporation's best interests, and that any other actions (i.e., actions taken in their individual capacities) were not opposed to the corporation's interests.

In a criminal proceeding, indemnification is allowed only if the director or officer had no reasonable cause to believe the conduct was illegal. A corporation may not indemnify a director or officer if the director or officer is found to be liable to the corporation or if the director or officer received an improper personal benefit.

A nonprofit corporation may pay for or reimburse the reasonable expenses incurred by a director or officer who is a party to a proceeding in advance of the final settlement of the proceeding if the director or officer states in writing that he or she acted in good faith and reasonably believed that his or her conduct was in the corporation's best interests and the director or officer states in writing that he or she will repay the advance if it ultimately is determined that the standard of conduct described above was not met.

The corporation must authorize an advance of expenses by a provision in its articles of incorporation or bylaws or by resolution adopted by the board of directors.

If a corporation indemnifies or pays the expenses of a director's or officer's defense against liability, the corporation must provide a written report to its members (if any) before the next members' meeting (note: this provision only applies if a corporation has "members").

c. Statutory Protections

A corporation's articles of incorporation or bylaws may contain certain provisions that eliminate or limit the personal liability of a director to the corporation. Such provisions, however, may not eliminate or limit the liability of a director for acts or omissions that involve:

- Intentional misconduct by a director;
- A knowing violation of law by a director; or
- Any transaction from which the director will personally receive a benefit in money, property or services to which the director is not legally entitled.

Limiting a director's personal liability is discretionary on the part of the corporation, and may be incorporated into an organization's articles. There is no similar provision for officers.

Both officers and directors of nonprofit corporations are afforded some protection against personal liability to third parties under Washington's special immunities law. A director or officer of a nonprofit corporation is not individually liable for any discretionary decision or failure to make a discretionary decision within his or her official capacity as a director or officer unless the decision or failure to decide constitutes gross negligence.

A federal statute entitled the Volunteer Protection Act of 1997 (the "Volunteer Act") may also provide some protection to directors and officers of nonprofit corporations. This statute, which took effect in September 1997, provides immunity from personal liability to volunteers, including unpaid directors and officers, working for nonprofit corporations for acts or omissions within the scope of their assigned responsibilities. To qualify for protection under the Volunteer Act, certain criteria must be met:

- A person seeking protection under the Volunteer Act must be a "volunteer." The Volunteer Act defines a volunteer as a person who provides services to a nonprofit organization but does not receive compensation or anything of value in excess of $500 per year for his or her services. Thus, if a nonprofit corporation's directors or officers receive compensation for their services, the Volunteer Act's protection will not apply. A director or officer may, however, receive reimbursement of his or her expenses.

- The volunteer must have been acting within the scope of his or her responsibilities for the organization at the time the harm took place. In other words, the officer or director must have been acting in his or her capacity as an officer or director of the corporation, rather than in some other capacity, such as volunteering at a fundraising event.

- The officer or director must show that the harm in question was not caused by his or her willful or criminal misconduct, gross negligence, reckless misconduct or a conscious, flagrant indifference to the rights or safety of others. Although these terms are all legal terms with specific meanings under Washington law, generally, merely being careless or inattentive is not considered willful, gross or reckless conduct.

There are several important things that the Volunteer Act does not do. Perhaps most importantly, the Volunteer Act does not prevent individuals acting as

volunteers from being sued or being named in a lawsuit. Instead, the Volunteer Act provides an affirmative defense to liability, which lawyers for the volunteer would raise in the course of the litigation. Although a volunteer might be named as a defendant in the initial stages of the case, it is very likely that the claims would be dismissed early in the process, assuming all the criteria of the Volunteer Act are satisfied.

The Volunteer Act does not protect the nonprofit organization itself from liability for harms suffered in the course of its activities. The organization may be held responsible for the acts or omissions of the persons working for it, even if the persons cannot be held individually liable. Finally, the Volunteer Act does not prevent nonprofit organizations from suing their volunteers for misconduct. Thus, if an officer or director harms the organization in some way, the organization still can bring suit against such officer or director without the protection provided by the Volunteer Act being invoked.

CHAPTER 21. Directors' and Officers' Insurance

A nonprofit corporation may purchase liability insurance on behalf of its directors and officers to cover certain claims. A directors' and officers' insurance policy ("D&O insurance") will generally provide coverage for liability claims against a director or officer whether or not the corporation indemnifies that individual. Directors and officers will often want the corporation to provide D&O insurance even if the corporation's articles of incorporation or bylaws have generous indemnification provisions.

D&O insurance provides three types of coverage: (1) coverage for the corporation's directors and officers when the corporation does not indemnify them; (2) coverage for the corporation for amounts the corporation actually pays directors and officers for indemnification; and (3) coverage for claims brought against the corporation. D&O insurance policies usually cover defense costs as well as liabilities arising from individual officers or directors allegedly committing "wrongful acts," which will be defined in the policy. Most D&O insurance policies exclude claims based on:

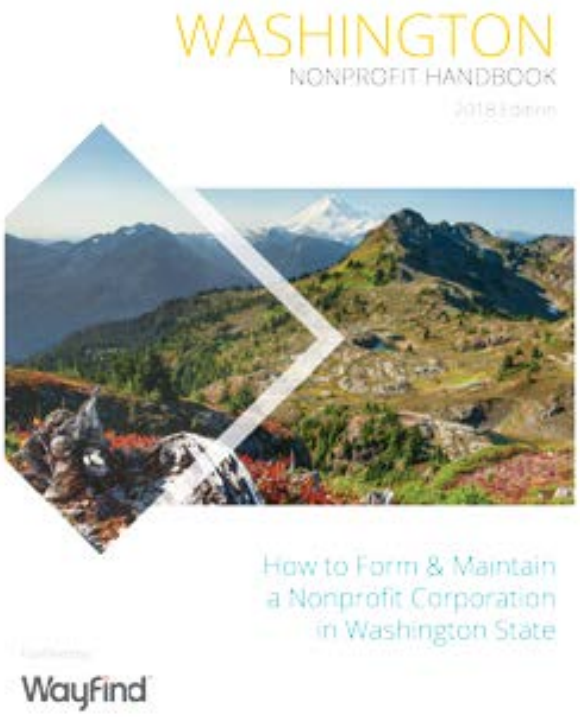
- Dishonest, fraudulent, or criminal acts. Even if the policy does not specifically exclude coverage for claims based on such conduct, most definitions of "wrongful act" specifically include only negligent conduct;

- Fines, penalties or punitive damages;

- Intentional conduct such as libel and slander—as a general rule, insurance does not cover intentional conduct;
- Bodily injury or property damage;
- A director or officer gaining any personal profit or advantage to which he or she was not legally entitled;
- ERISA claims;
- Employment claims;
- Claims brought by the corporation against its own directors or officers; or
- Losses covered by other insurance.

D&O insurance policies are generally claims-made policies. That is, a claim must be both made and reported during the policy period for there to be coverage. Therefore, it is extremely important to notify the carrier the moment the corporation or its directors or officers recognize that a claim may be made. D&O insurance policies may give the insurer the right to choose defense counsel, or, more often, may limit the policyholders' choice of counsel. D&O insurance policies generally require the policyholder to notify the carrier of all settlement offers and obtain its consent before accepting them. It is very important to recognize that, while D&O insurance policies generally require a carrier to pay ongoing defense costs, such payment can be charged against the policy's liability limit, reducing the amount available for payment of a judgment or settlement.

The elements of D&O insurance such as deductibles, co-insurance levels, exclusions and other aspects can vary significantly. The board committee dealing with insurance issues should review such items carefully and should consider consulting an insurance broker knowledgeable in this field. Except for exclusions for intentional conduct, other exclusions and coverage features can often be changed through negotiation with the carrier and/or payment of additional premium.



Part 4 Obtaining Recognition As A Code Section 501(C)(3) Organization

Chapter 22 Considerations in Determining Whether (and When) to Seek Code Section 501(c)(3) Status
Chapter 23 Applying with the Form 1023EZ
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PART 4. OBTAINING RECOGNITION AS A CODE SECTION 501(C)(3) ORGANIZATION

CHAPTER 22. Considerations in Determining Whether (and When) to Seek Code Section 501(c)(3) Status

Obtaining recognition as an organization exempt from federal income taxes under section 501(c)(3) of the Internal Revenue Code of 1986, as amended (also referred to as the "section 501(c)(3);" organizations exempt from federal taxes under Code section 501(c)(3) also referred to as a "501(c)(3) organization") requires (1) forming a nonprofit corporation or other suitable nonprofit entity under the law of a state, and then (2) completing and filing IRS Form 1023 or IRS Form 1023EZ. This Part describes the preparation of Form 1023 or IRS Form 1023EZ. *See* Chapter 23 Applying with the Form 1023EZ, for more information on the Form 1023EZ.

Federal tax-exempt status under section 501(c)(3) provides advantages including (1) tax benefits for some contributors to the organizations, (2) eligibility for private foundation grants, and (3) an exemption from the federal corporate income tax on most net income. However, to obtain this tax-exempt status, an organization must operate in compliance with certain restrictions: (1) its purpose must be charitable, (2) it cannot provide financial benefits to private individuals, (3) it cannot promote or oppose candidates for public office, and (4) its lobbying activities are restricted. Before deciding to proceed with an application for 501(c)(3) status, it is worth considering whether the advantages of this status are important to achieving the organization's goals, and whether the restrictions would materially impede the organization's ability to accomplish its goals. Also, it is worth considering whether the organization will meet the criteria necessary to qualify as a public charity and, if not, what the effect would be of needing to comply with the more restrictive rules applicable to private foundations.

a. Why Seek Code Section 501(c)(3) Status

A 501(c)(3) organization enjoys a variety of tax-related and other benefits.

(i) Individual and Gift and Estate Tax Deduction

One of the biggest advantages of being a 501(c)(3) organization is that the organization may receive contributions that also benefit the donor—in fact, 501(c)(3) organizations are the only organizations to which people can make tax-deductible charitable contributions. A donor who contributes to a 501(c)(3)

organization may be entitled to an income tax deduction, a gift and estate tax deduction, or both. Donors are subject to limitations on the deductions they can claim for charitable contributions in any given year. Donors should consult their tax advisors regarding the tax implications of their gifts.

(ii) Grants From Private Foundations

Private foundations, which often are grantmaking organizations, typically will distribute funds only to 501(c)(3) organizations that qualify as "public charities." (Private foundation status and public charity status are discussed below.) It is worth noting that private foundations are, in fact, permitted to make grants to any type of entity, provided that such grants are made in furtherance of the private foundation's 501(c)(3) purposes and provided that the private foundation complies with certain administrative requirements under section 4945 of the Code; however, because these administrative requirements can be burdensome, many private foundations choose to make grants only to 501(c)(3) public charities.

(iii) No Tax on Net Revenue

501(c)(3) organizations and the organizations described under other section 501(c) categories in the Code share the advantage of exemption from paying federal income tax on income related to their tax-exempt function and often on investment income as well.

(iv) Other Advantages

Other advantages include:

- Federal tax-exempt status is necessary for certain state and local tax benefits (e.g., exemptions from property tax, B&O tax and admissions taxes, as further discussed in Chapters 51-57).
- 501(c)(3) organizations are exempt from federal unemployment tax ("FUTA").
- Exempt organizations may qualify for bulk mailing rates.
- 501(c)(3) organizations may be permitted to engage in bingo or other gaming activities that otherwise would be prohibited.

b. Requirements and Limitations on 501(c)(3) Organizations

Organizations that obtain 501(c)(3) tax-exempt status must operate in accordance with specific rules applicable to 501(c)(3) organizations.

(i) Permissible Purposes

In order to gain recognition as a 501(c)(3) organization, an organization must be organized and operated exclusively for one or more of the purposes specified in section 501(c)(3) (e.g., charitable, educational, religious, literary or scientific purposes, fostering national or international amateur sports competition, testing for public safety or prevention of cruelty to children or animals). In addition, a 501(c)(3) organization must serve public rather than private interests. Generally, this means that its activities benefit a large and indefinite class of individuals (e.g., the general public, homeless people, youth), rather than a small identifiable group (e.g., residents of a single neighborhood, employees of a small company). The organization may not be organized or operated for impermissible private interests such as those of specifically designated individuals, the creator of the organization or his/her family, or persons (including companies) controlled, directly or indirectly, by such private interests.

Treasury Regulations provide that "charitable" includes "relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening the burdens of government; and the promotion of social welfare by organizations designed to accomplish any of the above purposes." *See* Treas. Reg. Section 1.501(c)(3)-1(d)(2). Some of these purposes are described in more detail below; however, a comprehensive discussion of permitted section 501(c)(3) purposes is beyond the scope of this Chapter. A more detailed discussion of permissible Code section 501(c)(3) activities is included in Chapter 3 of IRS Publication 557, available at http://www.irs.gov.

Descriptions of Common Categories of Charitable Purposes
Relief for the poor, distressed or underprivileged includes: a. helping low-income persons find employment; b. promoting the rights of public housing tenants; or c. providing other social services like low-income housing, food, or health services.

Descriptions of Common Categories of Charitable Purposes

Advancement of religion includes:

a. constructing or maintaining a church building, monument or burial grounds, or

b. peripheral services like providing music, distributing religious literature and maintaining missions.

Advancement of education includes the instruction or training for the purpose of improving or developing capabilities and/or the instruction of the public on subjects useful to the individual and beneficial to the community. Educational organizations might:

a. operate a primary or secondary school, a college, or a professional or trade school that has a regularly scheduled curriculum, a regular faculty, and a regularly enrolled body of students in attendance at a place where the educational activities are regularly carried on;

b. present public discussion groups, forums, panels, lectures, or other similar programs;

c. operate museums, zoos, planetariums, symphony orchestras, theatres, and other similar organizations; or

d. produce arts performances such as plays, music or dance.

Organizations formed to beautify and maintain the community may:

a. preserve a park or lake for public use;

b. promote city beautification projects; or

c. educate the public about advantages of planting trees in public areas.

Examples of the promotion of health include hospitals, outpatient clinics, homes for the elderly, and advancing medical knowledge through research.

Organizations engaged in promoting social welfare generally are involved in solving urban problems, easing racial tensions, furthering historic preservation, or improving the environment. Examples include organizations that:

a. construct low-income housing and renovate existing housing for low-income persons;

b. furnish low-interest loans to local businesses in depressed inner-city areas;

c. convert blighted inner-city property into industrial parks and give rental preference to employers who employ otherwise unemployed individuals; or

d. promote youth sports to combat juvenile delinquency.

(ii) No Private Inurement

A 501(c)(3) organization may not distribute its revenue or assets to benefit any private individuals. Called "inurement," this applies to those who have an opportunity to control or influence the organization's activities, such as directors or officers. *See* Chapters 29 and 30 for a more detailed discussion on private inurement and intermediate sanctions.

(iii) Restrictions on Lobbying and Prohibition of Political Activities

Chapter 32 describes the rules and restrictions 501(c)(3) organizations must follow with respect to lobbying and political activities.

(iv) Limitations on Unrelated Business Activity

As discussed in Chapter 33, an organization that engages in unrelated business activity may have some taxable income and may jeopardize its tax-exempt status if such activity is substantial relative to the organization's tax-exempt activity.

(v) Public Disclosure Requirements

As discussed further in Chapter 35, a 501(c)(3) organization must make certain documents available for public inspection.

(vi) Nondiscrimination

A 501(c)(3) organization should not discriminate. Race discrimination is strictly prohibited. An institution that racially discriminates cannot qualify for tax-exempt status as a charitable organization. In 1993, the United States Supreme Court held in the famous case of *Bob Jones University v. United States* that private schools that racially discriminate may not be tax-exempt and are not eligible for deductible charitable contributions. The rule against racial discrimination applies to all entities seeking tax-exempt status, not just private educational institutions.

c. Public Charities and Private Foundations

501(c)(3) organizations are divided into two broad categories: private foundations and public charities. An important consideration in applying for 501(c)(3) status is determining whether the organization will qualify for one of the enumerated public charity categories. If an organization qualifies as a 501(c)(3) organization but cannot establish that it qualifies for one of the public charity

categories specified under section 509(a) of the Code (and discussed further below), the organization is, by default, a private foundation. Generally, a private foundation receives most of its support from one or a limited number of sources, such as a single family or corporation. Unlike public charities, private foundations pay tax on their investment income. Also, private foundations are subject to additional rules and restrictions that do not apply to public charities.

(i) Public Charities

Public charities are covered in sections 509(a)(1) through 509(a)(4) of the Code. They include (a) entities that are considered inherently public by virtue of their activities (i.e., churches, schools, hospitals and medical research organizations); (b) publicly supported organizations (including both (i) organizations that normally receive a substantial part of their support from gifts, grants and contributions from the general public and (ii) organizations that normally receive more than one-third of their support from grants, contributions, membership fees, and gross receipts derived from activities related to their exempt function); (c) supporting organizations that are controlled by or in connection with one or more public charities; and (d) organizations organized and operated exclusively for testing for public safety.

Chapter 3 of IRS Publication 557 includes a detailed discussion of how private foundation status and public charity status are determined. It is worth spending time with this section of Publication 557 and determine which, if any, of the public charity categories apply to your organization before you begin drafting your organization's Form 1023 (application for 501(c)(3) status). This will help you ensure that you present information in your application that is relevant to the type of public charity or private foundation status you hope to obtain.

(ii) Disadvantages of Private Foundation Status

Federal tax law treats private foundations less favorably than public charities. Unlike public charities, private foundations must pay tax on their investment income, are prohibited from engaging in any lobbying activity and are subject to a variety of other highly technical and complicated requirements regarding how to invest their assets and conduct operations. Failure to comply with these rules can result in excise taxes imposed on the private foundation as well as on its officers, directors or trustees. If your organization is a private foundation, you should consult a legal professional.

The special restrictions and excise tax rules applicable to private foundations are set forth under sections 4940 through 4944 of the Code. They include:

- **Excise Tax Based on Investments.** Section 4940 imposes a 1-2% excise tax on investment income, such as interest, stock dividends, capital gains and other passive income.

- **Taxes on Self-Dealing.** Under section 4941, transactions between a private foundation and certain organizational insiders (including private foundation managers, large contributors and companies owned by large contributors) generally are prohibited unless a special exception applies.

- **Taxes on Failure to Distribute Income.** Each year a private foundation must distribute a minimum amount of its income for charitable purposes. If it does not, it will be subject to an excise tax under section 4942.

- **Taxes on Excess Business Holdings.** A private foundation may be subject to an excise tax under section 4943 if it owns more than a certain percentage of a trade or business enterprise.

- **Taxes on Investments that Jeopardize Charitable Purposes.** Under section 4944, a private foundation may be subject to excise tax if it cannot carry out its charitable purposes by making high-risk investments. This tax provides an incentive for private foundation managers to be prudent when investing private foundation funds.

- **Taxes on "Taxable Expenditures."** Section 4945 imposes a tax on amounts spent by private foundations that are used for carrying on propaganda or otherwise attempting to influence legislation, influencing the outcome of political campaigns, and making expenditures for noncharitable purposes. Section 4945 further regulates the use of private foundation funds for certain other activities by placing limitations on grants to individuals for travel, study, or other similar purposes (unless the private foundation follows certain procedures approved in advance by the IRS) and by taxing grants made to organizations other than public charities (unless the grantor private foundation exercises expenditure responsibility with respect to such grants).

d. When to Seek 501(c)(3) Status

New organizations normally have up to 27 months to submit a Form 1023 or a Form 1023EZ to the IRS. When a new organization files its Form 1023 or Form 1023EZ, and a favorable determination is issued by the IRS, the favorable determination is retroactive to the date of incorporation. When a Form 1023 is filed late and no exception applies, the IRS grants 501(c)(3) status effective beginning with the date postmarked on the application envelope. When a Form 1023EZ is filed late and no exception applies, the IRS grants 501(c)(3) status effective as of the date the Form 1023EZ is submitted online at www.pay.gov.

TIP:

New organizations should begin filing their Form 990 Return of Organization Exempt From Income Tax (annual tax return) even if the organization has not filed their Form 1023 or Form 1023EZ or received their approval of their tax-exemption application. *See* Chapter 35 for more information on the Form 990. Note that if an organization does not file the Form 990 for three consecutive years, their 501(c)(3) tax-exempt status will be automatically revoked and the organization will have to refile a Form 1023 to reinstate the organiztation's tax-exemption.

e. Considerations for Organizations Not Required to File for 501(c)(3) Status

Even though churches, organizations created before October 1969, and publicly supported organizations whose gross receipts average less than $5,000 per year are not required to file, there are benefits to filing:

- Section 508 of the Code provides deductibility of contributions for churches and small organizations, but the burden of proof for tax deductibility is on the donor. A church or small organization might choose to apply for 501(c)(3) recognition to save donors inconvenience during an audit.

- Almost every grantmaking agency, public or private, requires a 501(c)(3) determination letter from grant applicants regardless of whether the nonprofit is a church or a small organization.

- Other state and federal agencies, such as the Postal Service or the Washington Gambling Commission, may require proof of exempt

status before issuing permits or exemptions. Each agency has its own rules, which may not provide exceptions for churches and small organizations. Such organizations might have to apply for 501(c)(3) recognition to satisfy other governmental agencies.

- Failing to apply for tax-exempt status can sometimes undermine an organization's credibility with the press or the public. Obtaining 501(c)(3) recognition may be an important part of the image it wants to convey.

- An organization that expects to have employees can save a small amount of payroll taxes by applying for 501(c)(3) recognition, because it is exempt from federal unemployment tax.

CHAPTER 23. Applying with the Form 1023EZ

a. General Information about the Form 1023EZ

The IRS has provided a new Form 1023 for small organizations, called the Form 1023EZ. It is a simplified form for organizations that meet the certain eligibility requirements. The application is made online through the IRS website. You must register for a Pay.gov account and pay the application fee of $275 by credit or debit card or bank account payment. The form must be filed within 27 months of the organization's incorporation date.

b. Eligibility to use Form 1023EZ:

To meet the threshold eligibility requirements, the organization must:

- Have annual gross revenue of $50,000 or less; and

- Have assets of $250,000 or less.

The Instructions for Form 1023EZ contain an eligibility worksheet, located at the back of the instructions. The worksheet should be completed by hand before completing the Form 1023EZ. The responses to the worksheet questions will determine whether the organization will qualify to apply for tax-exemption using the Form 1023EZ.

The following organizations do not qualify:

- Foreign organizations

- Limited liability companies
- Churches, school, hospitals or HMO's
- Credit counseling organizations
- Joint ventures with for-profit entities
- Private operating foundations

If the organization answers "Yes" to any of the worksheet questions, it is not eligible to use Form 1023EZ to apply for exemption under section 501(c)(3). Organizations that are not eligible to file the Form 1023EZ can use the full Form 1023 to apply for tax-exempt status under section 501(c)(3).

c. Preparation and Completion of the Form 1023EZ

TIP:

It is helpful to download and print a copy of the Form 1023EZ from pay.gov and complete the form by hand before you attempt to complete the form online.

In preparation for filing the Form 1023EZ, gather the organization's articles of incorporation, as filed with the Secretary of State's office, the bylaws and the names, titles and addresses of the members of the board of directors. Review the instructions to resolve any issues or questions before going online and attempting to complete the application.

The Form requests a description of the organization's tax-exempt 501(c)(3) purposes and the activities to be conducted to further those purposes. This description is limited to 255 characters, so a response must be carefully considered.

TIP:

It may be helpful to type up the description of the organization's purposes and activities using Microsoft Word or other word processing software that counts text characters, so that you can determine when you are at 255 characters. You will then be able to cut and paste from your Word document to the online Form 1023EZ.

The Form 1023EZ contains the following specific sections:

- Attestation of eligibility
- Part I – Identification of the applicant
- Part II – Organizational structure
- Part III – Specific activities
- Part IV – Foundation classification
- Part V – Reinstatement after Automatic Revocation
- Part VI – Signature

To file the form, log in to https://www.pay.gov/public/home and fill out the actual Form 1023EZ based on the prepared draft. An officer, director or a person so authorized by the board of directors should sign the form electronically when it is completed and pay the filing fee of $275 using one of the online methods.

TIP:

Save your work and download a PDF version for the corporation's records.

According to the IRS website, you can expect to be contacted within 90 days from the date the Form 1023EZ was submitted. If you haven't been contacted after the 90 days, you can call the toll-free IRS Customer Account Services number at (877) 829-5500 to check on the status. Be sure to have the organization's full name and EIN with you.

CHAPTER 24. Assembling Your Form 1023 Application

An organization applies for 501(c)(3) status by submitting Form 1023 (also known as the Application for Recognition under section 501(c)(3)). In addition, depending on the organization's circumstances, it may submit other IRS forms along with this application (e.g., a power of attorney, if the organization is represented by someone other than an officer in connection with filing its application and/or an election to make lobbying expenditures). This Chapter describes the information you will need to complete your Form 1023, as well as the documents and other forms that you may submit with your application. In

addition, it provides tips that will help you compile your application in a manner that facilitates IRS review.

TIP:

All IRS forms discussed in this Chapter are available at http://www.irs.gov by clicking on "Forms and Instructions" on the IRS home page and searching for the appropriate Form and/or Form Instructions.

a. Before Assembling Your Application: Form SS-4

An organization should use Form SS-4 (Application for Employer Identification Number) to apply for its EIN before submitting its Form 1023. The quickest and easiest way to obtain an EIN is through http://www.irs.gov/formss4.

TIP:

Download and complete the Form SS-4 before completing the online application for EIN, so that you have all the information you need on hand. The online application is timed. Click on "Apply for an Employer Identification Number (EIN) Online" from the IRS homepage.

Alternatively, download the Form SS-4 from the IRS website, complete it, have it executed by an officer of the organization an then fax it to the IRS at (859) 699-5760. Be sure to enter a "fax-back" number on the SS-4. Once the EIN is assigned, enter it on every page of the Form 1023 (Part I, line 44, in the upper right-hand corner of each subsequent page and on all attachments to the Form 1023).

b. Ancillary Forms: Form 5768 and Form 2848

Depending on the organization's circumstances, it may file one or both of the following forms along with its Form 1023:

(i) Form 5768 Election/Revocation of Election to Influence Legislation

This is required if the organization has decided to elect to make expenditures to influence legislation under section 501(h) of the Code. *See* Chapter 32 for a more detailed discussion regarding deciding whether to make this election.

(ii) Form 2848 Power of Attorney

This is required if the organization will be represented, or the various IRS forms signed, by someone other than an officer or director, such as the organization's lawyer.

> **TIP:**
>
> When submitting a Form 2848, be sure that the date accompanying the officer's signature (Part I, line 7) is the same date as, or an earlier date, than the date accompanying the signature of the authorized representative under Part II.

The Form 1023 must be signed by an officer of the organization, regardless of whether a Form 2848, designating another individual to have power of attorney, is submitted.

c. Gathering Necessary Documents and Information

Form 1023 asks for information regarding the organization's activities and finances. Although daunting, it may be useful to think of this application as analogous to a business plan. Hopefully, the exercise of responding to the detailed questions posed by the application will help establish a well-thought-out road map to the organization's development. Below, is a list of the documents and information that should be gathered to prepare for Form 1023.

(i) Required Documents

Before drafting responses to Form 1023, gather the following documents, which will be incorporated into the final submission:

- **Articles of Incorporation.** A copy of the articles of incorporation must be submitted (bylaws alone are not enough). Articles of incorporation should have the Secretary of State's date stamp on the first page. The articles of incorporation must meet the "Organizational Test" two requirements: (a) the statement of purposes in the articles of incorporation must be limited to one or more tax-exempt charitable purposes and may not authorize the carrying on of any activities that are not in furtherance of one or more exempt purposes (unless they are insubstantial), and (b) the organization must dedicate its assets to one or more exempt purposes, which occurs in the dissolution

provision of the organization's articles. Such a provision may require that the organization's assets be distributed for one or more exempt purposes, be distributed to the federal government or to a state or local government for a public purpose, or be distributed by a court to another organization to be used in a manner as in the judgment of the count will best accomplish the general purposes for which the dissolved organization was organized. The sample articles of incorporation available online at https://wayfindlegal.org/tools/legal/ contain provisions for meeting the organizational test.

- **Bylaws.** The bylaws are a legal document that governs the board of directors and how decisions are made at the board level. The bylaws must be adopted by the board of directors.

- **Conflict of Interest Policy.** Although an organization is technically not required to have such a policy, the IRS strongly suggests that every organization adopt one, and the Instructions to Form 1023 include a sample document that can be adopted and included as part of the application. *See* sample Conflicts of Interest Policy online at https://wayfindlegal.org/tools/legal/.

(ii) Required Information

Before drafting responses to the Form 1023, gather the following information:

- **Description of Activities.** Form 1023 requires a description of the organization's past, present and planned activities. With respect to each activity, describe (a) what the activity is; (b) who conducts it; (c) where it will take place; (d) when the activity is conducted; (e) how it will be funded; (f) how it furthers the organization's tax-exempt purposes; and (g) what percentage of the organization's total time is dedicated to such activity.

- **Director/Officer Resumes.** Form 1023 asks for qualifications of the organization's officers, directors, trustees, highest compensated employees (who receive over $50,000 per year) and highest compensated independent contractors (who receive over $50,000 per year). The resumes or summaries of qualifications do not need to be extensive for volunteer officers and directors. Highly compensated

officers, directors and other individuals should have more detailed resumes or summaries of qualifications.

- **Financial Data.** Form 1023 requires historical and/or projected financial data. If the organization has been in existence for four or more years, it must provide information regarding its revenues and expenses regarding the past four years. If it has been in existence for more than one year, but less than four years, it must provide revenue and expense information for each year it has been in existence, plus projected revenue and expense information for a total of three years of financial information. If the organization has been in existence for less than one year, it must provide projections of its likely revenues and expenses for the current year and the two subsequent years, based on reasonable and good faith estimates of its future finances.

(iii) Information to Include if Applicable

Form 1023 asks for a variety of other documents and information, which may or may not be applicable to your organization. Gather the following documents if they are relevant to the organization and its activities:

- **Printed materials.** Printed materials that describe the organization's history, its activities and/or its plans for the future, which might include newsletters, brochures, pamphlets, descriptive literature, published materials, etc.

- **Materials Prepared for Members.** If the organization is a membership organization, any materials prepared for members, such as membership application forms, promotional materials, sample membership certificates or identification cards, sample copies of member-only publications, etc.

- **Clippings.** If the organization has received media coverage, include copies of newspaper clippings, transcripts of interviews, etc.

- **Events.** If appropriate, a "schedule of events," showing where and when the organization has held informational, educational, performance or other events during the last 12 months, including approximate attendance.

- **Fundraising Activities.** Information regarding the organization's fundraising plans, including how it plans to raise funds and in which jurisdictions it will undertake such activities.

- **Grantmaking Activities.** If the organization will be making grants to other organizations:

    - Copies of any grant agreements;

    - A description of grant records;

    - Information regarding the selection process, including whether a grant proposal or application is required; and

    - A description of procedures for oversight of distributions to ensure that resources are used for tax-exempt purposes (e.g., conducting pre-grant inquiry and/or requiring periodic or final reports regarding the use of grant funds).

- **Scholarships or Grants.** If the organization will have a scholarship or grant program:

    - A description of how potential applicants will hear about the program;

    - A description of eligibility requirements;

    - A sample of required application form(s);

    - A description of the selection process, including a description of any selection committee and how members are chosen;

    - Any guidelines prepared for the selection committee's use;

    - Conditions placed upon grants or scholarships, including any requirements for reports and a description of action that will be taken if the terms of the grant are violated; and

    - Records the organization keeps regarding its grants or scholarships.

- **Other Materials.** If relevant, gather the following:

    - Copies of leases, loan agreements or other contracts between the organization and its officers, directors, highest compensated employees, highest compensated independent contractors or any entity in which any of the above individuals owns more than a 35% interest;

    - Independent appraisals or other data substantiating the value of any assets the organization is renting or purchasing from related parties; and

    - Copies of any agreements pursuant to which another individual or organization will raise funds for the organization or pursuant to which the organization will raise funds for any other organization.

- **Information Required for Schedules.** Form 1023 has a number of schedules, including special schedules if the organization is a church, school, hospital or supporting organization or provides low-income housing or provides scholarships. If any of the Form 1023 schedules applies to the activities of your organization, be sure to review the applicable schedule and gather the required information.

d. Tips for Completing Form 1023

(i) General Considerations

If the Form 1023 does not permit enough space to answer the question posed, say "Please See Attachment" or "Please See Exhibit Attached" and attach a word document or spreadsheet. Inserting these in the appropriate spot within the pages of the application itself (i.e., behind the page of the application that references the attachment) will facilitate IRS review by making it easy for the IRS agent to find your attachments. Be sure to label each attachment with the organization's name and employer identification number and the question number to which the attachment relates.

In completing the application, it is important to be as transparent as possible regarding the organization's activities, finances, etc. If information relevant to a question has been provided in a prior part of the application, cross-referencing is acceptable. For example, if an organization intends to make grants to support

foreign charitable organizations, it might describe this activity in detail in its narrative description of activities under Part IV. The organization's responses to Part VIII, questions 13 and 14, might then cross-reference "Attachment 1, responses to Part IV."

(ii) Walk Through Form 1023

Refer to the Instructions for Form 1023 for guidance in completing the application. As noted above, the instructions, like Form 1023 itself, can be downloaded from http://www.irs.gov by clicking on "Forms and Instructions." This Chapter does not provide line-by-line instructions for completing Form 1023. Instead, below are tips intended to supplement the IRS instructions.

- **Part IV. Narrative Description of Your Activities**

This is the heart of the application. The narrative can make or break the application. One approach is to start with the formula:

> [Name of organization] is organized exclusively for [religious, charitable, scientific, literary or educational (choose one or more)] purpose(s) within the meaning of Code section 501(c)(3). Specifically, [Name of organization] (describe in one or two sentences what the organization does).

In succeeding paragraphs, define the problem the organization hopes to solve, using specific data or statistics if available. Try to cover WHO, WHAT, WHEN, WHERE, HOW, etc. Examples:

- Who will the organization's members, clients or patrons be? Who will carry on the activities of the organization?

- What will the organization offer to these individuals or entities? What will the organization charge? What will take place at a typical meeting or event of the organization?

- When did the organization's founders begin working to further the organization's purposes? When will the organization be fully operational? When will regular meetings, events or other program activities be held?

- Where will the organization be based? Where will the organization obtain its funding?
- How will members, clients or patrons hear about the organization's activities?
- How many members, clients or patrons does the organization expect to serve?
- How is the organization distinguishable from for-profit entities, if any, with similar activities?

If your organization plans to engage in activities or operate in a manner that may raise concerns for the IRS, it is best to address these issues head-on. For example, explain that "The organization accepts paid advertising in its newsletter and will file Form 990-T, and pay any tax due," or "Although the organization performed referral services for members in the past, this activity never constituted more than 1% of the organization's overall activities, and the board voted to discontinue this activity on [insert date]."

Part V. Compensation and Other Financial Arrangements

- **Line 1b & 1c**

Line 1b asks for compensation and other information regarding any employee who will receive more than $50,000 per year from the organization. If no employee is expected to receive more than $50,000 per year, simply state this fact. Line 1c asks whether any independent contractor is expected to receive more than $50,000.

- **Line 2b**

Line 2b asks whether the organization has a business relationship with any of its officers, directors or trustees, other than through their position as an officer, director or trustee. Answer "yes" to this question if, for example, the organization plans to contract with one of its directors to provide services to the organization.

- **Lines 4a-4g**

Form 1023 indicates that practices regarding compensation for officers, directors, trustees and highly compensated employees and independent contractors reflected in this question are recommended, but not required.

Nevertheless, answering "no" to any of these questions is likely to raise a red flag (or at least a yellow one) for the IRS agent reviewing the application. If the answer to any of these questions is "no", it is advisable to provide additional information describing why the organization has not adopted a particular practice and what other safeguards it has put in place to ensure that compensation paid to officers, directors, trustees and highly compensated employees and independent contractors is reasonable.

- **Lines 5a-5c**

As noted above, although an organization is technically not required to have a conflict of interest policy, the IRS strongly suggests that every organization adopt such a policy. The Instructions to Form 1023 include a sample document that can be adopted and included as part of the application. A sample conflicts of interest policy is available at https://wayfindlegal.org/tools/legal/.

- **Lines 6a & 6b**

While 501(c)(3) organizations are not prohibited from compensating individuals through nonfixed payments, such as discretionary bonuses or revenue-based payments, such arrangements must be carefully designed to ensure that they are reasonable and consistent with the rules applicable to 501(c)(3) organizations. See the discussion regarding intermediate sanctions in Chapter 30 if the organization intends to pay discretionary bonuses or make revenue-based payments, particularly if the organization will make such payments to directors, officers or highly compensated employees. It is advisable to do market research of similar organizations to determine whether compensation arrangements are appropriately structured.

- **Lines 7a & 7b**

It is preferable to truthfully answer "no" to both line 7a and 7b. A "yes" answer will likely raise a red flag with the IRS. As indicated in the IRS instructions, you do not need to answer "yes" simply because directors, officers or other persons described in this question can purchase goods or services from the organization on the same terms as the general public. Nevertheless, if the answer to either question is "yes", you may be able to alleviate IRS concern by indicating that the purchase or sale of goods or services between the organization and the officer, director or other person described in this question will be approved consistent with the rebuttable presumption set out under the intermediate sanctions regulations. *See* Chapter 30.

- **Lines 8 and 9**

As indicated with respect to line 7 above, a "yes" answer may raise concerns for the IRS. Address these concerns by demonstrating that the organization understands and will follow the requirements necessary to obtain the rebuttable presumption of reasonableness under the intermediate sanctions regulations.

Part VI. Your Members and Other Individuals and Organizations That Receive Benefits From You

- **Line 1a**

Answer "yes" if the organization provides goods or services to individuals (e.g., educational programs for youth or food to homeless people). If the organization provides goods or services to individuals, demonstrate that these goods or services are provided in a manner that serves a charitable class, rather than a small, identifiable group of individuals. Also, if the organization sells goods or services, as opposed to giving them away, show that the sales are structured in a manner that is different from the way a for-profit entity would operate. For example, do not say that the organization's charges are based on cost. Instead, survey what other nonprofits offering similar goods or services charge and base fees on that research. Then consider setting fees at a level that most people likely to need your services can afford; set your fees as low as possible, with the difference to be made up by donations; or establish a sliding scale for fees based on income and family size.

- **Line 1b**

As with line 1a above, the key is to show how the provision of goods or services to organizations furthers your 501(c)(3) purposes. This may be easy if goods or services are provided to other tax-exempt organizations or government entities (e.g., by conducting park cleanups or providing free computers to small community-based nonprofits). However, if goods or services are sold, distinguish these activities from the manner in which a for-profit entity would operate. (See comments regarding line 1a of Part VI above.)

- **Line 2**

If the answer to this question is "yes," indicate that the class of individuals to whom the organization provides services is a large and indefinite group (e.g. homeless people, youth), rather than a small, identifiable group (e.g. the

organization's members, residents of a single neighborhood, employees of a small company).

- **Line 3**

Generally, the answer to this question should be "no." If the answer is "yes" (for example, because you are starting a community orchestra and you expect that relatives of your directors and officers will be among the members of the general public that will attend performances), you should explain that goods or services will be provided to such individuals only on the same terms as they are provided to the general public.

Part VII. Your History

- **Line 2**

The answer to this question should be "no." Once an organization obtains tax-exempt status, this status generally will be retroactive back to the date of the organization's formation (i.e., incorporation), provided the organization submits its Form 1023 within 27 months of the end of the month in which it was incorporated.

Part VIII. Your Specific Activities

- **Line 1**

The answer to this question should be "no."

- **Lines 2a & 2b**

If the answer to this question is "yes," provide information to show that the organization is aware of and will comply with the limitations on lobbying activity applicable to Code section 501(c)(3) organizations. If the answer to line 2a is "yes," the IRS will likely want the organization to make the Code section 501(h) election (meaning that the answer to line 2b should also be "yes"). See Chapter 32.

- **Lines 3a-3c**

If the answer to this question is "yes," review IRS Publication 3079, which provides information on gaming for tax-exempt organizations, to understand whether the organization's bingo or other gaming activity will be treated as unrelated trade or business activity and, if so, what the implications of this activity

are for the organization. This publication is available through http://www.irs.gov. It is advisable to seek advice from a lawyer or accountant.

- **Line 4b**

If the answer to this question is "yes", the IRS will want enough information to assure that any compensation paid to the organization's fundraisers is reasonable. Generally, it is best to avoid arrangements pursuant to which the fundraisers' compensation is a percentage of the funds raised for the organization.

- **Line 4e**

If the answer to this question is "yes," seek advice from a lawyer or accountant to be sure that you understand and can comply with the complex rules applicable to donor-advised funds.

- **Line 6a**

If the answer to this question is "yes," seek advice from an attorney. While 501(c)(3) organizations may engage in economic development activities, the IRS will want to be sure that such activities are sufficiently circumscribed so as to be consistent with 501(c)(3) status. The instructions to this question provide a helpful summary of the facts and circumstances in which the IRS may find it acceptable for a 501(c)(3) organization to engage in economic development activities.

- **Lines 7a-7c**

Generally, the answer to lines 7a and 7b will be "no." If the answer to either one is "yes," provide the IRS with sufficient information to show that the arrangement does not result in undue benefit to private interests and that the organization retains sufficient control over its assets. If needed provide information in response to line 7c to establish that any such arrangements are approved pursuant to the organization's conflict of interest policy.

- **Line 8**

If the answer is "yes," seek advice from an attorney.

- **Lines 9a-9d**

If the answer to line 9a is "yes," the answers to lines 9b through 9d generally also should be "yes."

- **Line 10**

If the answer to line 10 is "yes," the organization should own the intellectual property. If the organization will not own intellectual property that it produces, this may raise a yellow flag for the IRS. Consult with an attorney.

- **Line 11**

If the answer is "yes," seek advice from an attorney.

- **Line 13a**

If the answer is "yes," the IRS will require appropriate safeguards to ensure that the funds granted to other organizations will be used only in furtherance of 501(c)(3) purposes. If grants are made only to other 501(c)(3) organizations, the IRS will not require the same safeguards (e.g., applications, grant agreements and detailed record-keeping) that it expects of grants to non-501(c)(3) organizations. If the organization is a private foundation, grants to non-501(c)(3) organizations will be taxable expenditures that trigger excise tax penalties under section 4945 unless you comply with certain additional administrative requirements (e.g., expenditure responsibility or equivalency determination procedures). Thus, if the organization is a private foundation that intends to make grants to non-501(c)(3) organizations, seek advice from an attorney.

- **Line 14a**

If the answer to line 14a is "yes," the answer to line 14c should be "no" and the answers to lines 14d through 14f should be "yes". *See* Chapters 37-44 for a discussion regarding international grantmaking.

Part IX. Financial Data

- **A. Statement of Revenues and Expenses.**

The IRS usually requires both actual financial information to date and a two-year projected budget. It is difficult to predict what the financial future holds; however, the IRS requires a projected budget even if it is difficult to prepare. A good-faith estimate of future revenues and expenses is sufficient.

Some organizations find that it works best to start with the goals the group wants to accomplish, estimating, goal by goal, what the planned activities will cost, and then creating a strategy to come up with the necessary income. For other

organizations, it makes more sense to start with projected income when budgeting. For instance, a membership group can estimate the number of people who might join, as well as the amount in dues members might be willing to pay, and then decide how much of the available money will be spent on planned programs. Make sure that the description of the organization's programs in Part IV of the Form 1023 is consistent with the financial information presented here.

When completing the Statement of Revenues and Expenses, be sure to watch for the lines that request schedules and to provide such schedules as attachments.

- **B. Balance Sheet**

The Statement of Revenues and Expenses is a summary of the organization's financial activity over a period of time, while the Balance Sheet is a snapshot of what the organization owns and owes on a given date. The IRS prefers that an organization's Balance Sheet reflect its assets and liabilities at of the end of its most recently completed tax year. If the organization has not completed a tax year, provide information that is effective as of the last day of the most recent month before filing the Form 1023 with the IRS.

Part X. Public Charity Status

When the IRS issues a favorable 501(c)(3) determination letter, it is actually two rulings in one. In addition to recognition of 501(c)(3) status, the IRS rules on "Foundation Status," a sort of subcategory under section 501(c)(3). As discussed above in Chapter 22, all 501(c)(3) organizations fall into one of two broad categories—public charities or private foundations.

An organization that cannot show that it qualifies for public charity status will be considered a private foundation. Generally, private foundations receive most of their support from a limited number of sources, such as one family, one corporation, or investments. It is generally less favorable to be a 501(c)(3) private foundation, which must pay tax on income from interest, dividends, capital gains and other passive income and subject to a wide variety of investment and operating restrictions. For a more detailed discussion of this distinction, see "Public Charities and Private Foundations" in Chapter 22. Also, Chapter 3 of IRS Publication 557 and the instructions to Part IX of the Form 1023 provide useful information to help you determine the appropriate category for your organization.

- **Lines 1a & 1b- Private Foundation**

The answer to this question is "yes" if the answer to line 2 is not "yes" or if a box under line 5 is not checked. If the organization will not qualify for one of the public charity categories listed under line 5, consult with an attorney to understand and comply with the rules applicable to private foundations.

- **Line 2- Private Operating Foundation**

True "private operating foundations" are rare. An organization that believes it is a private operating foundation should have its application professionally prepared.

- **Line 5- Reason for Public Charity Status**

Some organizations are "public charities" solely because of the activities they carry on (churches-line 5a, schools-line 5b, hospitals-box 5c, or supporting organizations-line 5d). If one of these boxes is checked, complete the appropriate schedule.

Other organizations are "public charities" because they receive at least 33⅓% of their support from the general public. Organizations whose public support is mostly in the form of gifts, grants and contributions are described in sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code, check line 5h. Organizations whose public support is mostly in the form of payments for goods or services, such as fees for admission to cultural events or educational seminars, are described in section 509(a)(2), should check line 5i. Many organizations have various sources of income. Check line 5j to let the IRS decide between these two public support categories.

Part XI. User Fee Information

The IRS charges a nonrefundable processing fee for exemption applications. The fee charged is currently $600. These amounts are subject to change, so check the IRS website at https://www.irs.gov/ and type "Exempt Organizations User Fee" in the search box.

The IRS does not begin processing an application until the check for the User Fee has cleared, so consider paying with a cashier's check or money order to speed up an application. A new IRS revenue procedure announcing the User Fee comes out each January; if you are submitting your application late in the year, there may be some benefit to submitting it before January 1.

Additional Schedules

If the organization is required to complete an additional schedule, please refer to the relevant Form 1023 instructions.

e. Assembling Your Application

After completing the Form 1023 and relevant attachments, refer to "Form 1023 checklist" (the last two pages of Form 1023). This checklist describes the order in which Form 1023 and documents that accompany it should be compiled and provides the address to which your application should be submitted. Before submitting your application, make certain that all applicable parts of the form are completed, including any required schedules. As noted above, attachments should be inserted in the appropriate spot within the pages of the application itself (i.e., behind the page of the application that references the attachment). Each attachment should be labeled with the organization's name and employer identification number and the question number to which the attachment relates. All other attachments, including articles of incorporation, bylaws, brochures and conflicts of interest policies, should be labeled with the organization's name and EIN.

TIP:

Be sure to place your check or money order, payable to the United States Treasury, in an unsealed envelope on top of the checklist.

An authorized person, such as the board president or other officer, rather than the executive director, must sign and date the Form. *See* discussion in Chapter 26 for more information on inclusion of the User Fee with the application. Following the User Fee determination, an authorized person (i.e., an officer of the organization) must sign the declaration portion of the Form. The declaration is a statement that the application is true, correct and complete.

TIP:

Be sure to keep a copy of the application package sent to the IRS. Occasionally, the IRS loses an application. In addition, the application package becomes subject to public disclosure once the determination letter is received from the IRS.

CHAPTER 25. Obtaining Recognition for a Publicly Supported Charity

A new organization will be classified as a public charity by virtue of its public support if it can show on its Form 1023 that it reasonably can be expected to meet the applicable public support test (*See* Chapter 22 for discussion of the differences between public charities and private foundations). During the first five years of operation, the organization retains its status as a publicly supported organization without regard to the calculation of the "public support test" on Schedule A of the Form 990. Beginning with the organization's sixth taxable year, the organization must show that it meets the public support test based on prior years' public support in order to remain classified as a publicly supported organization.

CHAPTER 26. IRS Processing of Exemption Applications

a. Mailing Address

Form 1023 (Application for Recognition of Exemption Under Code Section 501(c)(3)) and instructions are available at http://www.irs.gov. The instructions and checklist accompanying the form contain the mailing address for the application. If submitting the application by regular mail, send it certified mail to receive confirmation of the date the application was received by the IRS. Do ensure that however the application is sent, the organization will receive confirmation that the application was received by the IRS.

b. Expedited Handling

The IRS is reluctant to consider any application out of turn but will sometimes be persuaded if an organization can show that it will lose funding from an unrelated third party, such as a grantmaking foundation, if the organization does not receive an expedited ruling. To ensure that a request for expedited handling is not overlooked, place it on top of all other materials sent to the IRS and type "Request for Expedited Review" in large, bold type to call attention to the request. *See* page 3 of the Instructions for Form 1023 for more information about requesting expedited review.

c. User Fee

As noted above, the IRS does not begin processing an application until the check for the User Fee has cleared, so an organization may speed up its application slightly by paying with a cashier's check or money order. If payment is made by check, watch bank statements to make sure the IRS does, in fact, cash the check for

the User Fee. If the User Fee check is not promptly cashed, it is an indication that the application may have been lost in the mail. When the IRS has confirmed payment, a brief letter is sent to the applicant acknowledging receipt of the application and describing the IRS process with regard to applications.

d. Processing

The IRS receives more than 70,000 applications for tax-exempt status each year. Thanks to new processes, the inventory of applications is current. If a Form 1023-EZ application is submitted, expect to be contacted within 90 days from the date of submission. If a Form 1023 application is submitted, expect to be contacted within 180 days from the date of submission. Contact Customer Service at (877) 829-5500 if there are concerns regarding processing.

e. Inquiry Letter

Applications that cannot be closed immediately based on the information initially provided require additional development. Processing of an application that requires additional development may take as long as six to eight months (or longer) to complete.

When an inquiry letter is sent, the applicant will normally have 21 days to respond. Upon request of the applicant, accompanied by an explanation as to why an extension is required, the agent handling the case will sometimes grant an extension of ten days to two weeks. An extension is not guaranteed. If a timely response is not received by the IRS, the IRS may close the case. The file is kept available for up to one year and reopened automatically when additional information comes in; however, the IRS will charge a new User Fee if information is submitted more than 90 days after a case is closed. If the case is closed, the organization will receive a letter stating the date on which this 90-day period terminates.

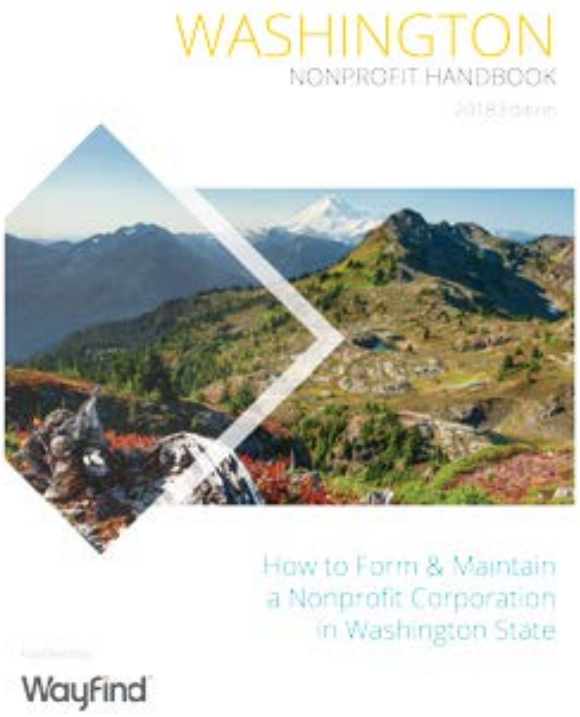
f. Final Disposition

Once all of the IRS agent's questions are satisfactorily answered, the IRS will issue a favorable determination letter.

If the IRS denies an application, the IRS must provide a written explanation of the facts, law, and argument upon which its decision is based, as well as an explanation of appeal rights.

g. Public Disclosure of Form 1023

A 501(c)(3) organization must furnish a copy of its Form 1023 exemption application (including any attachments, questions asked by the IRS subsequent to the submission of the initial application and the organization's responses to such questions) to any person who requests a copy. More details about the disclosures required and the process for disclosures can be found in Chapter 35.



Part 5 Maintaining Federal Tax-Exempt Status For Your 501(C)(3) Organization

Chapter 27 Continuing Obligations Under Federal Tax Law
Chapter 28 Charitable Purposes
Chapter 29 Private Inurement
Chapter 30 Intermediate Sanctions
Chapter 31 Political Activity
Chapter 32 Legislative Activity (“Lobbying”)
Chapter 33 Unrelated Business Income (“UBI”)
Chapter 34 Federal Filing Requirements
Chapter 35 Public Disclosure of Exemption Application and Form 990 Returns
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PART 5. MAINTAINING FEDERAL TAX-EXEMPT STATUS FOR YOUR 501(C)(3) ORGANIZATION

CHAPTER 27. Continuing Obligations Under Federal Tax Law

When an organization receives a determination from the Internal Revenue Service that it is qualified under section 501(c)(3) of the Internal Revenue Code of 1986, as amended (also referred to as "section 501(c)(3)"; organizations exempt from federal taxes under Code section 501(c)(3) also referred to as a "501(c)(3) organization"), it is the beginning, not the end, of a compliance process that will continue throughout the organization's life. An organization must continue at all times to comply with tax law requirements in order to maintain its tax exemption. Specifically:

- The organization must be organized and operated at all times exclusively to further charitable purposes;
- It must not allow any of its assets or net income to "inure" to the benefit of an "insider";
- It must not participate in any campaign for or against any candidate for political office;
- It must not engage in attempts to influence legislation as any substantial part of its activities;
- It must report and pay tax on any net unrelated business income; and
- It must comply with a variety of annual reporting and public disclosure requirements.

Each of these issues is addressed in more detail below. In general, this Part addresses nonprofit organizations exempt from federal taxes under section 501(c)(3) of the Internal Revenue Code of 1986, as amended (also referred to as "501(c)(3) organization(s)') that are qualified as public charities, and not private foundations, under federal law. A more restrictive set of rules applies to 501(c)(3) organizations that are private foundations. The private foundation rules are beyond the scope of this text, but are introduced and discussed briefly in Chapter 22. A special set of rules also applies to public charities that are classified as "supporting organizations." An organization is a supporting organization if its IRS determination letter identifies it as an organization described in Code

section 509(a)(3). The supporting organization rules are beyond the scope of this Handbook.

CHAPTER 28. Charitable Purposes

Federal tax law provides that for an organization to qualify for tax exemption as a 501(c)(3), it must be organized and operated exclusively for charitable, religious, scientific, educational, and certain other purposes. In order to maintain its tax-exempt status, a 501(c)(3) organization must comply with this standard throughout its entire period of existence. If its purpose changes – either in how its purposes are stated in its articles of incorporation and bylaws, or in the activities the organization actually conducts – its qualification for exemption may also change.

The tax law recognizes a wide variety of purposes and activities as being "charitable." While section 501(c)(3) enumerates other qualified purposes, such as religious and educational purposes, the law interprets these as subsets of the general category of charitable purposes, not as separate categories. Charitable purposes include relief of the poor, the advancement of religion, the advancement of education or science, the erection or maintenance of public buildings or monuments, lessening the burdens of government (in limited circumstances), promoting social welfare, lessening neighborhood tensions, eliminating prejudice and discrimination, defending human and civil rights secured by law, combating community deterioration and juvenile delinquency, and protecting the natural environment. Educational purposes, as a subset of charitable purposes, include both instruction of the public and the individual. Educational activities include scholastic publications as well as visual and performing arts.

In order for an organization's activities to qualify as charitable, they must benefit the general public or a segment of the general public that is broad enough to be considered a charitable class. A charitable class must be large or indefinite. For example, an educational organization formed to educate the children of one family will not qualify as charitable. In addition, activities that violate public policy, such as the provision of education on a racially discriminatory basis, will not qualify as charitable.

"Exclusively" for Charitable Purposes Means "Substantially." While the tax law specifies that a 501(c)(3) organization must be organized and operated "exclusively" for charitable purposes, the Treasury Regulations provide that an 501(c)(3) organization may also engage in activities that do not specifically further a

charitable purpose, provided that such activities do not constitute more than an "insubstantial" part of the organization's total activities. Accordingly, a 501(c)(3) organization may engage in a limited amount of activities that are not strictly charitable, so long as the activities do not violate any of the rules described in Chapters 29, 31, 32, and 33.

The Activity Itself Must Be Charitable. Each of the organization's activities must be evaluated separately to determine whether it furthers a charitable purpose. The fact that funds generated from an activity may ultimately be used to further a charitable purpose will not by itself cause the activity to be charitable. For example, the operation of a sandwich shop on a commercial basis for paying customers is not charitable even though all net income from the shop may be used for charitable purposes. The operation of a soup kitchen for the homeless, on the other hand, is charitable.

CHAPTER 29. Private Inurement

a. General Prohibition

A 501(c)(3) organization must be operated in such a manner that none of the organization's assets "inures to the benefit" of any private individual. An "insider" is an individual that has influence over the organization, such as an officer or director, or an officer or director's family member. Private inurement occurs when a person who is an "insider" with respect to the organization derives a benefit from the organization without giving something of at least equal value in return.

The determination of whether a person is an insider is based on all relevant facts and circumstances and will generally depend on the level of influence that the individual has over the organization. Entities such as corporations and partnerships that are controlled by insiders may also be treated as insiders with respect to an exempt organization. For example, a corporation that is wholly owned by a board member of the organization is an insider with respect to the organization.

In order to identify and avoid potential private inurement situations, an organization should adopt a conflict of interest policy and should annually survey its board members, officers and senior staff to identify all organizations in which they or their family members have substantial interests and to identify all situations in which the organization has financial dealings with potential insiders. The organization must take care to ensure that all such arrangements are entered into at "arm's length" and are in the best interest of the organization. The IRS publishes

on its website a model conflict of interest policy. For a sample conflicts of interest policy, see https://wayfindlegal.org/tools/legal/.

The IRS may revoke an organization's 501(c)(3) status if any private inurement occurs. As a technical matter, there is no *de minimis* exception. Private inurement may arise in many ways. Some of the most common situations are described below.

b. Compensation Arrangements

A 501(c)(3) organization may pay reasonable compensation to employees or others for services rendered. Excessive compensation, however, such as compensation that exceeds payments made by similar organizations for similar services, may result in inurement. In order to avoid private inurement, an organization should put into place procedures to create a "rebuttable presumption" of reasonableness discussed below in Chapter 30.

As a general rule, a 501(c)(3) organization should not pay any person a salary or other compensation that is calculated as a percentage of the organization's net earnings. For example, a 501(c)(3) organization cannot pay its executive director a salary calculated as 10% of the organization's net income. This would be private inurement and could result in revocation of the organization's federal tax exemption.

c. Purchases and Sales

If a 501(c)(3) organization purchases property or services from an insider for more than adequate consideration, or pays rent in excess of fair market value, either of these examples may constitute private inurement. Similarly, if a 501(c)(3) organization furnishes property or services to an insider without receiving adequate consideration in return, inurement may result. If the 501(c)(3) organization provides property or services for less than fair market value to the general public in the course of fulfilling its tax-exempt purposes (e.g., an orchestra performing free concerts), private inurement generally will not result.

d. Loans

If a 501(c)(3) organization borrows money from an insider at a rate of interest that is above market rate, or loans money to an insider without receiving adequate security or reasonable interest, this may also result in private inurement.

Loans by nonprofit corporations to their officers and directors are prohibited under Washington State law, even if the terms are favorable to the corporation.

e. Joint Venture Arrangements

Inurement may also arise from joint venture arrangements between 501(c)(3) organizations and for-profit entities, especially in situations where, under the joint venture arrangement, the for-profit entity has control over the exempt organization's assets or operations or receives a percentage of the exempt organization's net earnings.

CHAPTER 30. Intermediate Sanctions

a. Overview

The penalty for private inurement, as discussed above, is revocation of the organization's tax-exempt status. The tax law also imposes punitive excise taxes on individuals who engage in impermissible transactions with charitable organizations. The IRS may impose such excise taxes as an intermediate step instead of revoking the organization's exempt status, or it may penalize individuals in addition to revoking exempt status.

b. Outline of Penalties

The tax law imposes a punitive excise tax on any "disqualified person" (defined below.) who engages in an "excess benefit transaction" (defined below) with a 501(c)(3) organization that is not a private foundation (or a 501(c)(4) organization), and on "organization managers," which includes board members, officers and the executive director, who knowingly and willfully approve such transactions.

Initially, the tax on a disqualified person is 25% of the excess benefit that the disqualified person received. For example, if the person sold property to the organization for $10,000 when the fair market value was really $4,000, the excess benefit is $6,000 and the initial tax is $1,500 (25% of $6,000). If the transaction is not "corrected" or undone to the extent possible, the disqualified person is subject to an additional tax of 200% of the excess benefit. In the above example, the additional tax is $12,000 ($12,000 is 200% of the excess benefit, which was $6,000).

In addition, an "organization manager," may be subject to a separate tax if the manager approves an excess benefit transaction knowing that it is improper, unless the action is not willful and is due to reasonable cause. The tax on the

organization manager is 10% of the excess benefit, up to a maximum of $20,000 for each excess benefit transaction. In our example, the tax on an organization manager would be $600 ($600 is 10% of the excess benefit, which was $6,000).

The intermediate sanctions rules do not impose a penalty tax on the exempt organization itself.

c. "Disqualified Person"

A "disqualified person" is a person who is in a position to exercise substantial influence over an organization with respect to a transaction. Once a person is classified as a disqualified person, he or she will continue to be a disqualified person for a period of five years after ceasing to exercise such influence. A member of a disqualified person's family is also a disqualified person, as is a corporation, partnership, trust or estate in which a disqualified person directly or indirectly owns more than a 35% interest.

Under Treasury Regulations, a voting member of a 501(c)(3) organization's governing body is automatically a disqualified person, as are the organization's president, chief executive officer, chief operating officer, treasurer, chief financial officer, and any management company that performs services for the exempt organization. An individual's authority and responsibilities, rather than the person's title, determines whether he or she holds one of these positions. An individual who has or shares ultimate responsibility for implementing the governing body's decisions or supervising the organization's management, administration or operations will be a disqualified person, as will anybody who has or shares ultimate responsibility for managing an organization's financial assets, including check-signing authority, and authority to authorize electronic fund transfers.

Treasury Regulations provide that an employee who receives economic benefits from an exempt organization of less than $120,000 per year is not a disqualified person, so long as the individual is not otherwise a disqualified person under one of the categories above. For example, an executive director who receives $50,000 per year will be a disqualified person by virtue of his/her role, regardless of the fact that his/her salary is less than $120,000.

In cases not covered by the rules above, whether a person is a disqualified person is determined on the basis of all relevant facts and circumstances bearing on the person's level of influence over the organization.

d. "Excess Benefit"

An "excess benefit transaction" is any transaction in which a 501(c)(3) or 501(c)(4) organization provides an economic benefit, either directly or indirectly, to a disqualified person, where the value of that economic benefit exceeds any value that the organization receives in return, including the value of services performed for the organization. For example, the payment of a salary of $50,000 for services, where the fair market value of the services is $25,000, is an excess benefit transaction.

Reasonable expenses for board members to attend meetings, as long as these do not include luxury travel or payments for spouses, do not constitute excess benefit transactions. Similarly, benefits provided to the public in exchange for an annual membership fee of $75 or less, such as discounted admission to events or receipt of a newsletter, do not constitute excess benefits.

e. Rebuttable Presumption of Reasonableness

An organization can establish a rebuttable presumption that a transaction is reasonable (and therefore not an excess benefit transaction) when the three requirements set out below are satisfied. In general, organizations should seek to satisfy the rebuttable presumption in approving any transaction with or compensation involving a potential disqualified person, including payment of a salary. If an organization is unable to establish the rebuttable presumption, however, there is no inference that it is an excess benefit transaction. The three requirements are:

1) **Approval by Independent Board or Committee.** The transaction must be approved by a board or committee authorized under state law and composed entirely of individuals who do not have a conflict of interest with regard to the transaction and are not related to or under the direction and control of a disqualified person who does have a conflict of interest.

2) **Appropriate Comparability Data.** The board or committee must rely on appropriate comparability data. The issue of what data is appropriate is critical.

    - Where the transaction involves the purchase or sale of property, an independent appraisal is appropriate data.

- Where the transaction involves the payment of executive compensation, the board or committee should obtain a compensation survey that considers a variety of factors, including geographic location, the size of the organization, relevant experience, and comparability of services. A special rule applies for organizations with annual gross receipts of less than $1 million. In this case, comparability data for compensation is appropriate if it consists of compensation paid by three comparable organizations in the same or similar communities for similar services. Such data can be obtained through an informal survey of similar organizations.

3) **Adequate and Concurrent Written Documentation.** The board or committee must adequately and concurrently document the basis for its decision in writing (e.g., through minutes) For the documentation to be adequate, it must include the terms of the transaction; the date it was approved; the members of the board or committee who were present during debate and those who voted on it; the comparability data obtained and relied on, and how it was obtained; and member of the board or committee member with a conflict of interest. For the decision to be documented concurrently, the records must be prepared by the next board or committee meeting or 60 days after the initial action, and must be approved within a reasonable period.

CHAPTER 31. Political Activity

Federal tax law prohibits any 501(c)(3) organization from participating in any political campaign on behalf of or in opposition to any candidate for public office. This prohibition is absolute and any violation may result in loss of an organization's exempt status. The prohibited activity includes publishing or distributing written statements or making oral statements on behalf of or in opposition to a candidate, and paying salaries or expenses of campaign workers.

Section 501(c)(3) organizations must avoid any inadvertent violation of this prohibition. For example, an organization should not invite a candidate to speak at an organization-sponsored function during an election cycle, because this may be treated as participation in a campaign. Organizations should also refrain from

publishing voter education materials that may create an appearance of bias regarding issues that are significant to the organization, e.g., a "voter's guide" that compiles incumbents' voting records only on issues that are important to the organization.

CHAPTER 32. Legislative Activity ("Lobbying")

a. "No Substantial Part" Limitation

The tax law distinguishes political activity (i.e., participating in campaigns for political office) from attempts to influence legislation (commonly referred to as lobbying). An organization engages in attempts to influence legislation if it contacts legislators or their staff – or urges the public to do so – for the purpose of proposing, supporting or opposing legislation.

A 501(c)(3) organization that is a public charity may engage in lobbying, but only if such activities do not constitute a "substantial part" of the organization's activities. If the IRS determines that a public charity has attempted to influence legislation as a substantial part of its activities, the organization's exemption may be revoked. It is unclear when lobbying activity will be deemed to constitute a substantial part of an organization's activities since there is no precise standard.

Certain other types of tax-exempt organizations, e.g., social welfare organizations qualifying under section 501(c)(4), are not subject to limitations on legislative activities. If an organization wishes to engage primarily in lobbying, it should seek exemption under a category other than section 501(c)(3).

TIP:

Washington State has additional registration requirements for lobbying activities that are separate and distinct from Federal IRS rules. *See* RCW 42.17A.600-655 for more on State law requirements. For more information on Washington State requirements for lobbying go to https://www.pdc.wa.gov.

b. Section 501(h) Election

(i) Generally

Most section 501(c)(3) organizations that are public charities, other than churches, may elect to become subject to a more objective standard for lobbying activities than the vague "substantial part" test. This is called a section 501(h)

election. Section 501(h) provides specific dollar limits on lobbying expenditures. An organization that makes the election may spend up to 20% of the first $500,000 of its annual operating budget on lobbying (however, only 25% of that amount may be spent in "grassroots" lobbying, however, as defined below). As an organization's annual budget increases over $500,000, the percentage that may be spent on lobbying decreases. There is an absolute annual maximum on lobbying expenditures of $1 million, which is reached when an organization's annual budget is $17 million.

If an organization exceeds its limit in any year, it will be subject to an excise tax of 25% on the excess amount. An organization that has made a section 501(h) election will lose its tax exemption on the basis of excessive lobbying only if the organization exceeds its permitted expenditures by 150% over a four-year period.

The election is made by filing Form 5768 with the IRS, which is available at http://www.irs.gov/pub/irs-pdf/f5768.pdf.

(ii) Advantages of the Section 501(h) Election

The principal advantage of the section 501(h) election is that it avoids the ambiguity of the vague "substantial part" test. The election also allows an organization to take advantage of specific exceptions to what constitutes lobbying under the tax law. In general, the section 501(h) election allows an organization to plan lobbying expenditures with much greater certainty regarding the tax result. In addition, the excise tax that applies to excessive lobbying expenditures of an electing organization is much less harsh than the loss of tax-exempt status that can apply to a non-electing organization. An organization that anticipates any regular attempts to influence legislation is advised to make the section 501(h) election unless its annual revenues exceed $17 million.

TIP:

The section 501(h) election filing is relatively easy to do and makes it clear to the organization and to the IRS that the organization is compliant with the lobbying restrictions under section 501(c)(3).

c. "Attempts to Influence Legislation" Under Section 501(h)

(i) Legislation

Legislation includes action by the Congress, state legislature, county or city council, or similar legislative body, or by the public in a referendum, ballot initiative, constitutional amendment or similar procedure. It includes both legislation that has already been introduced in a legislative body and a specific legislative proposal that the organization either supports or opposes. It does not, however, include executive action, judicial processes, or the work of administrative agencies or boards such as school boards, housing authorities, sewer and water districts and zoning boards, whether elective or appointive. Attempts to influence the actions of regulatory agencies accordingly are not considered lobbying, even where the agency is primarily concerned with effectuating legislative mandates.

(ii) Direct Lobbying Communication

Attempts to influence legislation include direct lobbying, such as: (1) communications with any member or employee of a legislative body; (2) communications with any governmental official or employee who may participate in formulating legislation, if the principal purpose of the communication is to influence legislation; or (3) communications with the public with respect to a ballot measure. A communication with a legislator or governmental official will be treated as a direct lobbying communication if it (1) refers to specific legislation (including legislative proposals), and (2) reflects a view regarding the legislation. Similarly, a communication with the public will be treated as a direct lobbying communication if it (1) refers to a specific ballot measure up for a public vote, and (2) reflects a view regarding the ballot measure.

(iii) Grassroots Lobbying Communication

Attempts to influence legislation also include "grassroots" lobbying communications. These are communications that attempt to affect the opinion of the general public or a segment of the public and that (1) refer to specific legislation (including legislative proposals); (2) reflect a view regarding the legislation; and (3) encourage the recipient to take action.

A communication encourages the recipient to take action if it (1) encourages the recipient to contact a legislator; (2) gives the legislator's addresses, telephone number or other contact information; (3) provides a petition or tear-off postcard for the recipient to communicate with the legislator; or (4) specifically identifies one or

more legislators who will vote on the legislation. Paid mass media advertisements within two weeks before a vote on a highly publicized piece of legislation will be presumed to constitute grassroots lobbying if the advertisement reflects a view and encourages communication with legislators, even if it does not encourage the recipient to take action.

d. Exceptions to "Attempts to Influence Legislation"

(i) Nonpartisan Analysis, Study or Research

A 501(c)(3) organization may provide the public or legislators the results of any of its "nonpartisan analysis, study or research." This includes any independent and objective exposition of a particular subject matter, including educational materials. The materials may advocate a particular position, so long as they present sufficient facts to allow the audience to form independent conclusions. If the communication directly encourages the recipient to take action with respect to specific legislation, then it is excluded from this exception.

(ii) Technical Advice or Assistance

An organization that has developed a particular expertise in a given area may be called upon to render technical advice or assistance to a legislative committee or subcommittee. Provided that the invitation is issued in writing by the committee or subcommittee, rather than an individual member, the organization's response to that request will not constitute lobbying activity.

(iii) Self Defense Exception

Under the Self Defense Exception, an electing organization may appear before or communicate with any legislative body with respect to decision which might affect the organization's existence, its powers and duties as a tax-exempt organization, its tax-exempt status, or the deductibility of its contributions.

(iv) Examinations and Discussions of Broad Social, Economic and Similar Problems

The participation in, or sponsorship of, public discussion on issues of general concern will not constitute lobbying, provided that such discussion does not address the merits of a specific legislative proposal, and does not directly encourage participants to take action with respect to legislation.

CHAPTER 33. Unrelated Business Income ("UBI")

a. Tax Liability

While a 501(c)(3) organization is not generally subject to federal income taxation, it will be taxed on any net income derived from an "unrelated trade or business." Such income is referred to as unrelated business income, or "UBI." UBI is taxed at graduated rates similar to those that apply to taxable corporations or trusts (depending on the legal form of the organization involved).

The purpose of the UBI tax is to treat exempt organizations in the same manner as their taxable counterparts when they are regularly engaging in income-producing activities that do not further a charitable purpose. An organization's tax exemption may be jeopardized if a substantial part of its activities constitutes UBI. As with lobbying activities, there is no precise standard for how much unrelated business activity is too much.

b. Unrelated Trade or Business

An exempt organization's activity is an unrelated trade or business if all of the following three factors are present:

(i) Trade or Business

A "trade or business" activity is defined as any activity carried on for the production of income from selling goods or performing services;

(ii) Regularly Carried On

The trade or business activity is frequent, continuous, and pursued in a manner similar to comparable activities of non-exempt organizations; and

(iii) Not Substantially Related

The trade or business is not substantially related to the organization's exempt purpose. An activity is substantially related if the activity has a substantial causal relationship to the organization's exempt purposes (other than the production of income). In short, the activity must contribute importantly to the organization's exempt purposes. It is not enough that the net income from the activity will be used to further charitable purposes. The conduct of the activity must itself be charitable. For example, the operation of a restaurant where all net income will be used for charitable purposes is not charitable. On the other hand,

the operation of a restaurant used exclusively as a job-training program for indigent persons may be charitable.

c. Exceptions for Certain Activities

Certain activities are excluded from the definition of an unrelated trade or business, and income from these activities accordingly is not UBI.

(i) Volunteer Exception

A business where substantially all of the work is performed by uncompensated volunteers does not generate UBI. For example, operation of a retail store where all of the work is performed by unpaid volunteers is not an unrelated trade or business, and any income generated is not UBI.

(ii) Convenience Exception

A business carried on primarily for the convenience of an exempt organization's members, students, patients, officers or employees is not an unrelated trade or business and does not generate UBI. For example, a hospital cafeteria for employees, patients and visitors does not generate UBI.

(iii) Donated Merchandise

Selling merchandise, substantially all of which has been donated to the organization, is not an unrelated trade or business, and does not generate UBI. For example, a retail thrift store in which all merchandise sold is donated to the organization does not generate UBI.

(iv) Exclusions for Investment Income

The following categories are excluded from UBI, and therefore generally are not taxable, on the grounds that they are passive income from investment assets:

- Dividends, royalties, interest and annuities;
- Rents from real property are excluded, subject to a variety of exceptions, (although income from debt-financed property, discussed below, may be UBI); or
- Gains from the sale or exchange of property are generally excluded. For example, a 501(c)(3) organization generally is not subject to tax on gain on its sale of stock. If the organization regularly sells items that

constitute inventory, however, and the sales activity does not further charitable purposes (e.g., sales of commercial magazines), then the income may be taxable.

(v) Deductions

501(c)(3) organizations are permitted a standard deduction in the amount of $1,000 against any UBI earned in a taxable year, which effectively amounts to an exemption from tax on the first $1,000 of UBI. Organizations may also deduct expenses attributable to unrelated business activities in calculating net UBI.

(vi) Debt-Financed Income

While the types of income described above are generally excluded from UBI, income from debt-financed property is not. For example, net rental income from real property, or net gain from sale of stock may be subject to tax in whole, or in part, because the underlying property is subject to debt financing. The rules regarding debt-financed property are complex and confusing, and a full discussion is beyond the scope of this text.

Essentially, the policy behind the rules is as follows: It may be appropriate generally not to tax an organization on traditional investment income such as interest, dividends and rents, because this is the type of income that a charity typically earns from investment of its endowment. Such items should be taxed, however, to the extent that the organization borrowed to acquire the income-producing property, where the use of the property is not considered charitable.

For example, assume that an organization acquires a building, subject to a mortgage for 80% of the purchase price, and uses half of the building for its administrative offices and its charitable purposes, while it leases the other half of the building to other unrelated organizations. The rental activity itself is not charitable. Under the debt-financed income rules, 80% (the percentage that was debt-financed) of the net rental income (after deduction of related expenses) will be taxed as UBI.

d. Excessive UBI May Jeopardize Exemption

An exempt organization's tax-exempt status may be jeopardized if more than an insubstantial part of its activities constitutes unrelated business activities. While there is no precise quantitative test for substantiality, the IRS has ruled that there is no quantitative limit so long as an organization carries on a charitable program

"commensurate in scope with its financial resources." The IRS has also ruled that UBI constituting 5% of an organization's gross income does not jeopardize its tax exemption.

If an exempt organization's status is threatened by the extent of its unrelated business activities, it should consider spinning off the unrelated activity into a for-profit corporate subsidiary. Assuming that proper corporate formalities are observed, the corporate subsidiary's activities should not affect the parent's exempt status. The subsidiary will be taxed on net income from its activities. A subsidiary formed as a single-member limited liability company ("LLC") is not effective for these purposes.

CHAPTER 34. Federal Filing Requirements

a. Annual IRS Form 990

(i) Filing Requirement

Most tax-exempt organizations must file an annual information return with the IRS. For 501(c)(3) organizations that are public charities, and most other types of tax-exempt organizations, the information return is made on IRS Form 990 or Form 990-EZ, depending on the type and size of the organization. *See* the Instructions to Form 990, available at http://www.irs.gov/formspubs/lists/0,,id=97817,00.html.

Failure to file the return for three consecutive years will result in automatic revocation of tax exemption. The organization will have to reapply for 501(c)(3) tax-exemption to reinstate the organization's 501(c)(3) tax-exemption.

(ii) Annual Notice Requirements for Small Organizations

Small organizations (i.e., those that do not normally receive more than $25,000 in annual gross receipts) may file an annual electronic notice with the IRS reporting basic organizational information, called the Form 990-N "e-postcard." The e-postcard is available at https://www.irs.gov/charities-non-profits/annual-electronic-filing-requirement-for-small-exempt-organizations-form-990-n-e-postcard. Failure to file the electronic notice for three consecutive years will result in automatic loss of tax exemption.

(iii) Exception for Churches and Certain Religious Organizations

Churches and certain religious organizations that are affiliated with a church are not required to file an information return. For these purposes, "church" encompasses synagogues, temples, mosques, and other charitable houses of worship.

(iv) Filing Date

The return or the electronic notice must be filed on or before the 15th day of the fifth month following the close of an organization's annual tax accounting period (i.e., May 15 for a calendar-year organization). Organizations may request one automatic six-month extension of the due date by filing Form 8868. The Form 8868 must be filed no later than the initial due date for the Form 990.

(v) Professional Preparation

An organization may, at its election, either prepare its own Form 990 returns or utilize a professional service. Section 501(c)(3) organizations that rely on a public support test for public charity classification, supporting organizations described in section 509(a)(3), and private foundations should seriously consider engaging a professional accountant with experience in preparing this type of return.

(vi) Treatment as a Public Relations Document

Form 990 information returns are public documents. A 501(c)(3) organization must disclose to the public upon request its Form 990 returns for the three most recent tax years. Form 990 returns are available at the Guidestar website, https://www.guidestar.com.

(vii) Penalties

Failure to file a Form 990 in a timely manner may result in penalties of $20 per day, with a cap of the lesser of $10,000 or 5% of the organization's gross receipts for the year. For large organizations (those organizations whose gross receipts exceed $1 million for any year), the penalty is $100 per day, with a cap of $50,000. The penalty may be abated if reasonable cause is shown. An incomplete Form 990 information return may be treated as a failure to file, with penalties assessed.

TIP:

A tax-exempt organization should consider its Form 990 information returns to be public relations tools and should treat the preparation process as an opportunity to promote the organization's programs and good works to the public.

(viii) Organizations With a Tax Exemption Application Pending

Organizations that have applied for tax exemption but have not yet received a determination letter should file a Form 990 or other applicable form as if their tax-exempt status had been recognized. Small organizations that meet the requirements to file the Form 990-N "e-postcard" but are still waiting for their determination letter will need to call the IRS at (877) 829-5500 to notify the IRS that they are eligible to use the Form 990-N filing system.

b. Form 990-T: Organizations with UBI

An exempt organization that has $1,000 or more in gross UBI in a taxable year must report such income on Form 990-T, which must be filed in addition to the informational Form 990. Exempt organizations are also required to make quarterly estimated UBI tax payments, calculated at rates similar to corporate rates. Penalties apply for late filing, late payment or underpayments of taxes on income reportable on Form 990-T. Organizations generating UBI should consult an accountant.

c. Federal Returns and Reports Required of Organizations with Employees

- **Federal Income Tax Withholding.** Most tax-exempt organizations are required to withhold and pay federal income tax on their employees' wages in the same manner as for-profit organizations. Organizations should consult a bookkeeper, accountant or payroll management advisor regarding this and the other requirements listed in this section. *See* Chapter 67.

- **Social Security Taxes.** Most tax-exempt organizations are required to withhold and pay Federal Insurance Contributions Act (FICA) taxes in the same manner as for-profit companies. *See* Chapter 67.

- **Federal Unemployment Taxes.** A 501(c)(3) organization is not required to pay federal unemployment taxes, but may elect to participate in a state program. *See* Chapter 67.

- **Information Returns for Payees.** Tax-exempt organizations are required to prepare and file certain forms annually for purposes of reporting amounts paid to employees and others, in the same manner as for-profit companies. These include, but are not limited to, Forms W-2 and 1099.

d. Reporting Material Changes in the Organization to the IRS

- **Changes to Legal Structure.** Any organization that makes material changes to its legal structure may be required to file a new exemption application to ensure continued qualification for exemption. For example, a new exemption application is generally required if a nonprofit corporation is administratively dissolved by a state and a new corporation is formed to carry out its activities.

- **Amendments to Articles or Bylaws.** If an organization amends its articles of incorporation or bylaws, it should notify the IRS and describe the amendments on its annual Form 990. An organization should submit a copy of amendments to its organizing documents that effect a legal name change with the annual Form 990. Organizations that are not required to file a Form 990 should notify IRS Customer Account Services of any such change, at the address provided at https://www.irs.gov/charities-non-profits/political-organizations/eo-customer-account-services.

CHAPTER 35. Public Disclosure of Exemption Application and Form 990 Returns

a. Information Disclosure

A 501(c)(3) organization must provide a copy of its Form 1023 exemption application to any person who requests it. A limited exemption applies to an organization that filed its application before July 15, 1987, but only if the organization did not have a copy of the application on that date. A 501(c)(3) organization that is a public charity must also provide copies of its annual IRS Form 990 and Form 990-T (UBI return) for its three most recent tax years upon request.

A public charity is not required to disclose Schedule B to Form 990, which is the portion of the Form 990 that identifies the names and addresses of contributors to the organization. In addition, the organization may redact certain information from the Form 990 if the public availability of the information would adversely affect the organization (for example, information that relates to an organization's trade secret, patent, process or style of work). Similar rules apply to private foundations, except that the list of contributors is subject to disclosure.

If the request for a copy of the Form 990 is made in person, the organization must provide a copy on the day the request is made. In unusual circumstances where this would be unreasonably burdensome, the organization may provide the copy on the next business day. The organization must provide a copy in response to a written request within 30 days.

b. Fees

An organization may charge a reasonable fee for providing copies (currently $0.20 per page) plus postage costs. An organization may collect payment in before providing the requested copies.

c. Exceptions

A 501(c)(3) organization can avoid the requirement to provide copies by making the necessary documents widely available, which includes posting them on the organization's website, or by having the documents posted on another organization's website as part of a database of similar materials. A limited exception to the disclosure rules also applies to organizations that have been subject to a harassment campaign where a waiver of the rules would be in the public interest.

d. Penalties for Failure to Disclose

A penalty of $5,000 applies for any failure to provide copies of the required Form 990 returns or the Form 1023 exemption application.

CHAPTER 36. Documentation of Contributions

For additional information regarding substantiation and disclosure requirements, see Chapter 48 and IRS Publication 1771, Charitable Contributions, at http://www.irs.gov/pub/irs-pdf/p1771.pdf, and for issues to consider when fundraising, see Chapters 45-50.

a. Donor Substantiation for All Gifts

In order for a donor to claim a charitable contribution deduction for any gift paid by cash or check, the donor must maintain a record of the gift in the form of a bank record, or a written communication from the charity showing the charity's name, the date of the contribution, and the amount of the contribution.

b. Donor Requirement: Written Receipts for Donations of $250 or More

In order for a donor to deduct a contribution of $250 or more, the donor must obtain a written receipt from the recipient charity. The receipt must verify the amount of the contribution and must specifically state whether the charity provided any goods or services, such as a dinner or concert, in consideration for the contribution. If so, the receipt must include a good-faith estimate of the value of the goods or services provided. If the donation is of property other than cash, the receipt must describe the property, but is not required to specify the value of the property. The charitable organization may provide a separate acknowledgment for each contribution, or provide donors with an annual or more frequent acknowledgment that sets out the required information for each contribution of $250 or more. A canceled check will not satisfy this substantiation requirement.

c. Charity Requirement: Receipts for "Quid Pro Quo" Contributions

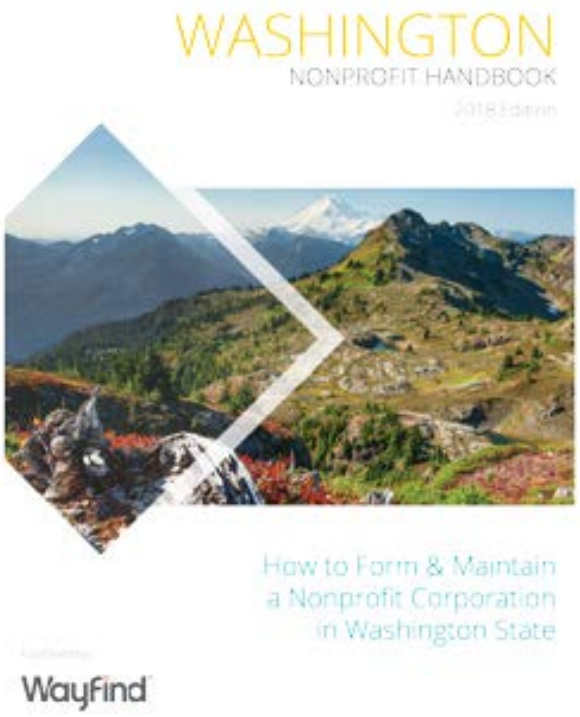
A charity that receives a payment partly as a contribution and partly as payment for goods or services has received a "quid pro quo" contribution. A charity that receives a quid pro quo contribution in excess of $75 must provide the donor with a written statement setting out the amount of the payment that is deductible as a contribution. This statement must indicate that the deduction is limited to the excess of the amount of the contribution over the value of the goods or services provided to the donor, and must include a "good-faith estimate" of the value of the goods or services. Failure to make this required disclosure can result in penalties of $10 per contribution, with a total maximum penalty of $5,000. An exception to the quid pro quo rules may apply if a charity provides only token goods and services, such as mugs or calendars.

d. Sale or Exchange of Donated Property

An individual or entity which contributes property to a 501(c)(3) organization and claims a deduction for more than $5,000 must in most cases obtain an appraisal that meets specific requirements set out in the Treasury Regulations and

report the donation on IRS Form 8283. If the recipient organization disposes of the property within three years after its receipt, the organization must file IRS Form 8282, indicating the property's sale price, and must provide a copy to the donor.

Cannabis and donations: It is important to remember that although use and sale of recreational marijuana is legal under Washington State law, it is illegal under Federal law. Nonprofits with 501(c)(3) tax-exemption should be careful not to be in violation of any federal laws, this includes being a part of any cannabis transactions including, but not limited to, donations of cannabis or money from a cannabis business. You may receive a financial donation from a retailer or producer (grower) of cannabis if there is no advertisement associated with that donation. Remember, cannabis is illegal at the federal level, so you should be careful if the donation is significant enough to be claimed on your IRS Form 990.



Part 6 International Activities And Grantmaking

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PART 6. INTERNATIONAL ACTIVITIES AND GRANTMAKING

CHAPTER 37. Ability Of 501(C)(3) Organizations To Carry On Foreign Activities—Non-U.S. Charitable Activities Qualify As 501(C)(3) Activities

A U.S. organization exempt from federal income taxes under section 501(c)(3) of the Internal Revenue Code of 1986, as amended (also referred to as the "section 501(c)(3);" organizations exempt from federal taxes under Code section 501(c)(3) also referred to as a "501(c)(3) organization") can conduct international activities without jeopardizing its section 501(c)(3) status, provided that the foreign activities would have been viewed as charitable within the meaning of section 501(c)(3) if they had been carried on in the United States and the conduct of such activities outside the United States does not preclude the organization from qualifying as an exempt organization under that section. *See* Revenue Ruling 71-460, 1972-2 CB 231.

The holding of Revenue Ruling 71-460 is consistent with the position of the IRS in Revenue Ruling 68-165, 1968-1 CB 253, which held that a domestic nonprofit organization that provides technical and material assistance for self-help projects intended to improve living conditions of the underprivileged and operates a student exchange program qualifies in Latin America as a 501(c)(3) organization. Similarly, in Private Letter Ruling 200408035 (02/20/2004), the IRS confirmed the holding of Revenue Ruling 71-460, stating that a private foundation's proposed grant to the government of an impoverished foreign country to provide housing for residents for the foreign country satisfied the requirement of section 501(c)(3). Private Letter Ruling 200121078 (05/29/2001) also reaffirmed the holding of Revenue Ruling 71-460 when it addressed a private foundation's proposed grant to a foreign orphanage.

CHAPTER 38. Indirect Contributions Of Gifts To Be Used Outside The United States—Earmarking

a. Earmarking Issues

Because of the inability of U.S. donors to take an income tax deduction under I.R.C. section 170 for direct contributions to non-U.S. organizations, and because of the expenditure responsibility rules of I.R.C. section 4945(h) and the qualifying distribution rules of I.R.C. section 4942 applicable to private foundations, donors often make contributions to U.S. public charities with the intention that their contributions be used outside the United States. This raises the "earmarking issue."

The question of earmarking arises in situations where the terms and conditions of a donor's gift (i.e., a requirement that that the gift be used for a specific beneficiary or be regranted to a specific organization) may prevent the recipient organization from controlling the gift. Where a gift is earmarked for the ultimate benefit of another organization, the recipient organization is a mere conduit, and the true recipient of the gift is the ultimate beneficiary. In these cases, the tax implications of the gift must be determined as if the donor directly made the gift to such recipient.

Clearly, the earmarking risk can arise where a donor makes a gift to a U.S. exempt organization with the intention that the gift ultimately be used for a non-U.S. organization. It can also arise in determining whether contributions intended to be used for another recipient will constitute "public support" for purposes of determining an organization's public charity status.

b. Revenue Ruling 63-252

Revenue Ruling 63-252, 1963-2 CB 121, sets out the general rule that a donor's income tax deduction will be disallowed under Code section 170(c) if the donor's contribution is inevitably committed to a foreign organization and it comes to rest only momentarily in a qualifying U.S. organization. The key question is whether the U.S. organization is the real recipient of the gift because of its right to exercise control over the disposition of the gift. If this control does not exist, the secondary donee will be the ultimate beneficiary.

The IRS uses five examples to illustrate the general rule of Revenue Ruling 63-252. In the first three examples (below), the IRS rules that the U.S. recipients were agents of the foreign organizations or conduits, and therefore contributions were earmarked, the U.S. entity was not the recipient of the contribution, and the donors could not deduct their contributions.

> (1) In pursuance of a plan to solicit funds in [the United States,] a foreign organization formed a domestic organization. At the time of formation, it was proposed that the domestic organization would conduct a fundraising campaign, pay the administrative expenses from the collected fund and remit any balance to the foreign organization.
>
> (2) Certain persons in [the United States,] desirous of furthering a foreign organization's work formed a charitable organization within the United States. The charter of the domestic organization provides that it will

receive contributions and send them, at convenient intervals, to the foreign organization.

(3) A foreign organization entered into an agreement with a domestic organization which provides that the domestic organization will conduct a fund-raising campaign on behalf of the foreign organization. The domestic organization has previously received a ruling that contributions to it are deductible under section 170. In conducting the campaign, the domestic organization represents to prospective contributors that the raised funds will go to the foreign organization.

In the following two examples the IRS concluded that the U.S. organizations exercised control over their funds and therefore were the true recipients of the contributions and not mere conduits.

(4) A domestic organization conducts a variety of charitable activities in a foreign country. Where its purposes can be furthered by granting funds to charitable groups organized in the foreign country, the domestic organization makes such grants for purposes which it has reviewed and approved. The grants are paid from its general funds, and although the organization solicits from the public, no special fund is raised by a solicitation on behalf of particular foreign organizations.

(5) A domestic organization, which does charitable work in a foreign country, formed a subsidiary in that country to facilitate its operations there. The foreign organization was formed for purposes of administrative convenience, and the domestic organization controls every facet of its operations. In the past the domestic organization solicited contributions for the specific purpose of carrying out its charitable activities in the foreign country, and it will continue to do so in the future. However, following the formation of the foreign subsidiary, the domestic organization will transmit funds it receives for its foreign charitable activities directly to that organization.

Revenue Ruling 63-252 was amplified by Revenue Ruling 66-79, 1966-1 C.B. 48, which held that "Contributions to a domestic charity described in section 170(c)(2) of the Internal Revenue Code of 1954 which are solicited for a specific project of a foreign charitable organization are deductible under section 170 of the Code where the domestic charity has reviewed and approved the project as being

in furtherance of its own exempt purposes and has control and discretion as to the use of the contributions."

c. Revenue Ruling 63-252 and "Friends-of" Organizations

"Friends-of" organizations are U.S. organizations formed to solicit and receive contributions from United States donors and to spend the funds on behalf of a charitable organization outside the United States. An example of a friends-of organization is Americans for Oxford. This organization is a section 501(c)(3) public charity that raises funds in the United States intended to benefit Oxford University in the United Kingdom. So long as certain requirements are met, U.S. donors to this organization may obtain a U.S. income tax deduction for their contribution, even though the funds are intended to benefit a non-U.S. organization. Americans for Oxford's website states that its board of directors retains control and discretion concerning grants to Oxford, and although gifts to Americans for Oxford, Inc. must be unrestricted, the board of directors agrees to consider specific preferences of donors.

In Revenue Ruling 66-79, contributions to a friends-of-organization were recognized as made to the U.S. organization (and not the foreign entity) and were therefore deductible, when the U.S. organization's bylaws provided that:

> (1) The making of grants and contributions and otherwise rendering financial assistance for the purposes expressed in the charter of the organization shall be within the exclusive power of the board of directors; (2) in furtherance of the organization's purposes, the board of directors shall have power to make grants to any organization organized and operated exclusively for charitable, scientific or educational purposes within the meaning of section 501(c)(3) of the Code; (3) the board of directors shall review all requests for funds from other organizations, shall require that such requests specify the use to which the funds will be put, and, if the board of directors approves the request, shall authorize payment of such funds to the approved grantee; (4) the board of directors shall require that the grantees furnish a periodic accounting to show that the funds were expended for the purposes which were approved by the board of directors; and (5) the board of directors may, in its absolute discretion, refuse to make any grants or contributions or otherwise render financial assistance to or for any or all the purposes for which funds are requested.

The bylaws further provided that the organization could solicit funds for grants to a specific project or purpose that the board of directors had previously approved; provided, however, that the board of directors must have the right to withdraw approval of the grant and use the funds for other exempt purposes. The organization's board of directors communicated to donors that it could withdraw its approval of a particular grant at any time. And finally, the organization refused to accept earmarked contributions to a particular foreign organization.

Commentators have suggested that organizations seeking to qualify as a domestic friends-of organization (1) include the bylaw provisions described above, (2) establish grant application review and approval procedures, (3) adopt the appropriate resolutions for fundraising proposals for each grant and each disbursement, and (4) require grant accountability. Furthermore, the organization's solicitation materials should ensure that donors understand that they are not giving to the foreign organization and that the domestic organization retains discretion over the use of the gift.

d. Private Foundations and Earmarking Concerns

Private foundations often elect to forego direct contributions to foreign organizations in lieu of making grants to "friends-of" organizations because by making a grant to a U.S. public charity, they avoid the expenditure responsibility requirements of I.R.C. section 4945(h) and are assured that the grant is a qualifying distribution under I.R.C. section 4942. (The expenditure responsibility and qualifying distribution requirements are discussed in further detail in Chapter 38.) The earmarking concerns discussed above apply to grants by private foundations in this type of situation. *See* Treas. Reg. section 53.4945-5(6). To obtain the benefits of making a grant to a U.S. public charity, the private foundation's grant must be viewed as made to and received by the U.S. public charity. If the U.S. charity is merely a conduit or an agent for the foreign organization, the private foundation will be considered to have made the gift directly to the foreign organization, and all the complex rules discussed in this chapter will apply to the grant.

CHAPTER 39. Grants By U.S. Public Charities To Non-U.S. Organizations

As discussed above, a U.S. public charity may fulfill its qualified exempt purposes by expending funds outside the United States, either by directly carrying on its exempt activities outside the United States or by making grants to individuals or organizations outside the United States that will advance the U.S. organization's exempt purpose.

If the foreign organization has obtained a favorable determination letter from the IRS regarding its section 501(c)(3) tax-exempt status, the U.S. public charity can presume that the recipient will use the contribution for a proper exempt purpose. However, if the foreign organization does not hold a favorable determination letter, the U.S. public charity must establish that the grant was made for an exempt activity, and was in fact, actually used for such purpose, all in furtherance of the grantor's exempt purpose. Although the detailed procedural requirements imposed on private foundations by the Code and Regulations do not apply to a public charity, the public charity must be able to demonstrate that is has complied with the requirements of section 501(c)(3). A U.S. public charity cannot make grants to a foreign organization without exercising sufficient supervision and control to demonstrate compliance with section 501(c)(3).

Public charities typically employ written grant agreements to assure that the recipient organizations comply with the requirements described above and that grantees use the grant funds for proper purposes. The grantor often establishes an internal procedure that demonstrates the charity's evaluation of the proposed foreign grant and the manner in which it advances the charity's exempt purposes, establishing controls in the grant arrangement to assure proper use of the funds, and creating reporting obligations from the grantee on its use of the funds. A U.S. charity will need to include provisions in the grant agreement that prevent violation of the requirements of section 501(c)(3), such as appropriate restrictions of lobbying and political campaigning activities and that empower the donor to reacquire the funds if used for an improper purpose. It is easier to comply with the requirements of section 501(c)(3) if the grant is for a specific project, rather than a general support grant.

CHAPTER 40. Grants By U.S. Private Foundations To Non-U.S. Organizations

a. Special Rules Applicable to Private Foundations

The Code imposes additional rules on private foundations making grants outside the U.S. These rules include the "expenditure responsibility" provisions of section 4945(h) of the Code and the "qualifying distributions" requirements of section 4942(g) of the Code.

(i) Expenditure Responsibility.

A private foundation's grants to another organization will constitute a "taxable expenditure" under section 4945 of the Code unless the recipient is a public charity or the foundation exercises "expenditure responsibility" with respect

to such grant. Treas. Reg. section 53.4945-5(a)(1). A foundation is considered to be exercising expenditure responsibility if it:

> …exerts all reasonable efforts and establishes adequate procedures:
> (a) To see that the grant is spent solely for the purpose for which made,
> (b) To obtain full and complete reports from the grantee on how the funds are spent, and
> (c) To make full and detailed reports with respect to such expenditures to the Commissioner.

Treas. Reg. section 53.4945-5(b)(1).

The granting organization must first perform a pre-grant inquiry into the nature of the grantee, confirming that the grantee will properly use the grant funds. Treas. Reg. section 53.4945-5(b)(2). The grantor and grantee must then enter into a written grant agreement outlining a variety of restrictions on the use of the grant, including a requirement that the grantee submit annual reports to the grantor and a prohibition on use of the grant funds or commercial, political or lobbying activities. Finally, the private foundation itself must satisfy certain recordkeeping requirements with respect to its expenditure responsibility grants and disclose them to the IRS on Form 990-PF. *See* Treas. Reg. section 53.4945-5(d).

(ii) Qualifying Distributions.

A private foundation (other than a private operating foundation) is required to make "qualifying distributions" essentially equal to 5% of its net investment assets. The private foundation will incur an excise tax under section 4942 of the Code, if it fails to make the required distribution.

A qualifying distribution is an amount paid to accomplish one or more of the purposes described in section 170(c)(1) or (c)(2)(B) of the Code, other than a contribution to (1) an organization controlled by the private foundation or a disqualified person with respect to the private foundation; (2) a non-operating private foundation; or (3) an organization described in section 4942(g)(4)(A)(i) or (ii) of the Code, if paid by a private foundation that is not an operating foundation. The term qualifying distribution also includes an amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c) (1) or (2)(B)." *See* Treas. Reg. section 53.4942(a)-3(a)(2).

A U.S. private foundation's grant to a foreign organization will generally only constitute a qualifying distribution if the recipient has received a favorable

determination from the IRS as to its public charity or private foundation status, or the grantor makes a good-faith determination that the foreign organization is the equivalent of a public charity or a private operating foundation (as discussed below). Treas. Reg. section 53.4945-5(a)(5).

If the donor private foundation has determined that the foreign recipient is equivalent to a 501(c)(3) organization but cannot determine that it is equivalent to a public charity or private operating foundation, the grant will only constitute a qualifying distribution if it satisfies the "out of corpus" requirements of section 4942(g)(3) of the Code, i.e., the recipient organization must redistribute the grant by the close of the first taxable year after the year of receipt and must provide evidence to the grantor private foundation that a qualifying distribution has been made that is treated under section 4942(h) of the Code as "out of corpus."

(iii) Exceptions.

In certain circumstances an organization will be treated as a public charity for purposes of the expenditure responsibility rules and the qualified distribution rules even though the recipient organization does not possess a determination letter from the IRS finding that it is a public charity. These circumstances are discussed below.

First, a grant to a foreign government or any agency or instrumentality of a foreign government, or an international organization designated as such by Executive Order under 22 U.S.C. section 288 (even if not described in section 501(c)(3) of the Code) that agrees to use the grant exclusively for charitable purposes will constitute a qualifying distribution and will not require expenditure responsibility. *See* Treas. Reg. section 53.4945-5(a)(4)(iii). A college or university that is an agency or instrumentality of a foreign government or of any political subdivision of a foreign government and that agrees to use the grant exclusively for charitable purposes also comes within this exception. *See* Treas. Reg. section 53.4945-5(a). In these situations, it is important that the contributing private foundation make a determination that the recipient organization is a government agency. Private foundations may want to obtain an opinion of counsel or an affidavit of the grantee to confirm that the recipient is a government agency under local law.

Second, a grant to a foreign organization that is "equivalent" to a U.S. public charity will constitute a qualifying distribution and will not require expenditure responsibility. *See* Treas. Reg. section 53.4942(a)-3(a)(6)(i). To come within this

exception, the donor private foundation must make a good-faith determination that the foreign organization is "equivalent" to a public charity (the "equivalency test"). *See* Treas. Reg. section 53.4945-5(a)(5)(i). The Treasury Regulations provide that a donor organization will have satisfied this requirement if its conclusions are based on an affidavit of the grantee organization or an opinion of counsel that the grantee is an organization described in section 509(a)(1), (2) or (3) of the Code. The opinion or affidavit must set forth sufficient facts concerning the grantee for the IRS to determine that the grantee would be likely to qualify as an organization described in section 509(a)(1), (2) or (3) of the Code

A private foundation must apply a two-part test in order to establish that the foreign organization is equivalent to a public charity: (1) the "reasonable judgment test," which addresses whether the organization is equivalent to a Code section 501(c)(3) entity, and (2) a "good faith determination test" which evaluates whether the entity is equivalent to a public charity.

To satisfy the reasonable judgment test, the private foundation must determine that the foreign organization is equivalent to a 501(c)(3) entity, i.e., it is organized and operated exclusively for charitable purposes, there is no benefit to private individuals, and it does not carry on prohibited activities (lobbying or political activities). If the foreign organization has received more than 15% of its lifetime support from U.S. sources and has not filed for exemption in the United States, it may not be considered a 501(c)(3) entity. *See* Code section 4948(b); Treas. Reg. section 1.508-1(a)(vi).

To satisfy the good faith determination test, the private foundation must conclude that the entity is equivalent to a public charity under section 509(a)(1), (2) or (3) of the Code or is an operating private foundation. The private foundation makes this determination by relying on either an opinion of counsel (either counsel to the donor or the recipient) or on an affidavit of the recipient. The opinion or affidavit must provide the same type of information that would be included on a Form 1023 application or a Form 990 return. The array of necessary facts depends upon the type of public charity to which the recipient organization is equivalent. For example, if the foreign organization is equivalent to a Code section 170(b)(1)(A)(vi) organization ("publicly supported"), the recipient needs to demonstrate that it meets the four-year support requirement.

Revenue Procedure 92-94 establishes a simplified procedure whereby the U.S. grantee may rely on a current qualified affidavit in making the equivalency determination for both the expenditure responsibility and the qualifying

distribution requirement. Typically, a current qualified affidavit provides information for the entity's latest complete accounting year and other current data. If the recipient's public charity status depends on demonstrating adequate public support, the grant must provide a statement containing sufficient financial data to establish that it continues to meet the applicable Code provision. *See* Rev. Proc. 92-94 section 4.04, 1992-2 CB 507. A private foundation cannot rely on an affidavit if it possesses information that suggests the affidavit may not be reliable. Furthermore, the grantor cannot rely on an affidavit if the public charity status is based on public support and the donor's grant will cause the organization to fail the support test.

b. Grantor's Duty to Inquire as to section 501(c)(3) Status of Foreign Organization Lacking Determination Letter

A private foundation that wishes to make a grant to a foreign organization can choose to make an equivalency determination or exercise expenditure responsibility over the foreign grantee. Based on a letter from the IRS to the Council on Foundations dated June 18, 2001, it is clear that a private foundation does not need to establish that a foreign charitable organization is equivalent to either a public charity or a private foundation; rather, the foundation may simply treat the foreign organization as a noncharitable entity to which it makes grants for charitable uses and exercise expenditure responsibility with respect to the grant. It must also require the recipient to hold the grant funds in a segregated account dedicated to the exempt purpose of the grant. If the private foundation takes these steps, the grant will constitute a qualifying distribution under section 4942 of the Code and will not be a taxable expenditure under Treasury Regulation section 53.4945-6(c). This approach contrasts with a situation in which the donor private foundation finds that the foreign charitable organization is equivalent to a 501(c)((3) organization but that it is NOT equivalent to a public charity. Here, the grantor would still have to exercise expenditure responsibility and the grant would avoid taxable expenditure status under Code section 4945. However, the grant will not constitute a qualifying distribution under Code section 4942 unless the recipient satisfied the "out of corpus" rules discussed above.

CHAPTER 41. Special Treatment Accorded Canadian And Mexican Organizations

There may be exceptions to the general rules regarding recognition of exemption of foreign charities if an income tax treaty exists between the United States and another country, as set forth below.

a. Canada

The 1980 United States-Canada Income Tax Convention (the "Convention") provides for reciprocal recognition of exemption for religious, scientific, literary, educational or charitable organizations under certain circumstances. Article XXI of the Convention governs inter alia, exemption of a Canadian or U.S. charity from income tax in the other country and it allows a limited charitable contribution deduction for gifts by U.S. citizens or residents to Canadian charities and by Canadian residents to U.S. charities.

Notice 99-47, dated September 7, 1999, states that recognized religious, scientific, literary, educational or charitable entities that are organized under the laws of either the United States or Canada will automatically receive recognition of exemption without application in the other country. Thus, U.S. organizations must be recognized as exempt under section 501(c)(3) to come within the requirements of the treaty, and Revenue Canada must recognize Canadian organizations as Canadian registered charities in order to come within the requirements of the treaty. Every Canadian registered charity is automatically treated as a 501(c)(3) organization, regardless of whether the entity has filed a Form 1023 with the IRS. The Canadian entity's 501(c)(3) status will continue until Canada withdraws its registration or the IRS determines that the organization fails to satisfy the requirements for exempt status.

It is important to note that under the Convention there is a presumption that all registered Canadian charities are private foundations for U.S. tax purposes unless they demonstrate otherwise. This presumption can create qualifying distribution issues for U.S. private foundations that make grants to Canadian registered charities if the private foundation cannot determine that the recipient is equivalent to a public charity.

b. Mexico

The 1992 United States-Mexico Income Tax Treaty (the "Treaty") also provides for reciprocal recognition of exemption and reciprocal deduction of charitable contributions, subject to limitations to the income arising in the other country. Article 22(1) of the Treaty provides that if an organization is tax-exempt in one country and the income received by such organization would be exempt in the other country if the organization were organized under the laws of the latter country, then the organization shall be exempt from tax in both countries.

A U.S. or Mexican contributor making a cross-border contribution to a charity in the other country may deduct the contribution in the state of residence because in Article 17(b) of the 1992 protocol, the two countries agreed that Article 70-B of the Mexican Income Tax Law and sections 509(a)(1) and 509(a)(2) of the Code (other than churches or a convention or association of churches as described in section 170(b)(1)(A)(i) of the Code) provide essentially equivalent standards as contemplated by Articles 22(2) and 22(3) of the Treaty. Entities qualifying under Mexican law will be treated as public charities for U.S. purposes, and unlike the U.S.-Canada treaty, there is no need for an entity-by-entity determination of public charity status for U.S. purposes.

In Information Letter 2003-0158, the IRS concluded "[i]f the Mexican authorities have granted special authorization to a Mexican charity as an organization described in Article 70–B, a U.S. private foundation or other grant-maker may treat the Mexican charity as equivalent to a section 501(c)(3) organization classified as a public charity described in section 509(a)(1) or (2)." *Id.*

CHAPTER 42. Consequences To Foreign Recipients Of Grants (Withholding Issues For Grantor)

The Code imposes federal income tax on certain U.S. sources of income. Sections 871(a)(1) and 881(a) of the Code impose a 30% tax on several types of U.S.-source nonbusiness income of nonresident aliens and foreign corporations. Section 1441(a) of the Code generally provides that the person making a payment that constitutes gross income from sources within the United States to a nonresident alien must withhold tax at a rate of 30% at the time the payment is made. However, in the case of scholarship or fellowship payments made to individuals in the United States on an F, J, M or Q immigration status, the withholding rate may be reduced to 14%. Code section 1441(b); Rev. Proc. 88-24, 1988-1 CB 800. In addition, the withholding rate may be reduced or eliminated by treaty.

Under the withholding rules discussed above, U.S. grantors are generally required to withhold U.S. tax on the nonexempt portion of scholarship and fellowship grants to foreign students for study in the United States. Code section 117 excludes from the recipient's income scholarships or fellowship grants used for "qualified tuition and related expenses (i.e., tuition, fees, books, etc.). However, grants used for other purposes, such as room and board, are not excluded from income. Likewise, amounts received for services performed for the

grantee (teaching or research activities) are taxable, even though these services may be required to obtain a degree or the scholarship.

In general, scholarships and fellowship grants (as defined in Code section 117), grants (as defined in Code section 4945(g)), and prizes and awards (as defined in Code section 74) made by a U.S. citizen or resident or private or governmental entity for study in the United States are treated as income from sources within the United States. Treas. Reg. section 1.863-1(d)(2)(i). Conversely, scholarships, fellowship grants, targeted grants and achievement awards made by a foreign government, international organization, or person other than a U.S. citizen is treated as sourced outside the United States and is not subject to U.S. tax. Treas. Reg. section 1.863-1(d)(2)(ii). And scholarships, fellowship grants, targeted grants, and achievement awards received by a person other than a U.S. person from activities conducted outside the U.S. are treated as U.S. sourced income. Treas. Reg. section 1.863-1(d)(2)(iii). Amounts paid as salaries or compensation are governed by the sourcing rules applicable to personal services under Treasury Regulation section 1.861-4.

In January 1, 2001, the IRS issued Treasury Regulations under section1441 of the Code that broadly defined the type of income subject to 30% withholding. The IRS has indicated that reimbursement for travel and living expenses of independent contractors is included in the type of gross income (as emoluments or remunerations) subject to withholding under Code section 1441(a). These facts have created uncertainty with respect to withholding by U.S. charities on grants solely for travel expenses of a grantee doing research, attending conferences or otherwise performing activities in the United States. The Council on Foundations has requested that the IRS provide guidance on the final regulations under section 1441 with respect to grants solely for travel expenses of a grantee who is doing research, attending conferences, or otherwise performing activities in the United States. The June 14, 2002 letter to the IRS requesting this guidance, and a supporting detailed memorandum are published in 37 Exempt Org. Tax Rev. 370 (2002). As of the present time, the IRS has not provided guidance on this point.

CHAPTER 43. Compliance With Antiterrorist Provisions

a. Executive Order 13224

In response to the terrorist attacks on the United States of September 11, 2001, President Bush signed Executive Order 13224 (the "Order"), aimed at cutting off resources to terrorists and terrorist organizations. The Order prohibits

transactions with individuals and organizations deemed to be associated with terrorism and blocks any assets controlled by or in the possession of such entities and those supporting them. While the Executive Order is not a law, it has the force of law.

The Order prohibits donations to certain persons and organization (i.e., "Listed Persons"). Listed Persons include individuals and organizations identified by the Executive Order, the Secretary of State, and by the Secretary of the Treasury. Exec. Order No. 13,224 section 1(a); (b); (c). Listed Persons can also include other parties who assist, sponsor or support acts of terrorism by Listed Persons or are otherwise associated with Listed Persons. Exec. Order No. 13,224 section 1(d).

Several U.S. government agencies, the United Nations and the European Union, have created lists of known or suspected terrorists. The Treasury Department's Office of Foreign Assets Control ("OFAC") maintains the most comprehensive U.S. list, which can be found at http://www.treas.gov/offices/enforcement/ofac/sdn/. OFAC operates a listserv that provides an electronic notice whenever the list is altered. The listserv is at http://www.treas.gov./press/email/subscribe.html. Other lists include the U.S. Government's Terrorist Exclusion List maintained by the Department of Justice at http://www.state.gov/s/ct/rls/other/des/123086.htm, the European Union's list at http://www.statewatch.org/news/2004/jun/01terrlists.htm, and the U.N.'s list at http://www.un.org/Docs/sc/committees/1267/pdflist.pdf. Note that the Order can extend to persons that are not actually included in the published lists due to a person's relationship with one who is on a published list.

The Order has neither a knowledge nor an intent requirement, and thus an organization can violate the Order (and have its assets frozen) even if it does not know that it is supporting a Listed Person and does not intend to support a Listed Person. In contrast, the USA Patriot Act (discussed below) does have a knowledge and intent requirement.

The reach of persons, entities and property subject to the Order is quite broad. It applies to all U.S. persons and entities, regardless of their location, and foreign organizations with a presence in the United States. Exec. Order No. 13,224 section 3(d). It also applies to property located within the United States or that subsequently comes within the United States, or property in the possession of a United States-based person or entity. Exec. Order No. 13,224 section 1. The Order also prohibits a variety of transactions, including financial, in-kind, material, and

technical assistance, as well as humanitarian donations. Exec. Order No. 13,224 section 1(d); section 4.

b. USA Patriot Act

The USA Patriot Act of 2001 (the "USA Patriot Act") includes a variety of anti-terrorism provisions, including expanded penalties for providing material or financial support for terrorism. The USA Patriot Act imposes civil and criminal penalties on individuals or organizations that provide "material support" or resources with the intent or knowledge that such resources be used to fund terrorist acts or by terrorist organizations. It is clear that the potential penalties under the USA Patriot Act apply to nonprofits, and commentators anticipate that investigation and enforcement activities may focus on exempt organizations involved in international grantmaking or that directly carry out international programs.

(i) Material Support for Terrorism.

"Material support" means "currency or monetary instruments or financial securities, financial services, lodging, training, expert advice or assistance, safe houses, false documentation or identification, communications, equipment, facilities, weapons, lethal substances, explosives, personnel transportation, and other physical assets, except medicine or religious materials." 18 U.S.C. section 2339A(b). Penalties for providing material support for terrorism include imprisonment for up to fifteen years or imprisonment for support of terrorism that results in death. 18 U.S.C. section 2339A(a); section 2339B(a)(1).

(ii) Financing Terrorism.

As of June 2002, financing terrorism is a federal crime. Terrorist Bombings Convention Implementation Act of 2002 section 202(a); 18 U.S.C. section 2339C. An individual or organization that directly or indirectly "willfully provides or collects funds with the intention that such funds be used, or with the knowledge that such funds are to be used" to carry out terrorist activities or "any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing any act," is subject to imprisonment of up to twenty years 18 U.S.C. section 2339C(a)(1); (d)(1).

(iii) Potential Civil Penalties.

The USA Patriot Act also provides for civil penalties against those who materially support terrorism. 18 U.S.C. 2333. Plaintiffs in a civil action may be entitled to damages, court costs and attorneys' fees. 18 U.S.C. section 2333(a). A criminal indictment or conviction is not a prerequisite to commencing a civil action. 18 U.S.C. section 2333(b); (c).

c. Voluntary Treasury Guidelines

On September 29, 2006, the Treasury Department issued an updated version of the U.S. Department of the Treasury Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities (the "Voluntary Treasury Guidelines"), available at https://www.treasury.gov/resource-center/terrorist-illicit-finance/Documents/guidelines_charities.pdf. The Voluntary Treasury Guidelines do not have the force of law, and an exempt organization is not obligated to comply with these guidelines. Furthermore, the Voluntary Treasury Guidelines do not create a "safe harbor." The Treasury Department suggests that an exempt organization following these guidelines will reduce the chance that it will unwittingly make problematic expenditures or that it will be found liable if it does make problematic expenditures.

The Voluntary Treasury Guidelines address five topics. The first four address (1) fundamental principles of good charitable practice, (2) governance accountability and transparency, (3) financial accountability and transparency, and (4) programmatic verification. The suggestions in these first four topics are typically practiced by most well-run nonprofits.

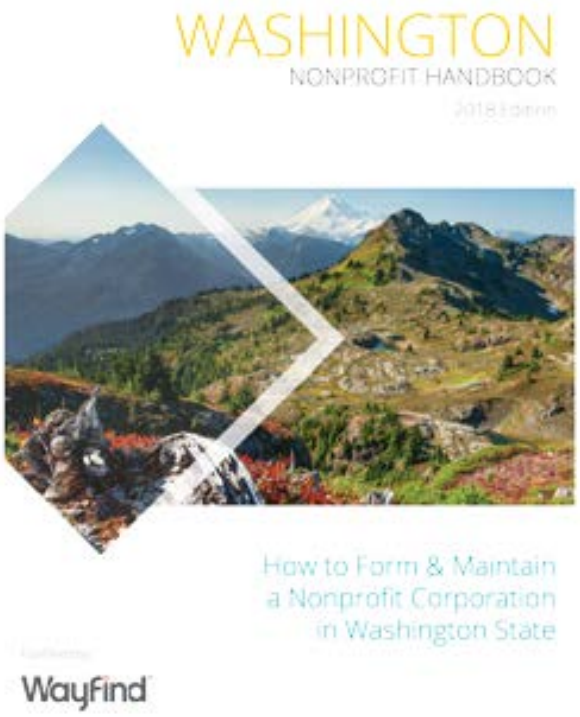
The fifth topic of the revised Voluntary Treasury Guidelines speaks to anti-terrorist financing best practices and has generated more controversy. In drafting the revised guidelines, the Treasury Department responded to various criticisms received regarding the initial draft of the Voluntary Treasury Guidelines. For example, the Council on Foundations stated that the initial version of the Voluntary Treasury Guidelines (1) were not tailored to the reality of international grantmaking by U.S. charitable organizations, (2) did not take into account either the legal requirements governing international grants or the extensive experience of U.S. grant-makers in administering foreign grant funds, and (3) included provisions that were unworkable in many respects, were wholly unrelated to achieving the intended objectives, and had a compliance cost so high as to deter many charitable

organizations from making international grants. However, the Treasury Department rejected many of the suggestions included in the comments.

The suggested anti-terrorist procedures require collecting extensive information about the potential recipient, and demonstrating that the grantor has (1) collected certain basic information about a grantee; (2) conducted basic vetting of grantees, including a reasonable search of publicly available information to determine whether the foreign recipient organization is or has been suspected of activity relating to terrorism, including terrorist financing or other support, and to determine that the grantee and its key staff are not on the OFAC list or subject to OFAC sanctions, and (3) conducted basic vetting of its own key employees, including a reasonable search of publicly available sources to determine whether they are suspected of activities relating to terrorism or are subject to OFAC sanctions. Furthermore, if a charity's vetting practice leads to a finding that any of its own key employees, any of its grantees, or any of the key employees of grantees is suspected of terrorism activities, the Voluntary Treasury Guidelines direct the charity to take certain actions.

CHAPTER 44. Best Practices

At the present time, grant-makers do not possess any "official" guidance from the Treasury Department to aid in developing compliance plans and procedures that will satisfy the requirements of Executive Order 13224, the USA Patriot Act, and other laws. As discussed above, the Voluntary Treasury Guidelines are simply that: voluntary. Moreover, these guidelines can generate significant burdens on grant-makers, especially smaller organizations, and are expensive to carry out. Finally, there is no assurance that a grant-maker complying with the Voluntary Treasury Guidelines will avoid violating the law.



Part 7 Fundraising: Key Compliance Considerations

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PART 7. FUNDRAISING: KEY COMPLIANCE CONSIDERATIONS

CHAPTER 45. Charitable Solicitation in Washington

a. Overview

Washington, like other states, regulates persons and entities requesting contributions to support a charitable purpose. Charitable solicitation in Washington is governed by the Charitable Solicitations Act ("CSA"), RCW 19.09 and the Consumer Protection Act ("CPA"), RCW 19.86. The CSA regulates the activities of persons and entities that make almost any type of charitable appeal to the public, including persons and entities requesting or collecting funds for a charitable organization or purpose (or who say they do this) and businesses that say they are contributing to a charitable organization based on purchases of goods or services. The CPA is a statute that protects consumers from unfair or deceptive acts or practices in trade or commerce, which includes unfair or deceptive acts or practices in the context of charitable solicitations. Violations of the CSA are per se violations of the CPA. A person or entity that violates the CSA may face a civil action alleging violations of both statutes.

b. Regulation of Charitable Organizations Under the CSA

The CSA regulates charitable organizations, to provide the public information about charitable organizations that engage in fundraising in order to prevent deceptive and dishonest practices and the improper use of contributions that are intended for charitable purposes. The CSA requires charitable organizations to (1) register and file annual reports with the Charities Program of the Secretary of State, and (2) make certain disclosures when soliciting for charitable contributions.

(i) Definition of "Charitable Organization"

A "charitable organization" under the CSA is an entity that solicits or collects contributions from the general public where the contribution is, or is purported to be, used to support a charitable purpose. A "charitable organization" does not include commercial fund-raisers, commercial coventurers, or fund-raising counsel. *See* RCW 19.09.020(2). Churches and their integrated auxiliaries, and political organizations are not charitable organizations, but they must comply with RCW 19.09.100(15) through (18). *See* RCW 19.09.020(2). (These statutory provisions bar deceptive solicitations, govern how and when solicitations and collections occur, and forbid any form of harassment of donors and potential donors.) Religious organizations that are not churches or their integrated auxiliaries are charitable

organizations. RCW 19.09.020(16). The CSA broadly defines "charitable purpose." The definition includes, but is not limited to, the generally accepted meaning of assisting the poor, distressed, or underprivileged—it also includes religious, scientific, literary, educational, environmental, humanitarian, patriotic, and civic purposes. *See* RCW 19.09.020(3).

Here are examples of what constitutes a charitable organization and what does not:

- Any person or entity that solicits charitable contributions from the public is a charitable organization. This includes for-profit businesses or loose associations of people. It also includes firefighters' unions that ask members of the public to purchase tickets to an event to benefit their members.

- Entities that raise money for charitable causes and donate all of the money to those causes are not charitable organizations if they do not solicit or collect charitable contributions from the public.

- An entity that solicits contributions only from its members is not a charitable organization if membership in the entity is determined by the payment of dues, fees, or other assessments that confer bona fide rights, privileges, professional standing or other direct benefits, in addition to the right to vote, hold office, or elect officers. "Membership" does not include those who become members of the entity upon making a contribution because of a solicitation.

- Entities with a physical presence inside or outside Washington that maintain websites or send email messages that solicit or accept charitable contributions from Washington residents are charitable organizations.

(ii) Definition of "Solicitation"

The CSA defines "solicitation" as (1) any appeal for a contribution from the general public where there is an appeal for any charitable purpose; and (2) any offer or attempt to make a sale where an appeal is made for any charitable purpose, the name of a charitable organization is used to help make or attempt to make a sale, or it is stated or implied that all or part of sales proceeds will benefit any charitable purpose or be donated to any charitable organization. *See* RCW 19.09.020(19).

Here are examples of what constitutes a charitable solicitation and what does not:

- A telephone call in which the caller asks the recipient to buy a ticket to a concert to benefit disadvantaged youths is a charitable solicitation.
- A letter that asks for a contribution to a named charity is a charitable solicitation.
- A website that describes a program to help homeless people find work and explains how to make a donation is a charitable solicitation.
- A postcard asking for donations of used clothing and household items to benefit the disabled is a charitable solicitation.
- Grant applications or requests submitted to any foundation, corporation, governmental agency, or similar entity that has an established process for reviewing such requests are not charitable solicitations. WAC 434-120-025(9)(c)(i).
- Bingo, raffles, and amusement games regulated by the Gambling Commission. RCW 19.09.020(19)(c).
- Attempts to sell goods or services that constitute the basis for the charitable organization's activities for which federal tax exemption status was granted are not charitable solicitations. WAC 434-120-025(9)(c)(ii).

(iii) Registration and Reporting Requirements

All charitable organizations must register with the Secretary of State unless they are exempt from the CSA. RCW 19.09.065; WAC 434-120-105. Exempt charitable organizations include (1) charitable organizations that raise less than $50,000 in any accounting year if the organization's activities (including all fundraising activities) are conducted exclusively by volunteers and none of the organization's officers, directors, members, or trustees receive compensation or assets from the organization; and (2) persons or entities that appeal for funds on behalf of specific individuals named in the solicitation if all of the proceeds of the solicitation are given to or expended for the direct benefit of the named individual. RCW 19.09.081; WAC 434-120-100(2). To further evaluate whether or not a charitable organization is exempt from registering with the Charities Program of the Secretary of State, and other information on charity registration, Secretary of

State Charity Forms website https://www.sos.wa.gov/charities/allforms.aspx#charity.

Cannabis and donations: It is important to remember that although use and sale of recreational marijuana is legal under Washington State law, it is illegal under federal law. Nonprofits with 501(c)(3) tax-exemption should be careful not to be in violation of any federal laws, this includes being a part of any cannabis transactions including, but not limited to, cannabis donations or receiving money from a cannabis business. Nonprofit organizations may receive financial donations from a retailer or producer (grower) of cannabis if there is no advertisement associated with the donation. Because cannabis is illegal at the federal level, proceed with caution if the donation is significant enough to be claimed on your organization's IRS Form 990.

Charitable organizations must provide the information requested by the Secretary of State on an annual basis, through an annual filing with the Secretary of State, Charities division.

TIP:

Make sure you allow adequate time for your charitable solicitations registration to arrive by the due date. Charitable Solicitations registration filings are done by post mail and must be received by the annual due date. There is a late fee for registrations that are received late. There are no exceptions.

Among other things, nonprofits must provide the contact information for officers accepting responsibility for the charitable organization, the names of the three highest compensated officers or employees, and financial information, including revenue and the total amount applied to charitable purposes, expenses, and solicitation information. *See* RCW 19.09.075; WAC 434-120-105. In addition to the standard financial reporting required pursuant to RCW 19.09.075, for charitable organizations with more than one million dollars in annual gross revenue averaged over the three previously completed accounting years:

- If annual gross revenue is one million dollars to three million dollars averaged over the three previously completed accounting years, the organization must make available to the public upon request (or make it accessible to the public on the internet) the organization's federal financial reporting form (e.g., IRS Form 990, 990PF, 990T) prepared by

a professional in the business of preparing such forms or an audited financial statement prepared by an independent certified public accounting for the preceding accounting year.

- If annual gross revenue is more than three million dollars averaged over the three previously completed accounting years, the organization must make available in paper form to the public upon request (or make it accessible to the public on the internet) the organization's independent, third-party audit of its financial records for the preceding accounting year. *See* RCW 19.09.541.

If a charitable organization has existed for less than three years, the calculation of gross revenue is based on the number of years of existence. *See* WAC 434-120-107(1). The requirement to obtain an audited financial statement prepared by an independent certified public accountant may be waived by the Charities Program of the Secretary of State if the organization receives $500,000 or less in cash averaged over the prior three accounting years and complies with the reporting requirements for organizations with less annual gross revenue or if the organization can demonstrate that it reached the three-year average of more than three million dollars in gross revenue because of unusual or nonrecurring revenue received in a single year. *See* WAC 434-120-107(2).

All charitable organizations must register before conducting solicitations. Charitable organizations must renew their registrations and file reports annually. Conducting solicitations without current registration is a violation of the CSA and may result in legal action. *See* RCW 19.09.065.

c. Regulation of Commercial Fund-Raisers Under the CSA

A "commercial fund-raiser" under the CSA means a person or entity that (1) solicits or receives contributions for or on behalf of any charitable organization or charitable purpose in exchange for compensation or other consideration; or (2) is in the business of conducting charitable solicitations or receiving contributions on behalf of others (or who say they do this) in exchange for compensation or other consideration. *See* RCW 19.09.020(5).

"Fund-raising counsel," "consultants," and commercial coventurers are not commercial fund-raisers. "Fundraising counsel" or "consultants" are retained by charitable organizations under written agreement to provide services such as advice and counseling regarding charitable solicitation activities, and do not engage in any fundraising activities on behalf of others. *See* RCW 19.09.020(10).

Commercial coventurers are persons or entities in the business of selling goods or services to the public for profit and they make representations to potential buyers that the purchase of their goods or services will benefit a charitable organization. *See* RCW 19.09.020(4). Commercial coventurers are not in the business of making solicitations or otherwise raising funds for charitable organizations and they do not ask purchasers to make checks (or other forms of payment) payable directly to a charitable organization or other third party. *See* RCW 19.09.020(4).

Commercial fund-raisers must register and file reports annually with the Secretary of State using the required forms prior to conducting any charitable solicitations. *See* RCW 19.09.065; WAC 434-120-200. Commercial fund-raisers must file information pertaining to the charitable organizations with which they contract, financial information regarding the total value of the contributions received and disbursed, and solicitation information. *See* RCW 19.09.079; WAC 434-120-215.

A commercial fund-raiser must post a surety bond of at least $25,000 and file a copy of the bond with the Secretary of State, if it meets one of the four following criteria: (1) the commercial fund-raiser directly or indirectly receives contributions from the public on behalf of a charitable organization; (2) the commercial fund-raiser is compensated based on the amount of funds raised or the amount to be raised, on the number of solicitations made or to be made, or on a similar method; (3) the commercial fund-raiser incurs or is authorized to incur expenses on behalf of a charitable organization; or (4) the commercial fund-raiser had not been registered with the Secretary of State in the last accounting year. *See* RCW 19.09.191.

d. Contracts Between Charitable Organizations and Commercial Fund-Raisers

The CSA requires written contracts between charitable organization and commercial fund-raisers. *See* RCW 19.09.097. The contract must be filed with the Secretary of State before the commercial fund-raiser commences solicitation activities on behalf of the charitable organization. The contract must contain the following provisions:

- A requirement that both parties must comply with the law.
- A provision that allows the officers of the charitable organization reasonable access to the fund-raiser's (1) financial records pertaining to the charitable organization, (2) operations, including the ability to be present during telephone solicitations, and (3) the names of all of the

commercial fund-raiser's employees or staff who are conducting the solicitations.

- A statement of the amount of funds that the charitable organization will receive or the method of computing the amount, the commercial fund-raiser's compensation or the method of computing that amount, and whether the compensation is fixed or contingent.

e. Solicitation Requirements

The CSA applies broadly to appeals for support of charitable organizations or charitable purposes; there are a few specific exceptions, discussed below. "Solicitation" in this context refers to any form of request for a contribution or donation, including most invitations to become a "member" or "supporter" of an organization or cause. Therefore, anyone making a solicitation (including formally organized groups and ad hoc efforts) must comply with the solicitations rules regardless of whether they must register with the Secretary of State. There are several provisions of the CSA that do not apply to churches and their affiliate auxiliaries; however, they must comply with RCW 19.09.100(15) through (18) (see below).

When making a solicitation, the solicitor must disclose the following:

- The name of the individual who is making the solicitation;
- The name of the charitable organization and the city of its principal place of business; and
- If requested by the solicited person, the Secretary of State's published telephone number (1-800-332-4483) and website (https://www.sos.wa.gov/charities/).

If the solicitation is by telephone, the disclosures must be made during the solicitation but before asking for a commitment of a contribution, and in writing to any solicited person that makes a pledge within five business days of the pledge. *See* RCW 19.09.100(3).

Commercial fund-raisers making a solicitation must disclose the following:

- The name of the individual making the solicitation;
- The full name of the commercial fund-raiser;

- The name of the charitable organization and the city of its principal place of business; and

- If requested by the solicited person, the Secretary of State's published telephone number (1-800-332-4483) and website (https://www.sos.wa.gov/charities/).

Disclosures required in solicitations by advertisement or mass distribution (e.g., posters, brochures, publications, audio or visual broadcasts, automatic dialing devices) include:

- The solicitation is conducted by a commercial fund-raiser, if it is;

- The required CSA registration is on file with the Secretary of State (if the person or entity is required to file under the CSA); and

- Additional financial and other information can be obtained by calling the Secretary of State's published telephone number (1-800-332-4483) or visiting the Secretary of State online (https://www.sos.wa.gov/charities/). RCW 19.09.100(4).

Anyone using a vending machine or container to solicit must make these disclosures:

- The name of the charitable organization for which the funds are solicited;

- The name, business address, and telephone number of the individual and commercial fund-raiser responsible for collecting the funds in the containers or vending machines; and

- This statement: "This organization is currently registered with the secretary's office under the charitable solicitations act — call 1-800-332-4483" with the registration number (if the person or entity is required to file under the CSA). *See* RCW 19.09.100(5).

Persons or entities soliciting for charitable organizations whose names are similar to government entities are required to make these additional disclosures:

- Whether the charitable organization is or is not part of any government unit; and

- The true nature of its relationship with the government unit. *See* RCW 19.09.100(8).

Persons or entities soliciting contributions may not (or attempt to) collect contributions in person or by courier unless:

- Contributions are noncash items such as clothing or other tangible personal property; or

- Solicitations are made in person and the collections, or attempts to collect, are made at the time of the solicitations; or

- The contributor has agreed to purchase items in connection with the solicitation and the collection or attempt to collect is made at the time of delivery of the items. *See* RCW 19.09.100(18).

f. Prohibited Representations

The CSA prohibits the following representations:

- That a solicited contribution is tax deductible unless the charitable organization has received tax exempt status from the IRS. *See* RCW 19.09.100(7).

- That the person conducting the solicitation is a volunteer or words of similar meaning or effect that create the impression that the person soliciting is not a paid solicitor unless that person is not paid for his or her services. *See* RCW 19.09.100(7).

- That the person conducting the solicitation is a member, staff member, helper, or employee of the charitable organization or words of similar effect that create the impression that the person is not a paid solicitor if the person is employed, connected, or paid by a commercial fund-raiser. *See* RCW 19.09.100(7).

- Any statement that is false, misleading, or deceptive. All solicitations, advertising material, and promotional plans must fully and fairly disclose the identity of the entity on whose behalf the solicitation is made. *See* RCW 19.09.100(15).

- That tickets to any fundraising event will be donated for use by another person unless all of the following requirements are met:

- The person or entity conducting the solicitation has a written commitment from people stating that they will accept the donated tickets and the number of tickets they will accept;

- The written commitments are kept on file by the person or entity for three years and makes them available to the Secretary of State, Attorney General, or county prosecutor on demand;

- The contributions solicited for donated tickets do not exceed the amount representing the number of ticket commitments on file; and

- The commercial fund-raiser gives all of the tickets to the people who made the written commitments to receive them no later than seven calendar days prior to the ticketed event. *See* RCW 19.09.100(6).

g. Prohibited Conduct

The CSA also prohibits the following conduct as part of charitable solicitation:

- Using the words "police," "sheriff," "firefighters," or similar words in a solicitation unless properly authorized by the police, sheriff or firefighter department or organization has authorized that use in a writing signed by two authorized officials of the department or organization. *See* RCW 19.09.100(9).

- Using the name of a nationally known or federally chartered military veterans' service organization in a solicitation unless the highest ranking official of that organization in Washington State has authorized that use in writing. *See* RCW 19.09.100(10).

- Leading the public to believe that registration with the Secretary of State constitutes state endorsement or approval of the charitable organization or the solicitation activities. *See* RCW 19.09.100(14).

- Harassing, intimidating, or tormenting conduct during a telephone solicitation. *See* RCW 19.09.100(17).

- Making a telephone solicitation before 8:00 a.m. or after 9:00 p.m. Pacific time. *See* RCW 19.09.100(16).

- Failing to comply with RCW 19.09 or local regulations regarding charitable solicitation. *See* RCW 19.09.100(11)-(12).

- Solicitations by a charitable organization or commercial fund-raiser that has been, or whose officers, directors, or principals have been, convicted of a crime involving charitable solicitations in the United States or any other country within the past ten years, or subject to a permanent injunction, administrative order, or judgment pursuant to RCW 19.09.080 or RCW 19.09.090 involving a violation of RCW 19.86.020 within the past ten years. *See* RCW 19.09.100(13).

h. Record Keeping

The CSA requires that all charitable organizations and commercial fund-raisers maintain accurate books and records at their business location. Books and records must include, at a minimum, documentation supporting the information contained in solicitation reports and authorizations required under the CSA. *See* RCW 19.09.200(1). The records must be readily available and retained for three years after the period for which they relate expires. Contracts between charitable organizations and commercial fund-raisers must be maintained for three years after the period to which they relate expires. *See* RCW 19.09.200(2).

Charitable organizations, or commercial fund-raisers who solicit on their behalf, must keep records of the following contributors for three years following the contributions:

- Each contributing entity that collects individual contributions from an employee or member group or a business and turns them over to a charitable organization as a single sum.

- Each corporation that contributed.

- Each individual who contributed more than $25. *See* WAC 434-120-135.

All records, contracts, and contributor lists must be made available to the attorney general or the county prosecutor upon demand.

Commercial fund-raisers must submit financial statements to the Secretary of State, attorney general, or county prosecutor upon demand. The statements shall include, without limitation:

- The gross amount of the contributions pledged and the gross amount collected.
- The amount retained and the amount given or to be given to charitable organizations and the details of distribution.
- The aggregate amount paid and to be paid for solicitation expenses.
- The amounts paid and to be paid to charitable organizations.
- Copies of annual reports. *See* WAC 434-120-255.

i. The Consumer Protection Act

CPA prohibits unfair and deceptive acts or practices. *See* RCW 19.86.020. The CPA applies to fundraising activity regardless of whether the activity is covered by the CSA, if the activity is in trade or commerce. Violations of the CSA are per se violations of the CPA. *See* RCW 19.09.340.

Under the CPA, the attorney general may bring an action to enjoin unfair or deceptive acts or practices, including acts prohibited by the CSA. The court may award civil penalties of up to $2,000 per violation. RCW 19.86.140. The court may award attorneys' fees to the prevailing party. RCW 19.86.080. A private litigant may also bring an action under the CPA to enjoin unfair or deceptive acts or practices and, in addition, the court may award treble damages. The court may award attorneys' fees to the prevailing party. *See* RCW 19.86.090.

CHAPTER 46. Charitable Solicitation Outside of Washington and Internet Solicitations

a. Charitable Solicitation Laws in Other States

Most states require nonprofits who are asking for donations in their state to register under the charitable solicitations law of that state. The rules of each state are different. If a nonprofit organization is soliciting the public in a state outside of Washington, the nonprofit should check the rules for the states they are asking for donations in. Soliciting contributions in a state will trigger the state's charitable solicitation laws and require registration unless a specific exemption applies. The solicitation may be through mail, email, internet, in-person, at fundraisers, or through other fundraising methods.

As discussed in the previous chapter, Washington has a Charitable Solicitations Act, RCW 19.09, that requires registration for nonprofits that solicit contributions in Washington State. The Washington Charitable Solicitations Act also has and exemptions to those requirements for different types and size of nonprofit organization. Please see Chapter 45, above for more about Washington State rules.

Most other states have similar charitable solicitation rules to Washington, including registration requirements and exemptions (exceptions) to those requirements. *See* the IRS website (https://www.irs.gov/charities-non-profits/state-links) for links to other state requirements. State agencies may take action against persons or entities that fail to properly register or otherwise comply with solicitation requirements.

Nonprofits that solicit for donations nationally, will likely have to register in every state. There are service providers that offer state registration services.

If a nonprofit has not solicited in another state, but receives a donation from an individual in that state, under the "Charleston Principles" outlined below, industry standards do not require registration in that state.

If the nonprofit is engaging in fundraising that could be construed as soliciting nationwide, via the internet or otherwise, it is a "safe" option for a charity to decide to register nationwide. There is no single portal for registering in every state, although one is being considered by the National Association of State Charities Officials (see http://www.mrfpinc.org) and there are services that can assist with registrations.

Importantly, registration may bring to light other compliance obligations. For example, a registration may require a person or entity to pay annual filing fees, submit copies of fundraising contracts or summary of the terms of contracts, provide audited financial statements, make certain solicitation disclosures, qualify to do business, obtain a registered agent, or otherwise comply with the state's solicitation laws. In particular, many states have regulations that affect solicitation conduct (such as limits on the time of day when individuals may be approached with a request for a contribution); the person or entity who will benefit from any contribution is generally considered responsible for ensuring compliance with such rules whether or not it conducts other charitable activities in the state. Even if a person or entity is not required to register with a state, states retain the right to enforce their consumer protection and charitable solicitation laws against deceptive charitable solicitations such as fraud or misuse of charitable

contributions to the extent that there is an impact to persons or entities in their state.

b. Internet Solicitations

Internet solicitations are trickier. There is limited regulatory guidance with respect to charitable solicitation compliance if a person or entity is soliciting in a state solely through the internet. In an attempt to provide clarity, the National Association of State Charity Officials published internet registration guidelines known as the "Charleston Principles" which outline when registration in a foreign state is required:

- If the person or entity solicits through the internet and specifically targets (e.g., email, telephone, or direct mail) persons or entities physically located in the state; or
- If the person or entity solicits through the internet and receives contributions on a repeated and ongoing basis (the number of contributions may vary, but some states would say that 25 or more contributions per year is considered repeated and ongoing) from persons or entities physically located in the state; or
- If the person or entity solicits through the internet and receives substantial contributions (this amount may vary, but some states would say $25,000 or 1% of total contributions per year in the aggregate constitutes substantial contributions) from persons or entities physically located in the state.

However, many states advise that a person or entity soliciting contributions on the internet proactively register and comply with every state's charitable solicitations laws, particularly if the solicitations are broadcast widely and are likely to receive responses in many states.

Registering nationwide is not required so long as the following elements are met:

- The only connection with the state is a small number of donations
- There is no plan to actively target residents of that state, and

- The person or entity's role is passive (e.g., there is simply a "donate here" button with no further outreach to encourage residents in that state to donate).

"Donate Here" button: If the organization merely has a "donate here" button on its website, its work is solely in Washington and only solicits donations in Washington, it is commonly accepted that the organization does not have to register in states outside of Washington.

CHAPTER 47. Nonprofit Mailings

Many nonprofit organizations qualify for discounted rates when sending U.S. Postal Service marketing mail (also known as "bulk mail"). To qualify for special nonprofit rates, the organization must complete PS Form 3624, Application to Mail at Nonprofit USPS Marketing Mail Prices and wait for the Post Office to approve its request.

The cost of mailing at nonprofit marketing rates is lower than ordinary first-class mail but determining the actual rate depends on many factors including the size and weight of the mail, how it is addressed and sorted, and whether automated processing is possible. A rate chart is available online and should be consulted before mailing.

Also, under United States Postal Service rules, not only must the organization must qualify to use these preferential rates but it must also maintain its eligibility by making at least one qualifying mailing during a two-year period.

a. How to Apply for Nonprofit Rates

As mentioned above, the first step is to fill out Postal Service Form 3624, which is available online. Once authorization is granted, arrangements will need to be made to pay the postage for mailings. There are several options: special stamps, postage metering, or use of a PostalOne account from which the Postal Service will deduct the postage charges for each mailing as it occurs.

Many organizations may be recognized as tax-exempt by the IRS under section 501(c)(3), but such recognition is not, in and of itself, sufficient to assure eligibility under the Postal Service regulations. Generally, organizations are eligible if their primary purpose is religious, educational, scientific, philanthropic (charitable), agricultural, labor, veterans, or fraternal. The Postal Service's

understanding of these terms is explained in some detail at https://pe.usps.com/text/dmm300/703.htm#ep1114977.

Organizations that may be recognized as tax-exempt under other sections of the Internal Revenue Code, such as auto clubs, business leagues, chambers of commerce, civic improvement associations, service clubs, social and hobby clubs, and trade associations generally will not be granted the nonprofit mailing rate. Political groups and voting registration offices are specifically authorized to use nonprofit standard mail.

b. Nonprofit Mail Content

In addition to the overall eligibility as describe above, organizations must ensure that the content of its mail, if at nonprofit rates, does not violate any restrictions including the following:

- The authorization for mailing at nonprofit rates applies to a single organization and cannot be shared with or delegated to another. Contents must refer to the affairs and operations of the authorized organization itself.

- If several organizations are cooperating to produce and distribute a single mailing, all of the organizations must be authorized to mail at nonprofit rates at the same Post Office — the one where the mail is being deposited for delivery.

- The mailing cannot advertise any product or service that is not substantially related to the organization's purpose, and, specifically, cannot promote a credit or debit card, an insurance policy (unless it is primarily for the members of the organization and not commercially available otherwise), or travel arrangements that do not contribute substantially to achieving the organization's purpose.

When a mailing is presented at a Business Mail Entry office for delivery, it may be inspected before it is accepted. If the inspection suggests that any of these restrictions has been violated, the mailing may be rejected, or payment of regular first-class postage may be applied. If a mailing is subsequently identified as having been accidentally accepted, the mailer may be required to pay the difference between the postage paid at the time of mailing and regular first-class rates. These determinations can be appealed to the Postmaster of the office where the additional postage was paid.

c. How to Complete a Nonprofit Mailing

Nonprofit standard mailings must be delivered to a Business Mail Entry office (locations are listed online at https://ribbs.usps.gov/locators/find-bme.cfm).

The minimum size of a mailing is 200 pieces or 50 pounds. The pieces to be mailed must be sorted and bundled following very specific procedures. When the mailing is delivered to the Business Mail Entry office, it must be accompanied by a completed PS Form 3601-N; a PDF version of this form can be downloaded at https://about.usps.com/forms/ps3602n.pdf. The postage rate that will be applied to the mailing will depend on the kind of sorting that is reported by the mailer. For example, lower rates are available for mailings when the pieces are "automation ready" with postal service bar codes imprinted near the addresses from an address file that has been screened as the Postal Service requires. Several Postal Service "Quick Service Guides" outline these requirements; they can be obtained online. (The "Quick Service Guides" are updated frequently, so an online search for "USPS quick service guide" to find the most recent edition is advised. Specifics for Nonprofit Marketing Mail are described in each of the sections under Marketing Mail.)

Current rates for various mailings are shown on PS Form 3602 N for occasional mailings and 3541 N for periodicals—these two forms are known as Postage Statements and are used to calculate the postage due at the time of mailing.

When nonprofit standard mail is presented for mailing at the Bulk Mail facility, a Postal Service employee reviews the Postage Statement, examines the items to be mailed, and checks to see if the postage charge is proper. The mailing will be rejected if the Post Office's requirements are not met. Errors on the Postage Statement can usually be corrected immediately. If the review of the items to be mailed suggests that they are not eligible to be mailed at nonprofit rates, it is possible to agree to pay the higher rate in order to have the mailing go out immediately and appeal the extra charges later through an administrative process. If the mail is marked with a Nonprofit Mailing Permit number (called "nonprofit indicia" by the Postal Service) and the deposit account balance is insufficient to cover the mailing, the facility may agree to hold it while a deposit is made.

d. Mailing Services

Many nonprofit organizations rely on mailing services to prepare nonprofit marketing mail to these specifications. Their services range from simply sorting,

bundling and delivering to the Business Mail Entry office to comprehensive consultation about the design and strategy of a continuing mailing program. Many firms that provide these services can be located online by searching for "Mailing Services."

e. Troubleshooting

Common mistakes or missteps that disqualify a nonprofit's mail from the special rate include:

- Items that are not identical. It is best to check in advance with the post office when there will be any variation from piece to piece.
- Use of an organization's permit to attempt a mailing for another organization that has not received authorization.
- Problems with "cooperative mailings" where more than one organization is sharing costs, risks, or benefits. Such an arrangement is only possible when all the cooperating organizations are authorized to mail at nonprofit rates and (unless special arrangements have been made) at the same Post Office.
- The mailing includes words such as "sponsored by" that suggest that some organization other than the authorized nonprofit mailer will benefit directly from the mail's distribution.
- The mailing contains promotional mention of travel, credit card, insurance or certain other goods or services.

There are different requirements for periodical mailings (which generally may contain advertising without loss of nonprofit eligibility). Considerations are discussed in useful detail in Publication 417.

The practice of using postage-paid reply envelopes or cards is covered by a separate set of regulations and standards. There are no special provisions for nonprofit organizations using business-reply mail.

The Postal Service will review the content of planned mailings while in the preparation stage. When difficulties can be foreseen in the preparation of a mailing, a Business Mail Entry office can provide advice and assistance. If there are any areas of concern that remain, the results of the prescreening may be requested in the form of a letter.

The Postal Service sends announcements and other information to authorized nonprofit organizations from time to time. It also conducts occasional training and information sessions and participates in meetings for mailers and other interested parties. Once an organization has been authorized to mail at nonprofit rates, these informational mailings and invitations are sent automatically.

Resources:

- *Nonprofit USPS Marketing Mail Eligibility* (Publication 417) has detailed instructions on applying for authorization to mail at nonprofit rates and the types of mail that can be sent. The text is available on the Postal Service website at https://pe.usps.com/text/pub417/welcome.htm.

- Application for Nonprofit post rate. A blank Postal Service Form 3624 is available at http://about.usps.com/forms/ps3624.pdf.

CHAPTER 48. Requirements for Deducting Contributions

A charitable contribution is deductible by the donor only if the donor and the donee organization (the nonprofit receiving the donation) follow certain verification procedures. While the majority of the burden to "substantiate" a charitable contribution falls on the donor, the donee organization has certain responsibilities of its own under the substantiation rules. This Chapter addresses the following topics: (a) the confirmation that the donee organization is qualified to receive deductible contributions; (b) the substantiation requirements for donors; (c) the "contemporaneous acknowledgment" requirement for donee organizations; (d) the "quid pro quo contribution" disclosure requirement for donee organizations; (e) the information return filing requirement for donee organizations selling contributed property within three years of receipt; and (f) gifts of property, including vehicles.

a. Donee Organization Must Be Qualified

To be deductible, a contribution must be made to, or for the use of, a qualified organization and not set aside for use by a specific person. A taxpayer claiming a charitable deduction has the burden of establishing that the donee organization is qualified to receive deductible contributions. Rather than compel donors to rely on the organization's statements or to prove independently that it is a qualified recipient, the IRS issues a Cumulative List of Exempt Organizations (IRS Publication 78).

The IRS has an online search tool at https://www.irs.gov/charities-non-profits/tax-exempt-organization-search that allows users to search for certain information about an exempt organization's federal tax status. It allows users to check whether an organization:

- Is eligible to receive tax-deductible charitable contributions
- Has filed a Form 990-N (e-Postcard) annual electronic notice
- Has had its tax-exempt status automatically revoked because it has not filed its required Form 990-series return for three consecutive years

The list of organizations eligible to receive tax-deductible charitable contributions is updated monthly.

Contributors and grantors may rely on either the Tax Exempt Organization Search or the Exempt Organizations Business Master File Extract (EO BMF). Both are updated monthly, although not necessarily on the same day. To assist with searches, the IRS publishes the date the information was posted. More information is found in Search Tips and Revenue Procedure 2011-33, Updated Reliance Rules for Practitioners.

If an organization has not received an IRS ruling confirming its tax-exempt status, the deductibility of contributions to the organization depends on when the donee was organized. If it was organized before October 10, 1969, the donor may establish that the organization satisfies the requirements of section 170(c) of the Code, a showing that can call for detailed analysis of the organization's charter, bylaws, and activities. *See* S. Rep. No. 552, 91st Cong., 2d Sess., *reprinted in* 1969-3 C.B. 459. If the donee was organized after October 9, 1969:

- The organization is not a 501(c)(3) organization unless it gives notice to the IRS of its application for recognition of exempt status (*see* section 508(a)(1) of the Code);
- If notice is not given within 27 months after incorporation, exempt status is not recognized for any period before the notice is given (*see* section 508(a)(2) of the Code); and
- No deduction is allowed for gifts or bequests made while the organization is not exempt (*see* section 508(d)(2)(B) of the Code).

In contrast, if timely notice is given and the organization is qualified, contributions are deductible, even if the contribution is made before the application for tax exemption is filed.

The foregoing rule requires would-be exempt organizations organized after October 9, 1969, to give notice to the IRS of their existence and to the status they claim by applying for tax exemption. The effect of the notice is procedural rather than substantive, and the action taken by the IRS on the application is not conclusive. Nevertheless, a favorable determination letter from the IRS is of great practical importance because it reassures potential donors and, unless revoked, relieves them of the need to prove independently that the organization is qualified to receive deductible contributions.

The requirement to apply for tax exemption does not apply to:

- Churches and certain related organizations;
- Organizations, other than private foundations, that do not normally have gross receipts in excess of $5,000 per taxable year; and
- Subordinate organizations, other than private foundations, covered by a group exemption letter.

b. Requirements for Donors

(i) Gifts of Property

An individual, partnership, or corporation is allowed no deduction for a charitable gift of property claimed to exceed $500 unless (i) the donor's return for the year during which the gift was made includes a description of the property and such other information as the IRS may require, or (ii) the donor shows that the failure to include this statement was "due to reasonable cause and not to willful neglect." *See* Code sections 170(f)(11)(A)(i), 170(f)(11)(A)(ii)(II), 170(f)(11)(B). For purposes of the dollar threshold, all similar items of property donated to one or more organizations are treated as one property. *See* Code § 170(f)(11)(F).

This requirement applies to a C corporation only if it is either a personal service corporation or a closely held C corporation. *See* Code sections 170(f)(11)(A)(i), 170(f)(11)(B). With respect to a gift by a partnership or S corporation, the partnership or corporation must include a statement with its return, but if the statement is not so included, the deduction is denied at the partner or shareholder level. *See* Code section 170(f)(11)(G).

Contributions of certain property are subject to special rules under federal tax law. These include contributions of:

- Clothing or household items;
- A car, boat, or airplane;
- Taxidermy property;
- Property subject to a debt;
- A partial interest in property;
- A fractional interest in tangible personal property.

This chapter will provide general information regarding gifts of property and some information regarding gifts of vehicles. IRS Publication 526 contains information regarding the special rules for gifts of the other types of property listed above.

(ii) Appraisal Requirement

An individual, partnership, or corporation is allowed a deduction for a charitable contribution greater than $5,000 if the donor obtains a qualified appraisal of the property and the donor's return for the taxable year the contribution was made includes information regarding the property and the appraisal, as the IRS may require. *See* Code section 170(f)(11)(C). If the claimed deduction exceeds $500,000, the donor's return must include a copy of the qualified appraisal. *See* Code section 170(f)(11)(D). These requirements apply to a C corporation whether or not it is a personal service corporation or closely held corporation. They do not, however, apply to gifts of cash, inventory property, and publicly traded securities or to gifts of vehicles, which are governed by different rules described below. *See* Code section 170(f)(11)(A)(ii)(I). Also, a taxpayer failing to meet the requirements may salvage the deduction by showing that the failure is due to reasonable cause and not to willful neglect. *See* Code section 170(f)(11)(A)(ii)(II).

For purposes of the appraisal requirements, including the $5,000 and $500,000 thresholds, all similar items of property donated to one or more organizations shall be treated as one property. *See* Code section 170(f)(11)(F). With respect to a gift by a partnership or S corporation, the requirements apply at the

entity level, but if they are not satisfied, the deduction is denied at the partner or shareholder level.

A qualified appraisal is an appraisal satisfying requirements established by the Treasury or IRS. *See* Code section 170(f)(11)(E). An appraisal is qualified if it meets four requirements. *See* Treas. Reg. section 1.170A-13(c)(3)(i).

- First, it must be made not earlier than 60 days before the gift or later than the due date (with extensions) of the return on which the deduction is claimed.

- Second, it must be made by a "qualified appraiser," who must sign and date the appraisal report. To be qualified, an appraiser must declare in the report that he or she:

    - Performs appraisals regularly or holds himself or herself out to the public as an appraiser;

    - Is qualified to appraise property of the type involved;

    - Is not the donor, the donee, the person from whom the donor acquired the property, or a person employed by or related to any of the foregoing; and

    - Understands that an intentionally false or fraudulent appraisal subjects him or her to penalties.

- Third, a qualified appraisal must be embodied in a report that contains several items of information. *See* Treas. Reg. section 1.170A-13(c)(3)(ii).

    - The report must describe the property sufficiently so that a person other than an expert can tell that the property appraised is the donated property.

    - If the property is tangible, the report must describe its physical condition.

    - Any agreement or understanding limiting the donee's use of the property must be described.

    - The report must state the appraiser's name, address, and taxpayer identification number, describe the appraiser's

qualifications, and note the date of the appraisal and the date (or expected date) of the taxpayer's gift.

- The report must state the property's fair market value on the date of the gift and describe the valuation method or methods used in determining that value and the facts used in applying that method.

- Fourth, an appraisal is not qualified if the appraiser receives a fee calculated as a percentage of the donated property's value or a fee that may vary with the amount allowed as a charitable deduction. *See* Treas. Reg. section 1.170A-13(c)(6).

Generally, a separate qualified appraisal is required for each item of property. *See* Treas. Reg. section 1.170A-13(c)(3)(iv)(A). However, if a taxpayer makes two or more gifts of similar items of property to one or more organizations within a taxable year, one appraisal may cover all of these gifts. A donor must obtain an appraisal not later than the due date (with extensions) of the return on which the deduction for the gift is claimed. *See* Treas. Reg. section 1.170A-13(c)(3)(iv)(B). A taxpayer must retain an appraisal for so long as it may be relevant in the administration of any internal revenue law. *See* Treas. Reg. section 1.170A-13(c)(3)(iv)(C).

(iii) IRS Form 8283

Donors must report noncash gifts in excess of $500 on Form 8283, which is attached to donor's tax return. The donor must provide information on the type and amount of the gift, including a description of property, the date of gift, the date the property was acquired by the donor, how the property was acquired, the donor's cost or other tax basis, and the fair market value of the property and how it was determined. Schedule B to the form is an appraisal summary of the qualified appraisal required for donated property of $5,000 or more (except for publicly traded securities).

c. Acknowledgment Requirement for Donee Organizations

A contribution of $250 or more is not deductible unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee organization. *See* Code section 170(f)(8)(A). If the taxpayer gives $250 or more to an organization more than once during a particular year, the deduction for gifts may be substantiated by one acknowledgment

covering all of the gifts or by a separate acknowledgment for each gift. *See* Treas. Reg. section 1.170A-13(f)(1). The $250 threshold applies separately to separate gifts, and no contemporaneous acknowledgment is required for separate contributions of less than $250 each, even if the sum of the taxpayer's contributions to the donee organization during the taxable year equals $250 or more. *See id.*

If the donor's payment is distributed to another charity, the initial payee is usually treated as the donee for this purpose, even if the ultimate recipient of the funds is designated by the taxpayer. *See* Treas. Reg. section 1.170A-13(f)(12). However, if the ultimate recipient provides goods or services to the taxpayer and the payment is put through the intermediate charity in an attempt to avoid a reduction of the taxpayer's deduction for the value of the goods or services, the gift is deemed made to the ultimate recipient, not the intermediate charity.

The contemporaneous acknowledgment must state the amount of a cash contribution and provide a description, but not a valuation, of donated property other than cash. *See* Code section 170(f)(8)(B). It must also state whether the donee organization provided any goods or services in consideration for the contribution and, if so, it must include a description and good faith estimate of the value of these goods or services. However, no contemporaneous acknowledgment is required if, after subtracting the value of the goods and services, the charitable gift is less than $250. *See* Treas. Reg. section 1.170A-13(f)(1).

If the donee organization provides any intangible religious benefits, the acknowledgment must contain a statement to that effect. *See* Code section 170(f)(8)(B)(iii). An "intangible religious benefit" is a benefit provided by an organization organized exclusively for religious purposes that generally is not sold in a commercial transaction outside the donative context. *See* Code section 170(f)(8)(B). An example is admission to a religious ceremony. *See* H.R. Rep. No. 213, 103d Cong., 1st Sess. 566. Tuition for education leading to a recognized degree, travel services, and consumer goods are not intangible religious benefits unless they are *de minimis* and incidental to a religious ceremony (e.g., communion wine). *See id.* at n.34.

The acknowledgment need not contain the donor's taxpayer identification number. *See* H.R. Rep. No. 213, 103d Cong., 1st Sess. 565 n.30. No particular form is required, and the acknowledgment may consist, for example, of a letter, postcard, or computer-generated form. *See id.* at n.32. An acknowledgment is contemporaneous if the taxpayer obtains it no later than the date on which the

taxpayer's return for the year is filed or, if earlier, the filing due date, taking extensions into account. *See* Code section 170(f)(8)(C).

For a taxpayer performing gratuitous services for charity, unreimbursed expenses incident to these services are considered adequately substantiated if the taxpayer's records adequately substantiate the amount of the expenses and the charity provides a written statement:

- Describing the taxpayer's services;
- Stating whether the organization provided any goods or services in consideration for the unreimbursed expenses and, if so, providing a good faith estimate of the value of the goods or services; and
- Stating whether the organization provided any intangible religious benefits for the taxpayer. *See* Treas. Reg. section 1.170A-13(f)(10).

If payments to charity are made by withholding from the taxpayer's salary or wages, the amount withheld from each payment of wages is a separate contribution for purposes of the $250 threshold. *See* Treas. Reg. section 1.170A-13(f)(11). If the amount withheld for any pay period is $250 or more, the gift is adequately substantiated by a pay stub or Form W-2 from the employer stating the amount withheld and the recipient of the withheld amount, and a pledge card or other document prepared by or at the direction of the donee organization stating that the organization provides no goods or services in consideration for contributions made by payroll deduction.

A contribution by a partnership or S corporation is treated as made by the entity, not its partners or shareholders, who are allowed the deduction for the gift. *See* Treas. Reg. section 1.170A-13(f)(15). The entity must therefore obtain contemporaneous acknowledgment for a gift of $250 or more, even if no partner's or shareholder's share of the gift is as much as $250, and a partner or shareholder whose share of the gift is $250 or more is not required to substantiate the gift further.

The contemporaneous acknowledgment requirement is waived if the donee organization files a return including the information required to be given by the acknowledgment. *See* Code section 170(f)(8)(D). Also, the Treasury, by regulations, may waive some or all of the requirements of the acknowledgment rule in appropriate cases. *See* Code section 170(f)(8)(E).

d. Quid Pro Quo Contribution Requirement for Donee Organizations

The recipient of a quid pro quo contribution in excess of $75 must provide a written statement to the donor in connection with the solicitation or receipt of the contribution. *See* Code section 6115(a). The term "quid pro quo contribution" generally includes any payment made partly as a contribution and partly in consideration for goods or services provided to the donor by the donee organization. *See* Code section 6115(b). However, a contribution to a religious organization is not quid pro quo if the donor receives solely an intangible religious benefit that generally is not sold in a commercial transaction outside the donative context. Also, no statement is required for a gift to the federal government or a state or local government if the gift is exclusively for public purposes. *See* Code section 6115(a). Moreover, transactions that have no donative element (e.g., sales of goods by a museum gift shop that are not, in part, donations) are not quid pro quo contributions. *See* H.R. Rep. 213, 103d Cong., 1st Sess. 566. The $75 threshold is applied separately to each contribution. *See id.* at n.36.

The statement required must inform the donor that the federal income tax deduction for the contribution is limited to the amount of the contribution (the sum of the money and the fair market value of any contributed property), less the value of the goods or services provided by the organization. *See* Code section 6115(a)(1). The organization must also provide a good faith estimate of the value of such goods or services. *See* Code section 6115(a)(2).

The organization may estimate fair market value by any reasonable method, so long as the method is applied in good faith. *See* Treas. Reg. section 1.6115-1(a)(1). If the goods or services are not generally available in a commercial transaction, their value may be estimated by reference to the fair market value of similar or comparable goods or services, even if those goods or services do not have the unique qualities of the goods or services that are being valued. *See* Treas. Reg. section 1.6115-1(a)(2).

Various goods and services, including many items of smaller value and most benefits allowed to members who pay annual membership contributions of $75 or less, may be disregarded in determining whether a contribution is quid pro quo and, if so, in valuing goods or services. *See* Treas. Reg. section 1.6115-1(b). These items are also disregarded if they are provided to employees or partners of a corporate or partnership donor. *See* Treas. Reg. section 1.6115-1(d)(1).

The statement need not be in any particular form, but the disclosure must be made in a manner that is reasonably likely to come to the attention of the donor. *See* H.R. Rep. No. 213, 103d Cong., 1st Sess. 566 n.35. A disclosure of the required information in small print set forth within a larger document might not meet the requirement.

A penalty of $10 is usually imposed for each quid pro quo contribution for which the required written statement is not provided. *See* Code section 6714(a). The penalties will apply if an organization either fails to make any disclosure in connection with a quid pro quo contribution or makes a disclosure that is incomplete or inaccurate. *See* H.R. Rep. No. 213, 103d Cong., 1st Sess. 566. However, the aggregate penalty for a particular fundraising event or mailing may not exceed $5,000, and the penalty is excused for a contribution if the failure to provide the statement is due to reasonable cause. *See* Code section 6714(a), (b).

A donor receiving a quid pro quo contribution can generally rely on a written acknowledgment provided by the charity in valuing the charitable gift, but a donor must disregard the charity's valuation if the donor knows, or has reason to know, that such treatment is unreasonable. *See* Treas. Reg. section 1.170A-1(h)(4).

e. Information Return Requirement for Donee Organizations Selling Contributed Property Within Three Years of Receipt

If a recipient of charitable deduction property sells, exchanges, or otherwise disposes of the property within two years after receiving it, it must file a Form 8282, which is an information return showing:

- The donor's name, address, and taxpayer identification number;
- A description of the property;
- The date of the contribution;
- The amount received on the disposition;
- The date of such disposition;
- A description of the donee's use of the property; and
- A statement indicating whether the use of the property was related to the purpose or function constituting the basis for the donee's exemption under Code section 501. *See* Code section 6050L(a)(1).

"Charitable deduction property" is property other than money for which a donor claimed a charitable deduction based on a claimed value that, when added to the claimed value of all similar items of property donated by the donor to one or more donees, exceeds $5,000. *See* Code section 6050L(a)(2)(A). Publicly traded securities for which market quotations were readily available on an established securities market when the contribution was made are not charitable deduction property and are disregarded in applying the $5,000 threshold. *See* Code section 6050L(a)(2)(B). The donee must furnish a copy of the return to the donor. *See* Code section 6050L(c).

If the original donee transfers the property to another charitable organization within three years, the original donee should provide a copy of its report on the transfer to the successor donee, and the successor donee should also report any disposition it makes within three years after the original gift. *See* Treas. Reg. section 1.6050L-1(c). The return is due 125 days after a disposition triggering the obligation to file. *See* Treas. Reg. section 1.6050L-1(f). The information return is excused in three situations:

- First, it need not be filed if the gift is of money or publicly traded securities or if, for some other reason, the donee is not required to sign an appraisal summary under the donor substantiation rules described above. *See* Treas. Reg. section 1.6050L-1(e).

- Second, no return is required to report the sale of an item if the donor attests in the appraisal summary that the item's appraised value does not exceed $500. *See* Treas. Reg. section 1.6050L-1(a)(2).

- Third, the return need not be filed if the property is consumed by the donee in the pursuit of its charitable purposes. *See* Treas. Reg. section 1.6050L-1(a)(3).

f. Gifts of Vehicles

If the claimed value of a charitable gift of a qualified vehicle exceeds $500, no deduction is allowed for the gift unless the donor substantiates it with a contemporaneous written acknowledgment from the donee organization and includes the acknowledgment with the return on which the deduction is claimed. Even if so substantiated, the deduction may not exceed the donee's gross proceeds on selling the vehicle unless the donee uses the vehicle in its charitable activities or materially improves it. *See* Code section 170(f)(12).

(i) Qualified Vehicles

A "qualified vehicle" is a motor vehicle manufactured primarily for use on public streets, roads, and highways, a boat, or an airplane. *See* Code section 170(f)(12)(E). While the rules apply to donations of new as well as used vehicles, they do not apply to a donor that held a donated vehicle as inventory or for sale to customers in the ordinary course of business.

(ii) Vehicles Sold Without Significant Intervening Use or Material Improvement

If a donee organization receiving a charitable gift of a qualified vehicle sells it without making any significant intervening use or material improvement of the vehicle and realizes gross sales proceeds exceeding $500, the donor's deduction for the gift is the lesser of the gross proceeds or the vehicle's fair market value at the time of the gift, provided all other requirements of Code section 170 are satisfied. *See* Code section 170(f)(12)(A)(ii). If the gross sales proceeds are $500 or less, the donor's deduction is the lesser of the vehicle's fair market value when contributed or $500. *See* Notice 2005-44, 2005-25 I.R.B. 1287, section 4.02.

(iii) Vehicles Significantly Used or Materially Improved

The rule limiting the deduction for a charitable gift of a qualified vehicle to the gross proceeds on the donee organization's sale does not apply if the donee significantly uses or materially improves the vehicle before selling it. *See* Code section 170(f)(12)(A)(ii). If properly substantiated, the deduction for such a contribution equals the vehicle's fair market value when donated.

To meet the significant use test, an organization must actually use the vehicle to substantially further the organization's regularly conducted activities, and the use must be significant. A donee organization will not be considered to significantly use a qualified vehicle if the use is incidental or not intended at the time of the contribution. Whether a use is significant also depends on the frequency and duration of use. *See* Notice 2005-44, 2005-25 I.R.B. 1287, section 7.01(1).

Material improvements include major repairs to a vehicle, or other improvements to the vehicle that improve the condition of the vehicle in a manner that significantly increases the vehicle's value, but not cleaning, minor repairs, or routine maintenance. *See id.* section 7.01(2). Services not qualifying as material improvements include painting, waxing, rustproofing, applications of other finishes, removal of dents and scratches, repair of upholstery, and installation of theft

deterrent devices. *See id.* Moreover, an improvement funded by an additional payment to the donee organization from the donor of the qualified vehicle cannot be a material improvement, regardless of its nature.

(iv) Vehicles Transferred to Needy Individuals

The rule limiting the deduction to the gross proceeds on a donee organization's sale without significant use or material improvement does not apply if the donee sells a qualified vehicle to a needy individual at a price significantly below fair market value or makes a gift of the vehicle to such an individual in direct furtherance of a charitable purpose of the donee organization of relieving the poor and distressed or the underprivileged who are in need of a means of transportation. *See id.* section 3.02(3). The charitable purpose must be served by making vehicles available to the sellers or transferees; it is not sufficient that the charity uses the proceeds of sales to help needy individuals for charitable purposes. *See id.*

(v) Fair Market Value

The fair market value of a qualified vehicle, like that of any other property, is the price at which the property would change hands between a willing buyer and a willing seller, neither being under a compulsion to buy or sell and each having reasonable knowledge of relevant facts. *See* Treas. Reg. section 1.170A-1(c)(2). An established used vehicle pricing guide establishes a particular vehicle's value only if it lists a sales price for a vehicle that is the same make, model, and year, sold in the same area, in the same condition, with the same or substantially similar options or accessories, and with the same or substantially similar warranties or guarantees, as the vehicle in question. *See* Notice 2005-44, 2005-25 I.R.B. 1287, section 5. A donor of a qualified vehicle must obtain a qualified appraisal if his or her deduction is not limited to the gross proceeds of the donee organization's sale of the vehicle and is claimed to exceed $5,000. *See id.* section 6.

(vi) Acknowledgments

For a gift of a vehicle with a claimed value exceeding $500, the donee organization's acknowledgment must include the donor's name and taxpayer identification number, the vehicle identification number of the donated vehicle, and the date of the contribution. *See* Code section 170(f)(12)(B). If the donee sells the vehicle without a significant intervening use or material improvement, the acknowledgment must also certify that the vehicle was sold in an arm's length transaction between unrelated parties, indicate the date and gross proceeds of the

sale, and state that the donor's deduction may not exceed the gross sale proceeds. *See* Code section 170(f)(12)(B)(iii). If the donee intends to use or improve the vehicle, the acknowledgment must include a certification and detailed description of the intended use or improvement, the intended duration of such a use, and a certification that the vehicle will not be sold before the use or improvement is completed. *See* Code section 170(f)(12)(B)(iv). If the donee intends to sell or give the vehicle to a needy person at a price significantly below fair market value in direct furtherance of a charitable purpose, the acknowledgment must also certify that the donee will make such a sale or gift and that the sale or gift will directly further the organization's charitable purpose of relieving poor and distressed or underprivileged persons in need of means of transportation. *See* Notice 2005-44, 2005-25 I.R.B. 1287, section 3.03(4).

An acknowledgment must be "contemporaneous." A donee organization satisfies this requirement by providing an acknowledgment within 30 days after its sells a vehicle at fair market value or, if the acknowledgment certifies an intended use, improvement, or sale or gift to a needy person, within 30 days after the contribution is made. *See* Code section 170(f)(12)(C). A donee organization must provide the information contained in an acknowledgment to the IRS. *See* Code section 170(f)(12)(D). An organization may provide an acknowledgment in any reasonable manner. *See* Notice 2005-44, 2005-25 I.R.B. 1287, section 8.03. A donee must report contributions of qualified vehicles to the IRS on Form 1098-C and may use copies of this form as contemporaneous written acknowledgments to donors.

(vii) Penalties for False or Fraudulent Acknowledgments

The IRS may impose a penalty on a donee organization required to furnish a contemporaneous written acknowledgment to a donor of a qualified vehicle if the organization knowingly furnishes a false or fraudulent acknowledgment or knowingly fails to furnish such acknowledgment in the manner, at the time, and showing the information required by the foregoing rules. *See* Code section 6720. For each vehicle that the donee organization sells without significant intervening use or material improvement, the penalty for a false or fraudulent acknowledgment, no acknowledgment, or a noncompliant acknowledgment is the greater of the gross sale proceeds or 35% of the sales price stated in the acknowledgment. *See* Code section 6720(1). If a donee organization does not so sell a vehicle, the penalty for a false or fraudulent acknowledgment is the greater of 35% of the claimed value of the vehicle or $5,000. *See* Code section 6720(2).

CHAPTER 49. Fundraising Involving Gambling

a. Introduction

All gambling in Washington State, with the exception of the state lottery and horseracing, is subject to regulation by the Washington State Gambling Commission (and in certain circumstances, controlled by tribal governments). Qualified nonprofit organizations may hold gambling activities to raise funds. While some gambling activities are allowed without a gambling license, other activities require licensure from the Gambling Commission.

Gambling is defined as an activity that has three elements: consideration, chance and prize. These terms are further defined as:

- Consideration: Payment
- Chance: Outcome not determined by skill
- Prize: Money or anything of value

All three elements must be met for the activity to constitute gambling.

b. Unlicensed Gambling Activities

The forms of gambling that can occur without a license are described, along with limitations or restrictions, in the Gambling Commission's pamphlet, "Unlicensed Gambling Activities for Charitable/Nonprofit Organizations." This pamphlet is available on the Gambling Commission's website, https://www.wsgc.wa.gov/. Permitted activities include bingo; raffles and amusement games; raffles for members only; turkey shoots; golfing sweepstakes; card and dice games and limited social card games. In most cases, the total receipts from such activities cannot exceed $5,000 per year, and participation is often restricted to members of the organization or members and their guests.

Only certain authorized charitable and nonprofit organizations are permitted to host or organize these forms of unlicensed gambling activities. An authorized organization is one that has been in operation for at least 12 months prior to the gambling event or activity, and it must be able to show that it has made "significant progress toward achieving [its] stated purposes" during the preceding 12 months.

c. Gambling Licensing

All other gambling activities require a license. RCW 9.46.010 states gambling activities must be for "the raising of funds for the promotion of bona fide charitable or nonprofit organizations is in the public interest" when conducted as authorized by the law. Accordingly, charitable and nonprofit organizations may apply for a license to engage in various sorts of gambling for fundraising purposes. In addition to the requirements for unlicensed activities, organizations seeking a license for gambling activities must have at least 15 members with authority to elect board members, and there are many other requirements to consider before proceeding.

Generally, a nonprofit needs a gambling license for gambling activities if either 1) the total annual receipts from such activities is more than $5,000 or the nonprofit holds more than 2 gambling events (raffles, bingo or amusements games) in a year. In addition, there are different licensing requirements for public and private (member only) activities. If your activity is open to the public, a license may be required. Please review specific rules on the Gambling Commission's website, see the Liquor, Cannabis, Gambling...and Your Fundraising Event Toolkit or call the Gambling Commission directly.

d. Record Keeping

The Gambling Commission requires organizations to keep records, of certain gambling activities, such as licensed raffles. Example records can be found on the Gambling Commission website. The Gambling Commission also requires that all funds collected from gambling be accounted for with an audit trail showing the funds raised from gambling were used to further the organization's stated purpose. Some activities even require organizations to maintain a separate gambling receipts bank account.

e. Reporting Theft

The Gambling Commission is a limited jurisdiction law enforcement agency. Their agents are trained in conducting investigations. If you suspect a theft of gambling funds, contact them for help. Their agents will also help answer questions regarding gambling.

f. Tax Considerations

Lastly, there are federal tax considerations that require attention before an exempt organization engages in a gambling activity. A useful summary is in IRS Publication 3079, which can be found at http://www.irs.gov/pub/irs-pdf/p3079.pdf.

CHAPTER 50. Liquor and Cannabis at Nonprofit Events

Liquor and Cannabis in Washington is regulated by the Washington State Liquor and Cannabis Board ("WSLCB" – http://www.lcb.wa.gov). Before hosting an event where liquor is served, sold, or offered as a raffle prize, nonprofits should review current Liquor and Cannabis Board rules. The Liquor, Cannabis, Gambling...and Your Fundraising Event toolkit breaks down and charts the complex rules for liquor, cannabis and gambling at fundraising events.

Serving liquor at an event can expose an organization to a wide variety of risks. Before planning a party or any other activity involving liquor, consider consulting with a knowledgeable insurance agent to review the coverages in place, or needed. Venues where alcoholic beverages are served may also require insurance and impose other conditions.

Banquet Permits: Nonprofit organizations that serve alcohol at events will need to obtain a banquet permit from the WSLCB before serving liquor at an event. Once the permit is issued, a WSLCB inspector or law-enforcement agent may visit the venue during the event to determine that all requirements have been met including the following:

- The event is by invitation only; it cannot be advertised or open to the public.
- The liquor must be bought at full retail price from a Washington liquor dealer or brought by the participants. Donated liquor may not be served.
- While there may be a charge for attending the event, there cannot be any separate charge for liquor; scrip or drink tickets may be provided to attendees so that all participants share equally.
- Liquor may not be served between the hours of 2am and 6 am or to anyone under 21 years old.

- If the location or venue requires any other permits for the event, those permits must also be obtained.

- To raffle liquor at an unadvertised, members-only event requires a raffle permit from the WSLCB and a raffle license from the Washington State Gambling Commission (WSGC). Information for how to apply for these and other licenses from the WSGC is available online at https://www.wsgc.wa.gov/sites/default/files/public/forms/apps/4-028-f-nonprofit-org.pdf.

- Liquor cannot be raffled at any event that is open to the public.

If a nonprofit organization is helping to put on an event, or will benefit from it in some way, a banquet permit is necessary even if the invitations come from individuals (from board members or key fundraising volunteers, for example).

To apply for a banquet permit go to https://lcb.wa.gov/licensing/online-banquet-permit; an email address is required to receive a printable copy of the permit and a debit or credit card is necessary for payment of the $10 (per day) fee. Further information about banquet permits is available on the WSLCB website at https://lcb.wa.gov/licensing/banquet-permits.

Special Occasion Licenses: A Special Occasion License allows a nonprofit organization to sell liquor at a specified date and place and is required when alcohol will be sold to participants during events like fundraising dinners, galas, auctions, and wine tastings. The application can be found online at https://lcb.wa.gov/publications/licensing/forms/LIQ-285-App-for-Special-Occasion-License-for-NP.docx and must be filed by mail at least 45 days in advance of the event.

All proceeds from liquor sales must be retained by the nonprofit organization; no other person or entity may receive a share or percentage. The liquor may be purchased at wholesale or retail from any vendor licensed to sell liquor in Washington; organizations recognized by the IRS as 501(c)(3)s or 501(c)(6)s may also receive donated liquor from producers or distributors.

The fee for a special occasion license is $60 per day, per location. Special occasion licenses are limited to 12 single-day events per calendar year. WSLCB will notify the mayor or county executive of the location where the event will be held; that official will have an opportunity to comment on whether or not the license should be granted.

There are many specific requirements and restrictions that apply to Special Occasion Licenses. The best way to review these requirements is to examine the application forms or review the Liquor, Cannabis, Gambling...and Your Fundraising Event toolkit. If underage attendees are present, an addendum must also be filed and may be found online at https://lcb.wa.gov/sites/default/files/publications/licensing/forms/LIQ-1314-Special-Occasion-License-Addendum3.doc. This application (with addendum) is due 60 days before the event. The address for filing is on the WSLCB information page at https://lcb.wa.gov/licensing/special-occasion-licenses.

WSLCB recommends that anyone who is unfamiliar with the requirements or the application process for Special Occasion Licenses contact customer services staff by calling 360-664-1600. Also, frequently asked questions about Special Occasion Licenses may be found at https://lcb.wa.gov/licensing/special-occasion-licenses/faq.

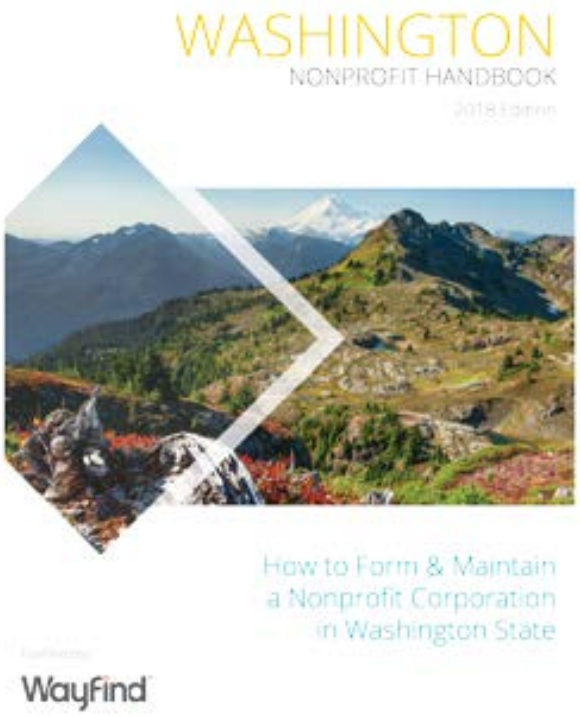
Other Licenses for Nonprofits: There are several other kinds of alcoholic beverage licenses that may be of interest to arts organizations, private clubs, and in some cases to other types of nonprofit organizations. The application process usually involves consultation with WSLCB staff because identifying the right license can be difficult, and the consequences of starting down the wrong path can be frustrating especially if fees have been paid, expensive. The telephone number for the WSLCB is 360-664-1600.

TIP:

Nonprofits that are exempt from charitable solicitations registration described above, may want to register anyway. Donors often check to see if the nonprofit they are considering donating to are registered with the Secretary of State to verify they are a registered "charitable organization."

Resources on Liquor and Cannabis:

- Washington State Liquor and Cannabis Board at www.wslcb.wa.gov
- The Liquor, Cannabis, Gambling...and Your Fundraising Event toolkit (2018)



Part 8 Washington State Taxes And Nonprofit Corporations

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PART 8. WASHINGTON STATE TAXES AND NONPROFIT CORPORATIONS

CHAPTER 51. Nonprofit Organizations Are Subject to State Taxes

In Washington State, nonprofit organizations are presumed taxable in the same manner as for-profit organizations. Therefore, if no statutory exemption or deduction exists, a nonprofit organization must pay each of the following taxes: (i) state and local business taxes, (ii) state and local retail sales taxes, (iii) state and local use taxes, and (iv) real and personal property taxes.

The general presumption in favor of taxation means that while a nonprofit organization should assume that all its business activities are taxable, it should also determine whether an exemption or deduction applies to the specific activity or transaction. A nonprofit organization claiming any exemption or deduction has the burden of proof of establishing that it qualifies for the benefit or deduction.

CHAPTER 52. The State Business and Occupation Tax

a. Defined

Washington imposes the Business and Occupation tax ("B&O tax") on the gross receipts of every person engaged in business activities in the State. Nonprofit organizations must pay the B&O tax based on the value of its products, the gross proceeds of its sales, or the gross income of its services, as appropriate. Typically, nonprofit organizations pay tax under at least two general classifications of the B&O tax. These classifications are: (i) retailing and (ii) service and other activities. *See* RCW 82.04 for the statute governing Business & Occupation Tax, and the Department of Revenue website on business & occupations tax online at https://dor.wa.gov/find-taxes-rates/business-occupation-tax.

(i) Retailing.

Retailing includes every sale of tangible personal property to consumers (e.g., sales of publications, periodicals, books and tapes). Retailing also includes certain services such as repair or improvement of property and certain personal services. Nonprofit organizations must pay a tax, currently at a rate of 0.471% of the organization's gross sales proceeds on these activities. Because the retail sales tax uses this same definition as a starting point, sales of property or services in this classification are also subject to the retail sales tax.

(ii) Service and Other Activities.

The Service and Other Activities classification includes all other sources of income that do not fall into another B&O tax classification. Nonprofit organizations must pay a tax rate of 1.5% of the gross income the organization receives from services, rents, fees, advertising income, dues, reimbursements, agency fees, and commissions. Unlike retailing, items in this classification are not subject to the retail sales tax.

b. Exemptions for Low Gross Receipts and the Small Business Tax Credit

(i) Low Gross Receipts.

Nonprofit organizations are not required to register with the Washington State Department of Revenue or pay the B&O tax if their gross annual receipts are $12,000 or less and the organization is not required to pay any other state tax such as the sales or use tax.

(ii) The Small Business B&O Tax Credit.

The Small Business B&O Tax Credit may offset all or a portion of the B&O tax. For example, a nonprofit organization that reports in the Service and Other Activities classification will pay no B&O tax if its annual gross receipts are $56,000 or less. This credit, however, applies only to the B&O tax due from the organization and does not apply to any retail sales and use taxes due.

c. Exemptions and Deductions for Artistic and Cultural Organizations

Washington exempts certain nonprofit organizations from liability for the B&O tax.

Artistic and cultural organizations may deduct from their B&O tax liability all of their income from business activities.

Artistic or cultural organizations include nonprofit corporations that are organized and operated exclusively for the purpose of providing "artistic or cultural exhibitions, presentations, or performances or cultural or art education programs" for viewing or attendance by the general public. The term "artistic or cultural exhibitions, presentations, or performances or cultural or art education programs" includes and is limited to:

- An exhibition or presentation of works of art or objects of cultural or historical significance, such as those commonly displayed in art or history museums;

- A musical or dramatic performance or series of performances; or

- An educational seminar or program, or series of such programs, offered by the organization to the general public on an artistic, cultural, or historical subject.

To qualify for the permitted deduction, a nonprofit corporation must meet the following requirements (*see* RCW 82.04.4328):

- The organization must be either be (i) a nonprofit corporation organized and managed by a governing board of not less than eight individuals, none of whom is a paid employee of the corporation or (ii) a corporation sole as defined under RCW 24.12.010 (church and religious societies);

- No part of the corporation's income may be paid directly or indirectly to its members, stockholders, officers, directors or trustees, except in the form of services rendered by the corporation in accordance with its purposes and bylaws;

- Salary or compensation paid to the corporation's officers and executives must be only for actual services rendered, and at levels comparable to the salary or compensation of like positions within the state;

- Assets of the corporation must be irrevocably dedicated to the activities for which the exemption is granted and, upon liquidation, dissolution, or abandonment by the corporation, may not inure directly or indirectly to the benefit of any member or individual, except a nonprofit organization, association, or corporation which would also be entitled to the exemption;

- The corporation must be duly licensed or certified when licensing or certification is required by law or regulation;

- The amounts received that qualify for exemption must be used for the activities for which the exemption is granted;

- Services must be available regardless of race, color, national origin or ancestry; and
- The Department of Revenue must have access to the corporation's books to determine whether the corporation should be exempt.

Requirements Concerning Boards

The most problematic area is the first requirement: at least eight board members, none of whom is a paid employee. This means no member of the board of directors may be a paid employee, regardless of the number of directors. For example, an organization with 39 board members, five of whom are paid employees, would not qualify for the deduction. Similarly, if the executive director, a paid employee, is directly involved in the decision making or management by the board of directors, no deduction is applicable. However, if the executive director serves the board in an advisory capacity, without voting rights, a deduction is allowed. Cautious nonprofit organizations that qualify for this deduction may want to ensure that the organization's articles call for at least eight directors and provide that the executive director can only act in an advisory capacity to the board of directors, without voting rights.

Articles or bylaws that call for a minimum of eight board members are also valuable for boards with only eight members in the instance of a board resignation, which leaves the board temporarily with only seven members. As long as the governing documents call for eight and the board can demonstrate it is actively searching for the eighth member, a deduction is still allowed.

The second requirement is that no part of the corporation's income may be paid directly or indirectly to its members, stockholders, officers, directors or trustees, except in the form of services rendered by the corporation in accordance with its purposes and bylaws. This requirement is intended to limit the ability of others to profit indirectly from the operations of the nonprofit. This does not limit the ability of the organization to reasonably compensate officers who are not board members, to pay board stipends, or to provide services to board members who are also constituents served by the nonprofit.

Artistic and cultural organizations are also exempt from paying the retail sales or use tax on certain objects used for the purposes of exhibition or presentation to the general public. These objects include objects of art or cultural

value and objects to be used in displaying art or presenting artistic or cultural exhibitions or performances.

d. Exemptions for Other Specified Organizations

- **Blood, Bone, and Tissue Banks.** Blood, bone and tissue banks are exempt from the B&O tax to the extent amounts received are exempt from federal income tax. *See* RCW 82.04.324.

- **Adult Family Homes.** Adult family homes are exempt from the B&O tax. *See* RCW 82.04.327.

- **The Red Cross.** State law specifically exempts this organization from the B&O tax. *See* WAC 458-20-190.

- **Sheltered Workshops.** Sheltered workshops are exempt from the B&O tax. The operation of sheltered workshops means performance of business activities of any kind, on or off the premises of a nonprofit organization, which are performed for the primary purpose of either (1) providing gainful employment or rehabilitation services to the handicapped as an interim step in the rehabilitation process for handicapped individuals who cannot be readily absorbed in the competitive labor market or during such time as employment opportunities for the handicapped in the competitive labor market do not exist; or (2) providing evaluation and work adjustment services for handicapped individuals. *See* RCW 82.04.385.

- **Comprehensive Cancer Centers.** Comprehensive cancer centers are exempt from the B&O tax to the extent amounts received are exempt from federal income tax. *See* 82.04.4265.

- **Organ Procurement Organizations.** Organ procurement organizations are exempt from the B&O tax to the extent amounts received are exempt from federal income tax. *See* 82.04.326.

- **The State, the Federal Government, and Housing Authorities.** These organizations are exempt from B&O tax.

- **Nonprofits providing legal services to low-income persons.** Nonprofit legal services organizations serving low-income individuals that do not charge or services are exempt from State B&O taxes. *See* RCW 82.04.635 & 82.04.431.

e. Exemptions and Deductions for Fundraising Activities

(i) Generally

Washington allows certain nonprofit organizations, as defined below, to deduct income received from a qualifying fundraising activity under the B&O tax. *See* RCW 82.04.3651. In addition, the nonprofit is not required to collect the retail sales tax on sales made as part of the fundraising activity.

"Fundraising activity" means activities involving both the direct solicitation of money or other property and the anticipated exchange of goods or services for money between the soliciting organization and the organization or person solicited, for the purpose of furthering the goals of the nonprofit organization.

A fundraising activity does not include the operation of a regular place of business in which sales are made during regular hours such as a bookstore, thrift shop, restaurant or similar business. It also does not include the operation of a regular place of business from which services are provided, such as retail, personal, or professional services.

"Nonprofit organization," for the purpose of the fundraising activity exemption, means one of the following:

- An organization exempt from tax under section 501(c)(3), (4), or (10) of the Code;
- A nonprofit organization that would qualify for the exemption except that it is not organized as a nonprofit corporation; or
- A nonprofit organization that meets all of the following criteria: (1) the members, stockholders, officers, directors or trustees of the organization do not receive any part of the organization's gross income, except as payment for services rendered; (2) the compensation received by any person for services rendered to the organization does not exceed an amount reasonable under the circumstances; and (3) the activities of the organization do not include a substantial amount of political activity, including, but not limited to, influencing legislation and participation in any campaign on behalf of any candidate for political office.

(a) Retail Sales Tax Exemption for Items Purchased for Fundraising Activities

Organizations that purchase items to be resold as part of a qualifying fundraising activity may either purchase the items to be resold without payment of the retail sales tax if the organization has a reseller's permit, or pay tax at the point of sale and take the credit for tax paid at the source. For example, a qualifying nonprofit has an annual auction at which it serves a meal. If the attendees pay a fee to the nonprofit to come to the event, the nonprofit is reselling the meal to the attendees. Therefore, the nonprofit gives the caterer or hotel a reseller's permit for the meals and does not pay retail sales tax on the purchase of the meals because of the resale exemption. The nonprofit also does not collect retail sales tax on the fee received from attendees due to the fundraising exemption discussed earlier.

(b) Other State Tax Consequences of Fundraising Activities

Nonprofit organizations must still pay the retail sales tax on consumable items incorporated into fundraising activities. For example, if as part of an auction, an organization rents a hotel ballroom, buys decorations, or pays the caterer or hotel table rental fees, those purchases are consumable items, and the organization must pay sales tax or use tax on the purchases.

A limited use tax exemption exists for buyers of tangible personal property for purchases of applicable items at any fundraiser. Effective until July 1, 2020, any article of personal property valued under $12,000 and acquired at a fundraiser is exempt.

(*See* discussion on the use tax in Chapter 55.)

Nonprofit organizations exempt from real or personal property taxes are allowed to use their exempt property for fundraising purposes for limited time periods without impairing their property tax exemptions. The use of exempt property for fundraising activities sponsored by an exempt organization does not subject the property to taxation if the fundraising activities are consistent with the purposes for which the exemption was granted. For property tax exemption purposes, the term "fundraising" means: any revenue-raising activity, limited to less than five days in length, that disburses 51% or more of the profits realized from the activity to the exempt nonprofit organization conducting the fundraising activity.

(c) Trade Shows, Conventions and Seminars

Nonprofit organizations may deduct attendance and space charges received in connection with trade shows, conventions and seminars from the B&O tax if the following conditions are satisfied:

- The sponsoring organization must be exempt under section 501 of the Code;

- The sponsoring organization must either be a "trade organization" or a "professional organization." A "professional organization" is an entity whose members are engaged in a particular lawful vocation, occupation or field of activity of a specialized nature. A "trade organization" is an entity whose members are engaged "in trade" (i.e., in one or more lawful commercial trades, businesses, crafts, industries or distinct productive enterprises); and

- The event must not be open to the general public. This means that (1) attendance is limited to members of the sponsoring organization and to specific invited guests of the sponsoring organization; or (2) if attendance is not limited to members and specifically invited guests, all proceeds from the trade show, convention or seminar are subject to B&O tax.

(d) Exemptions and Deductions for Specific Revenue Streams

- **Rents.** Rents received from long-term leases of real property are exempt from the B&O tax. Otherwise, rental income is likely subject to the B&O tax. For example, short-term rentals by those who hold themselves out to the public as hotels and motels are subject to the Retailing B&O tax. In addition, the organization must collect the retail sales tax and remit it to the state. Short-term rentals or other types of real property are subject to the Service and Other Activities B&O tax; and rentals of personal property are subject to the Retailing B&O tax, and the organization must collect and remit the retail sales tax to the state.

- **Advancements and Reimbursements.** Advancements and reimbursements received by nonprofit organizations are excludable if the organization receiving the reimbursement had no liability other

than as agent when the original payment was made. Nonprofit organizations should be aware, however, that this possible deduction poses a significant audit trap, especially for affiliates or subsidiaries of the organization and any cost sharing relationships. Reimbursement arrangements must be carefully structured to avoid being treated as taxable gross receipts.

- **Income Exempt Under the U.S. Constitution.** The federal constitution prohibits Washington from taxing revenue derived from interstate sales, imports and exports, Indians and Indian tribes, or sales made by the federal government. Nonprofit organizations that sell to the federal government are generally subject to the B&O tax. *See* WAC 458-20-190.

- **Investment Income.** Investment income is deductible. Investment income includes amounts derived from one of three sources: (1) investments, (2) dividends or distributions from a capital account, or (3) interest on loans between a subsidiary entity and its parent, but only if the total investment and loan income of the parent is less than 5% of total annual gross receipts. *See* RCW 82.04.4281.

  This deduction does not apply to amounts received by a banking, lending, or security business. In addition, no deduction is allowed for any organization for loans or the extension of credit to another, revolving credit arrangements, installment sales, and the acceptance of payment over time for goods or services.

- **Bona Fide Dues.** A nonprofit organization may deduct the bona fide dues of its members. Bona fide dues are defined as those amounts paid periodically by members solely for the purpose of entitling those persons to continued membership in the club or similar organization. *See* RCW 82.04.4282.

  A nonprofit organization may not be eligible for this deduction, however, if, in consideration of the dues, the members receive significant goods or services, or if dues are graduated based on the level of services provided.

  The Department of Revenue has ruled that a nonprofit organization may provide the following significant goods and services without losing eligibility for bona fide due deduction: (1) the provision of

newsletters of a general informational nature to members; (2) the conduct of regulatory and legislative liaison or lobbying activities of a nonspecific nature on the behalf of its members; (3) the conduct of conventions and shows for its members; (4) the conduct of meetings and seminars of general and varied interest to its members; and (5) member discounts for goods and services, which will not cause a portion of dues to be taxable if those members are separately charged for the goods and services and the charges are, after discounts, for at least the full cost of the goods and services.

- **Bona Fide Contributions and Donations.** Gifts, contributions and donations received by a nonprofit organization are not subject to the B&O tax. If the income received is part sale and part gift, the measure of the B&O tax is the lesser of the selling price or the fair market value of the item sold. The excess of the selling price over the fair market value is a nontaxable donation. *See* RCW 82.04.4282.

- **Initiation Fees.** Initiation fees are deductible. "Initiation fees" means those amounts paid solely to initially admit a person as a member to a club or organization. These fees are only those one-time amounts paid that genuinely represent the value of membership in a club or similar organization. An initiation fee does not include any amount paid for or attributable to the privilege of receiving any goods or services other than mere nominal membership. *See* RCW 82.04.4282.

- **Tuition Fees.** Tuition fees are deductible. "Tuition fees" includes library, laboratory, health service and other special fees, and amounts charged for room and board by an educational institution when the property or service for which such charges are made is furnished exclusively to the students or faculty of such institution. "Educational institution" means only those institutions created or generally accredited as such by the state. An "educational institution" offers to its students an educational program of a general academic nature. *See* RCW 82.04.4282.

- **Daycare.** Charges for the operation of privately operated kindergartens are deductible. The Department of Revenue interprets this deduction to include income received by nursery schools, preschools, day care providers and privately-operated kindergartens for the care or education of children who are under eight years of age

and not enrolled in or above the first grade. A special B&O tax rate of 0.484% exists for those who provide day care services or care of children eight years or older or at the first-grade level or above. *See* RCW 82.04.4282 & 82.04.431.

- **Endowment Funds.** Income from endowment funds is deductible. *See* RCW 82.04.4282.

- **Grants.** Grants received by nonprofit organizations may be deductible from the B&O tax under the bona fide contribution and donation deduction. However, if the grants received are in exchange for significant goods or services, the bona fide contribution and donation deduction does not apply. To qualify a grant for this exemption, the grantee may have to establish that the grantor had a "gratuitous intent" when making the grant.

  A grant is presumed nontaxable if three conditions are met: (1) the grantor must receive no significant goods, services or benefits in return for making the grant; (2) the grantee is a nonprofit or governmental organization; and (3) the grant must be used to promote, advance, or fulfill charitable purposes, including related administrative expenses, within the meaning of section 501(c)(3) of the Code.

  A safe harbor provision exists for certain restrictions imposed by the grantor regarding grantee accountability. This provision permits a grantor to place restrictions on the use of the grant for specific charitable purposes and provides that a grantee may submit accountability reports to the grantor regarding the use of the funds or describing the general nature of the project.

  Sponsorship or public acknowledgement that the grantor provides a grant alone does not trigger B&O tax liability for the grantee.

  Several statutory provisions permit nonprofit research institutions to reduce their potential tax liability. A special B&O tax classification exists for nonprofit organizations that engage in research and development within Washington. The current tax rate is 0.484%. In addition, if a grant is otherwise taxable but services are performed both inside and outside of Washington, a nonprofit can apportion its

gross income and pay tax on only the portion attributable to the services performed within the state.

Grants by the federal government to municipal corporations or political subdivisions of the state may be deducted from B&O tax liability.

(e) Health or Social Welfare Organizations

"Health or social welfare organizations" are allowed to deduct grants or fees received from government sources for providing certain "qualifying services." First, the organization must qualify as a "health or social welfare organization," which requires that the organization meet all of the following requirements (*see* RCW 82.04.431):

- The organization must be either (A) a nonprofit corporation managed by a governing board of not less than eight individuals, none of whom is a paid employee of the organization, or (B) a corporation sole (See box above on Requirements Concerning Boards for further discussion);

- No part of the corporation's income may be paid directly or indirectly to its members, stockholders, officers, directors or trustees, except in the form of services rendered by the corporation in accordance with its purposes and bylaws;

- Salary or compensation paid to the corporation's officers and executives must be only for actual services rendered, and at levels comparable to the salary or compensation of like positions within the public service of the state;

- Assets of the corporation must be irrevocably dedicated to the activities for which the exemption is granted and, upon liquidation, dissolution or abandonment by the corporation, may not inure directly or indirectly to the benefit of any member or individual, except a nonprofit organization, association or corporation which would also be entitled to the exemption;

- The corporation must be duly licensed or certified where licensing or certification is required by law or regulation;

- The amounts received qualifying for exemption must be used for the activities for which the exemption is granted;

- Services must be available regardless of race, color, national origin or ancestry; and

- The Department of Revenue must have access to the corporation's books in order to determine whether the corporation should be exempt.

Second, "qualifying services" are limited to: mental health, drug or alcoholism counseling; family counseling; health care services; therapeutic, diagnostic, rehabilitative or restorative services for the care of the sick, the aged or certain disabled individuals; activities for the prevention of juvenile delinquency or child abuse; care of orphans or foster children; day care of children; employment development, training, and placement; indigent legal services; low-income weatherization or home repairs; low-income heating assistance; or community services to low-income families and groups designed to reduce poverty in a measurable way.

Third, this deduction applies only to amounts the corporation received as compensation for, or to support, health or social welfare services from any of the following sources: The United States or any instrumentality thereof, or from the State of Washington or any municipal corporation or political subdivision thereof.

Several issues frequently arise surrounding the health or social welfare deduction. If a fee or grant is received from a nongovernmental organization, such as a for-profit organization, a charitable foundation or another nonprofit organization, this deduction does not apply, and the nonprofit corporation must analyze its B&O tax liability under the general rule that permits taxation of grants if those grants are exchanged for services. Any compensation for services from a nongovernmental payer is taxable.

The same analysis applies if a qualifying nonprofit corporation receives a government grant to provide services other than services meeting the definition of "qualified services" described above.

Salary or compensation paid to officers and executives must be at levels comparable to the salary or compensation of like positions within the public service of the state. The Department of Revenue has attempted to disqualify an organization from this deduction by showing that the organization's executives

were not paid salaries comparable to salaries paid at like positions in the public service.

(f) Deductions for Public and Nonprofit Hospitals and for Community Health Centers

A public hospital district, a nonprofit hospital, a nonprofit community health center, or a network of nonprofit community health centers that qualifies as a health and social welfare organization is allowed to deduct amounts received as compensation for health care services covered under Medicare, Medicaid, Children's Health, and the State of Washington Basic Health Plan. The deduction does not apply to amounts received from patient copayments or patient deductibles.

(g) Deductions for Camps and Conference Centers

The B&O tax does not apply to amounts received by a nonprofit organization from the sale or furnishing of certain items at a camp or conference center conducted on property exempt from property tax. Exempt revenues are those for lodging, conference and meeting rooms, camping facilities, parking, and similar licenses to use real property; food and meals; and books, tapes, and other products that are available exclusively to the participants at the camp, conference, or meeting and are not available to the public at large. *See* 82.04.363.

(h) Deductions for Childcare Resource and Referral Services

The B&O tax does not apply to nonprofit organizations in respect to amounts derived from the provision of childcare resource and referral services. *See* RCW 82.04.3395.

(i) Deductions for Credit and Debt Services

The B&O tax does not apply to nonprofit organizations in respect to amounts derived from provision of certain credit and debt services. Exempt services include presenting individual and community credit education programs, including credit and debt counseling; obtaining creditor cooperation allowing a debtor to repay debt in an orderly manner; establishing and administering negotiated repayment programs for debtors; or providing advice or assistance to a debtor with regard to the above-noted services. *See* RCW 82.04.368.

(j) Deductions for Group Training Homes

The B&O tax does not apply to income received from the Department of Social and Health Services for the cost of care, maintenance, support, and training of persons with developmental disabilities at nonprofit group training homes. "Group training home" means a facility equipped, supervised, managed, and operated on a full-time basis for the full-time care, treatment, training, and maintenance of persons with developmental disabilities.

(k) Deductions for Student Loan Programs

B&O tax does not apply to gross income received by nonprofit organizations that are guarantee agencies under the federal guaranteed student loan program, that issue debt to provide or acquire student loans, or that provide guarantees for student loans made through programs other than the federal guaranteed student loan program. Qualifying organizations are nonprofit organizations exempt from federal income tax under section 501(c)(3) of Code. *See* RCW 82.04.367.

(l) Deductions for Nonprofit Boarding Homes

The B&O tax does not apply to amounts received by a nonprofit boarding home for providing room and domiciliary care to residents of the boarding home. "Domiciliary care" means assistance with activities of daily living, health support services, or intermittent nursing services, any of which may be provided by the boarding home either directly or indirectly. "Nonprofit boarding home" means a boarding home that is operated as a religious or charitable organization, is exempt from federal income tax under section 501(c)(3) of the Code, is incorporated under RCW 24.03, is operated as part of a nonprofit hospital, or is operated as part of a public hospital district.

CHAPTER 53. Local Licensing and Local B&O Taxes

State law permits cities to impose a local business and occupation tax. Forty Washington cities assess such a tax, including Seattle, Tacoma, Bellevue, Bellingham, Everett, and Olympia. Each city administers its business and occupation tax independently.

Most cities imposing a local B&O tax follow the state-level definitions of activities such as manufacturing, wholesaling, retailing and services. However, cities offer far fewer exemptions and deductions to their local B&O tax than Washington State does. Moreover, unlike the state-level tax, local B&O taxes are

true "gross receipts" taxes and are essentially taxes on the "privilege" of doing business within the city rather than taxes on the actual business activity conducted within the city. Consequently, cities often impose a B&O tax on activities with only minimal connection to business activities conducted within the taxing city.

Most cities with a local B&O tax typically exempt the activity of nonprofits, with the exception of retailing activity, which is subject to tax. The City of Seattle is a notable exception to this rule and subjects more nonprofit activities within its borders to different tax classifications. Because cities have broad freedom to define their local B&O taxes differently from the state and offer different exemptions and deductions, it is advisable to review the local tax code for any city in which an organization has activity.

Even if an organization has otherwise taxable activity, many cities have established an annual minimum gross receipt threshold that must be reached before any tax is due.

Many Washington cities impose other requirements, such as the need for a business license or other purely local taxes such as the admissions tax, which is a local sales tax on tickets. Nonprofits should contact the finance office of any cities in which they have activities to verify the specific local licensing and tax requirements.

CHAPTER 54. Retail Sales Tax Issues for Nonprofit Organizations

Washington imposes a tax upon the sale of any article of tangible personal property to consumers and certain services performed for consumers. *See* RCW 82.08. This is the retail sales tax, which is imposed upon the same activities subject to the Retailing B&O tax. Therefore, unless an exemption applies, nonprofit organizations should collect the retail sales tax on all sales of tangible personal property and any services that fall within the definition of retailing.

a. Exemptions (See RCW 82.08.0203-82.08.036, WAC 458-20-190 for Exemptions.)

The following sales are exempt from the retail sales tax:

- Sales to the Red Cross;
- Sales of food products for human consumption. The exemption applies only to certain food products that are not sold for immediate consumption on the premises;

- Sales to artistic or cultural organizations of certain objects acquired for exhibition or presentation. This includes objects of art and objects to be used in presenting cultural exhibitions or performances;

- Certain fundraising activities;

- Dues or membership fees paid to nonprofits that do not operate a health or fitness facility, such as an aquatic facility for swimming, gun clubs or gun ranges, or skating facility;

- Sales of medical supplies, chemicals, or materials to a blood, bone, or tissue bank, comprehensive cancer center, or organ procurement organization;

- Sales of lodging, meals, and books at a nonprofit camp or conference center;

- Sales of drugs for human use pursuant to a prescription;

- Sales of certain medical items such as prosthetic devices, medically prescribed oxygen, osmotic items, and disposable devices used to deliver drugs for human use;

- Sales of meals provided to senior citizens, disabled persons, or low-income persons by a nonprofit organization;

- Sales of emergency lodging for the homeless; and

- Purchases of items for resale, including items resold as part of fundraising events.

b. Collection of Sales Tax

The seller acts as the collection agent for the state in collecting the retail sales tax. A seller commits a misdemeanor if it fails to pay collected retail sales taxes to the state by the due date. If a seller fails to collect the required tax on a taxable transaction, the tax remains a debt owed by the buyer to the seller and the seller becomes personally liable for the uncollected tax to the state.

c. Rates

On the Washington State Combined Excise tax return, filers must use four-digit location codes to source local sales or use taxes to the correct jurisdiction. The

Department of Revenue quarterly publishes the Local Sales and Use Tax Flyer that contains the codes, rates, and reports of recent changes. The flyer appears online at https://dor.wa.gov/get-form-or-publication/forms-subject/local-sales-and-use-tax-rates-and-changes-flyer.

CHAPTER 55. Use Tax Issues for Nonprofit Organizations

Washington imposes a tax on the user of any article of tangible personal property or certain services acquired by purchase or gift where the user or donor has not paid the retail sales tax.

a. Rates and Reporting

The use tax rates are the same as the combined state and local portions of the retail sales tax.

Nonprofits are required to accrue and remit their use tax obligations on the Combined Excise Tax Return, the same form used to pay the B&O tax and remit collected sales tax. Smaller organizations that are not required to be registered with the Department of Revenue can remit their use tax obligations on the Consumer Use Tax Return, which is available from the Department of Revenue.

b. Liability When No Sales Tax Is Collected

Most nonprofit organizations, like most other consumers and businesses, have contingent use tax liabilities for small items purchased such as:

- Computer equipment, computer parts, software licenses, and software purchased from out-of-state sources;
- Purchases from small in-state unregistered service providers such as contractors, landscapers, and information technology service providers;
- Any mail order catalog items;
- Items purchased over the Internet;
- Fixed assets shipped into Washington from a seller outside of Washington who does not collect the retail sales tax;
- Magazine and periodical subscriptions; and

- Office supplies, if purchased from out-of-state sources.

c. Donations of Property

The use tax does not apply to use by a nonprofit charitable organization or state or local governmental entity of any item of tangible personal property that has been donated to the nonprofit charitable organization or state or local governmental entity. *See* RCW 82.12.02595.

The use tax does not apply to the donation of tangible personal property without intervening use to a nonprofit charitable organization, or to the incorporation of tangible personal property without intervening use into real or personal property of or for a nonprofit charitable organization in the course of installing, repairing, cleaning, altering, imprinting, improving, constructing, or decorating the real or personal property for no charge.

d. Donations of Retailing Services

The use tax does not apply to the use by a nonprofit charitable organization of labor and services rendered in respect to installing, repairing, cleaning, altering, imprinting, or improving personal property provided to the charitable organization at no charge, or to the donation of such services. *See* RCW 82.12.02595.

The use tax does not apply to the donation of amusement and recreation services without intervening use to a nonprofit organization or state or local governmental entity, to the use by a nonprofit organization or state or local governmental entity of amusement and recreation services, or to the subsequent use of the services by a person to whom the services are donated or bailed in furtherance of the purpose for which the services were originally donated.

e. Real Estate Excise Tax Issues

Washington imposes a transfer tax on the sale of real property including leasehold improvements and those involving a 50% or more controlling interest in any entity that owns the real property.

Nonprofit organizations, even if exempt from real or personal property taxes, are nevertheless subject to the real estate excise tax unless the transaction is otherwise specifically exempt.

There are numerous exceptions to the real estate excise tax, including:

- Gifts of real property;
- Transfers of real property that consist of a mere change in the identity or form of ownership; and
- Transfers of real property that for federal income tax purposes do not involve the recognition of gain or loss for the purposes of entity formation, dissolution or reorganization.

CHAPTER 56. Property Tax Issues

Washington exempts qualifying nonprofit organizations from the payment of (*see* RCW 84.36):

- Real property taxes;
- Personal property taxes; and
- Leasehold excise taxes. The leasehold excise tax is a 12.84% tax on leasehold interests in publicly owned real or personal property. The tax base is measured by the amount paid for the use of the property. If a nonprofit organization receives the use of donated property, the tax base is the fair market value of the rents on similar property.

a. Exemptions Limited to Certain Nonprofit Activities

Not all nonprofit organizations qualify for exemption from payment of property taxes. *See* RCW 84.36. Exemptions are only allowed for specific types of activities. Qualifying activities include:

- Public property;
- Cemeteries, churches, parsonages, convents, and grounds;
- Property used for character building, benevolent, protective or rehabilitative social services, camp facilities, veteran or relief organization-owned property, and property of nonprofit organizations that issue debt for student loans or that are guarantee agencies;
- Administrative offices of nonprofit religious organizations;
- Nonprofit organizations engaged in procuring, processing, etc., blood, plasma or blood products;

- Nonprofit organizations' property connected with operation of public assembly halls or meeting places;
- Nonprofit day care centers, libraries, orphanages, homes or hospitals for the sick or infirm, and outpatient dialysis facilities;
- Nonprofit homes for the aging;
- Nonprofit organizations' property used in providing emergency or transitional housing to low-income homeless persons or victims of domestic violence;
- Nonprofit organizations' property available without charge for medical research or training of medical personnel;
- Nonprofit cancer clinics or centers;
- Nonprofit organizations' property used for transmission or reception of radio or television signals originally broadcast by governmental agencies;
- Schools and colleges;
- Art, scientific and historical collections and property used to maintain such collections; property of associations engaged in the production and performance of musical, dance, artistic, etc., works; property to be used for an exempt purpose in the future; fire engines, implements, and buildings of cities, towns, or fire companies; and property owned by humane societies;
- Water distribution property owned by nonprofit corporations or cooperative associations; and
- Property owned or used for sheltered workshops for handicapped.

b. Application for Exemption

A nonprofit organization must apply in advance of receiving an exemption for property taxes and renew its exemption with the Department of Revenue by March 31 of each year. See Department of Revenue website on property tax exemption for nonprofit organizations at https://dor.wa.gov/content/property-tax-exemption-nonprofit-organizations.

c. Uses of Exempt Property

Once exempt, the property must be exclusively used for its exempt purpose. As a general rule, the loan or rental of all or a portion of the exempt property does not subject the property to property taxes if:

- The rents or donations received for the use of the property are reasonable and do not exceed the maintenance and operation expenses attributable to the portion of the property loaned or rented; and

- The property would be exempt from tax if owned by the organization to which it is loaned or rented.

If exempt property is loaned or rented, the tax-exempt status of the property will not be affected if:

- The property is loaned or rented for a period of 15 consecutive days or less;

- The property is loaned or rented to another nonprofit organization, association, or corporation that would qualify for exemption if it owned the loaned or rented property; and

- All income received from the rental is devoted exclusively to the exempt purpose of the nonprofit organization that receives the tax exemption.

If the property is loaned or rented and the lessor or lessee intends to produce revenue from the loan or rental, the property loses its exemption. Property loaned or rented, and intended to produce revenue, must be segregated and taxed whether or not the revenue is devoted to exempt purposes.

Over the last few years, a standardized exception was created for nonprofit organizations to rent or loan their property to the public. Nonprofits can now loan or rent their exempt property to individuals and organization for non-exempt purposes up to 50 days in a year, as long as the rent or donation received for the use does not exceed the maintenance and operations costs attributable to the property. Of the 50 days, a maximum of 15 days can be spent for profit or to promote business purposes, with no limitation on the amount of rent or donation received. Days that immediately precede or follow an event do not count towards the 50 or 15 day allowances, if only used for set-up or take down activities. (Rental

income may be subject to Business and Occupation Tax as discussed in Chapter 53.)

The use of exempt property for "fundraising" activities sponsored by an exempt nonprofit organization does not subject the property to taxation if the fundraising activities are consistent with the purposes for which the exemption was granted. "Fundraising" means any revenue-raising activity, limited to less than five days in length, that disburses 51% or more of the profits realized from the activity to the exempt nonprofit organization conducting the fundraising.

CHAPTER 57. Further Information

More information on Washington taxes may be obtained by contacting the Department of Revenue, as follows:

State of Washington
Department of Revenue
Taxpayer Information and Education
Telephone 1-800-647-7706

The Department of Revenue also maintains an internet site with access to laws, rules, forms, and the Department's topical publications and notices. The address is https://dor.wa.gov/doing-business/business-types/industry-guides/nonprofit-organizations.

More information on local business and occupation taxes and licensing issues may be obtained by contacting the finance office of the city in question.

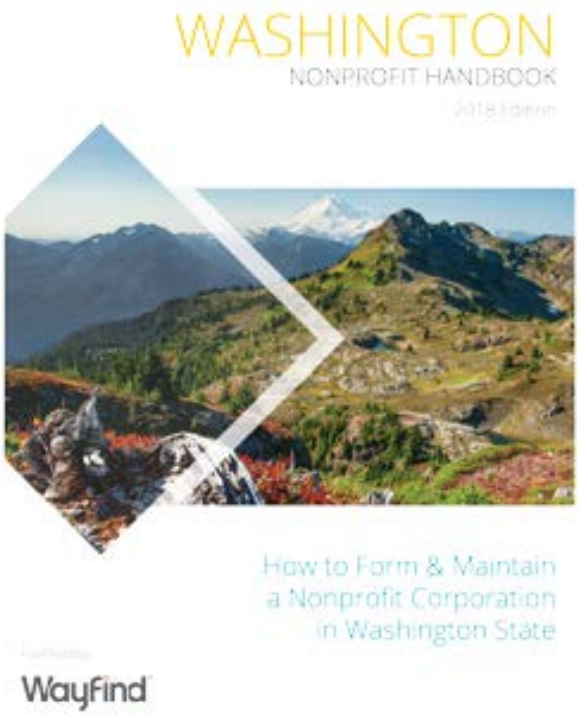
The following resources are available online at the listed sites:

- **Revised Code of Washington. (RCW)** The best and most readily searchable Revised Code of Washington is available through the website for the Washington State Legislature. The RCW on excise taxes is located at http://app.leg.wa.gov/rcw/default.aspx?cite=82.

- **Washington Administrative Code.** The best and most readily searchable Washington Administrative Code is available through the website for the Washington State Legislature. It is located at http://apps.leg.wa.gov/WAC/default.aspx?cite=458.

- **Taxpedia.** Taxpedia is the free state tax research service from the Department of Revenue. It provides access to laws, rules, advisory

bulletins, precedents from the Department's Appeals Division, the Board of Tax Appeals, and the courts. It is located at http://taxpedia.dor.wa.gov.



Part 9 Fiscal Sponsorships, Joint Ventures And Other Collaborations

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PART 9. FISCAL SPONSORSHIPS, JOINT VENTURES AND OTHER COLLABORATIONS

CHAPTER 58. Working With Others

It is often advantageous, for financial or programmatic reasons, to work with other organizations to further your own organization's objectives. A successful collaboration can result in cost savings and improved efficiency for your organization and can provide access to needed skills and resources. In arranging these relationships, however, you must take care not to jeopardize your organization's tax-exempt status by ceding too much control to others or by unwittingly furthering noncharitable purposes. The following chapters outline two common ways in which organizations work with others: through fiscal sponsorships and contractual collaboration (including joint ventures). For a discussion of nonprofit mergers and consolidations, see Chapter 78.

CHAPTER 59. Fiscal Sponsorships

Sometimes, when one or more individuals begin conducting charitable activities, start up a new organization or conduct a one-time or short-term project, they find that they need tax-exempt status to receive donations and grants to continue the work. Fiscal sponsorship is a way for that new project or organization to have the advantages of tax exemption without having to apply to the IRS. In a fiscal sponsorship a 501(c)(3) organization ("Sponsor" or "sponsoring organization") enters into an agreement with another organization or group that does not have tax-exemption ("Sponsored organization"), in which the Sponsored Organization can be covered by the Sponsor's tax-exemption. This gives a Sponsored Organization the opportunity to apply for and receive tax exemption while carrying out charitable activities. Sometimes this arrangement is referred to as a "fiscal agency." However, this term should not be used to describe this type of relationship, because it implies control by the sponsored organization over the sponsoring organization and is disfavored by the IRS.

There are two main reasons that nonprofit organizations seek 501(c)(3) status. First, many donors give money to tax-exempt organizations with the expectation of taking a charitable deduction for their donations on their federal income taxes. Some organizers of projects cannot attract these donors because their projects have not been qualified as tax-exempt (and may never be). Second, usually grant-making entities, such as foundations and government entities, have policies or legal constrictions that require grants only to 501(c)(3) organizations that

are public charities. To gain access to those revenue sources, organizers of a particular project can establish a fiscal sponsorship with a 501(c)(3) organization.

The Sponsor in a fiscal sponsorship agrees to receive and disburse funds for the project on behalf of the sponsored organization. Donations are made directly to the sponsoring organization, which runs the funds through its books and includes the funds as part of its income on its reports to the IRS. Subsequent disbursements are then made to, or on behalf of, the sponsored organization. An administrative fee is usually paid to the sponsor by the sponsored organization.

In Revenue Ruling 68-489, 1968-2 C.B. 210, the IRS set forth the following three guidelines for arrangements like fiscal sponsorships to ensure that such arrangements are not used to circumvent laws governing charitable giving:

(1) The sponsored project must further one or more of the charitable purposes of the sponsor. The sponsor should determine not only that the project will further a specific charitable purpose of the sponsor, but also that the sponsored project, or the legal entity or organization accepting funds for the sponsored project, will not engage in any other activities that might jeopardize the sponsor's tax-exempt status. For example, the fiscal sponsorship agreement should prohibit political activities and restrict lobbying activities during the term of the fiscal sponsorship.

(2) The sponsoring organization must maintain records establishing that the funds were actually used for such charitable purpose. The sponsor should establish procedures in the agreement for ongoing oversight of the sponsored organization. For example, the sponsoring organization may require periodic reports regarding the use of funds disbursed for the sponsored project. The level of oversight and control can vary from regular reporting obligations for the sponsored organization to the direct submission and payment of invoices for the sponsored project by the sponsor.

(3) The sponsor must retain control and discretion (described as "complete discretion and control" in related IRS rulings) over the use of the funds. In other words, the sponsor must make disbursements for the sponsored project as if the sponsor is undertaking the project as part of its own operations and is solely legally and financially responsible.

These guidelines reflect the IRS prohibition of a "conduit" transaction. A donor could not make a deductible donation directly to the sponsored organization, since it does not have tax-exempt status. Thus, if a donation is made

to the sponsor with a requirement that it be disbursed for the sponsored project (i.e., the donation is "earmarked"), the IRS deems that the donation has been made to the non-exempt sponsored project and no deduction is allowed. This is a conduit transaction. To avoid this "pass through" characterization, the sponsor must have discretion to refuse to disburse funds if the sponsored project engages in any activities that would be prohibited for the sponsor as a tax-exempt organization, or uses the funds for purposes other than to implement the agreed-upon sponsored project.

All parties should realize that in a fiscal sponsorship there are actually two levels of granting. In the first level, the donor agrees to make a grant to the sponsor, usually provided certain conditions are satisfied. In the second level, the sponsor agrees to support the sponsored project, again provided certain conditions are satisfied. Thus, the sponsor is responsible for satisfying any requirements of the original donor, and the sponsored project is responsible for satisfying the requirements of the sponsoring organization. This means that the sponsoring organization must agree to the fiscal sponsorship of the sponsored project giving the sponsor complete discretion and control over any funds prior to accepting any funds for the sponsored project

What should be in a Fiscal Sponsorship Agreement?

The agreement between the sponsoring organization and the sponsored organization should be in writing and should set forth:

- A description of the project and the charitable purpose of the sponsoring organization it furthers;
- Any performance requirements for the project;
- Prohibited and restricted activities of the sponsored organization and project;
- When and how donations will be solicited and whether there will be any restrictions on solicitations (to avoid situations where multiple requests are made to the same source);
- A description of how the sponsor will account for the funds to be made available to the sponsored project;
- When and how donations will be remitted to the sponsoring organization and disbursed to the sponsored project;

- Responsibility for providing acknowledgments and receipts to donors;
- The extent to which the sponsoring organization, the sponsored organization, and the project will be identified in promotional materials;
- Clarification of employment and/or supervisory relationships for any personnel involved in the project;
- Timing and nature of financial reports from the sponsoring organization to the sponsored organization;
- Timing and nature of project reports from the sponsored organization to the sponsoring organization;
- The amount of any administrative or other fees charged by the sponsoring organization (either as a fixed fee or a percentage of funds received);
- The duration of the fiscal sponsorship;
- Indemnification and insurance provisions; and
- Events of and remedies for default, including specifically the ability of the sponsoring organization to cease making disbursements, demand return of funds, or terminate the fiscal sponsorship arrangement if the fiscal sponsorship conditions are not satisfied or if the sponsoring organization's tax-exempt status is in any way jeopardized by the relationship with the sponsored organization.

For a discussion on whether to seek fiscal sponsorship for your organization, see Chapter 3.

CHAPTER 60. Joint Ventures And Other Contractual Collaborations

Sometimes a donor may not want to just make a grant of funds to a nonprofit organization, but nonetheless wants to collaborate with the organization in furthering its charitable purpose. Or there may be an instance where organizations with compatible missions desire to collaborate to further a charitable purpose. One organization may be seeking financing or resources for an exempt-related project and looking for different ways to attract private partners. There are two basic models of collaboration: project-specific, where the two organizations

partner to fulfill a specific project or goal; and comprehensive, where organizations partner to fulfill a comprehensive set of shared goals. In either of these cases, there may be risks to the organization's tax exemption.

In order for an organization to qualify for tax exemption under Code section 501(c)(3), it must be organized and operated exclusively (generally interpreted to mean "substantially") for charitable purposes. Where a collaboration is with a for-profit entity, the concern is that the participation of a private partner in a venture with a tax-exempt entity significantly increases the likelihood that the venture will undertake activities that are outside of the organization's charitable purpose (and that the tax-exempt may lack sufficient control over the venture to prevent such activities). It is also critical to section 501(c)(3) qualification that no part of the tax-exempt organization's earnings inure to the benefit of a private individual and that such organization serve a public interest rather than a private interest, which is more difficult to do when operations and economics become interrelated in a joint venture or other collaboration. When forming a collaboration with a private partner, it is important to guard against unrelated business income and illegal shelters of taxable income. For more information, see Chapters 27-36.

Regardless of the form of the collaboration, the two organizations should, as in any partnership, enter into a written agreement that sets forth their respective rights and obligations. Some of the more important details to consider in forming any type of partnership, which should be included in a written agreement between the two organizations, include (in no specific order):

a. Vision/Goals

Both parties should share the same vision, expectations, and goals with respect to their participation in the partnership, which need to be clearly defined from the outset. Why does each of the parties want to participate in this partnership? Does the partner organization have a primary interest in furthering your organization's purposes? Does it have other interests, such as attracting positive public recognition? Does the partner organization have any goals that conflict with those of your organization? Any private partner with your tax-exempt organization should understand that the written agreement between the parties will specify that making sure the venture operates in furtherance of the tax-exempt organization's purposes must override the desire to produce profit. Can either organization pursue other goals without the partner organization? Will either organization object to having its name associated with the other organization in areas in which the two organizations are not collaborating?

b. Control and Decision Making

After establishing a shared vision and goals, the issue of control is probably the most important factor. If an organization aspires to be a tax-exempt entity, all decisions must be made in furtherance of charitable purposes. If the organization yields too much decision-making control to a partner organization, even another nonprofit, there is a risk that some decisions will not further charitable purposes and this can jeopardize tax-exempt status.

At a minimum, the terms of the agreement should allow an organization to terminate or limit involvement in the partnership to protect its tax-exempt status at any time. Consider carefully which organization gets to make decisions over which issues, including, for example, program design and implementation and funding priorities.

It is also important to consider how decisions are made. The organization could, for example, dedicate a governing or advisory board seat to a representative from the other organization. Alternatively, it could agree that certain decisions will require the approval of both organizations, or could establish an entirely new entity in which both organizations participate. Well-defined decision-making processes that require transparency, and a process for resolving inevitable disagreements is essential. The agreement should also state whether and how any additional parties may join as partners.

c. Capitalization and Distribution

If the partner organization is providing funding, the agreement needs to state clearly what this funding will cover. A project budget that specifies the sources and uses of all funds should be attached as an exhibit to the agreement, and the agreement should state whether and how the budget may be modified. The agreement should specify the extent to which funds are discretionary or restricted. It should also specify the extent to which additional fundraising or capitalization is required, how funds will be distributed or disbursed as between the two organizations, whether any costs are to be covered by others, and whether there are in-kind contributions or previously dedicated funds that need to be calculated when determining the respective contributions of the partners.

In general, the ownership interest of the parties in the venture should be proportionate to the value contributed. When contracting with a donor, the agreement should state the purposes for which funds may be used, the circumstances or conditions under which funds will be disbursed (such as whether

certain milestones must be accomplished) and whether there are any circumstances under which funds would have to be returned (for example, for breach of the agreement). Determine whether the organization's books and records will be subject to review and/or audit by the funding organization.

d. Implementation

Implementation issues include identification of each partner's respective roles and responsibilities. What are the strengths and expertise of each partner in areas such as fundraising, political savvy, public relations, and staff support? To what extent will each partner be involved in day-to-day operations? Will some responsibilities be shared and others carried out by only one of the organizations? What is the time frame for implementation? Can any responsibilities be assigned or subcontracted?

e. Communication

Who speaks for each organization and in what ways? How do the two organizations communicate between themselves? How do they communicate with third parties and the public?

f. Accountability

What standards will the organization utilize to measure respective responsibilities? How will it measure progress towards your collective goals? What specific targets or benchmarks are important to acknowledge? What reporting and monitoring standards and procedures will it utilize, for example, in areas of accounting, project implementation, audit and evaluation? How frequent will these reports be?

g. Intellectual Property Rights

Which entity will own materials created during the course of the collaboration? Can those materials be used by third parties? What will become of those materials upon termination of the partnership? Will the collaboration result in the use or creation of any trade names or marks? Which entity organization is entitled to use those during and upon the termination of the partnership?

h. Taxes, Indemnification and Insurance

Which of the two organizations will be responsible for receiving funds and reporting the funds as income? Will either organization be responsible for

employment taxes? Will any insurance requirements be imposed on either organization (liability, medical, travel, life, etc.)? Will either organization be required to secure additional insurance? Will one party indemnify the other?

i. Duration

How long will the partnership last? Under what circumstances can the partnership be terminated before the agreed-upon termination date (for example, loss of funding or breach of the agreement)? What are the consequences? Will either organization owe money to the other? Will the organization agree in advance to an alternative dispute resolution process, such as mediation or arbitration, in the case of litigation?

j. Recognition/Visibility

What type of recognition will each organization receive? Will the organization acknowledge each other in written materials or on their respective websites? Will press releases be sent out? What other type of public recognition will be required?

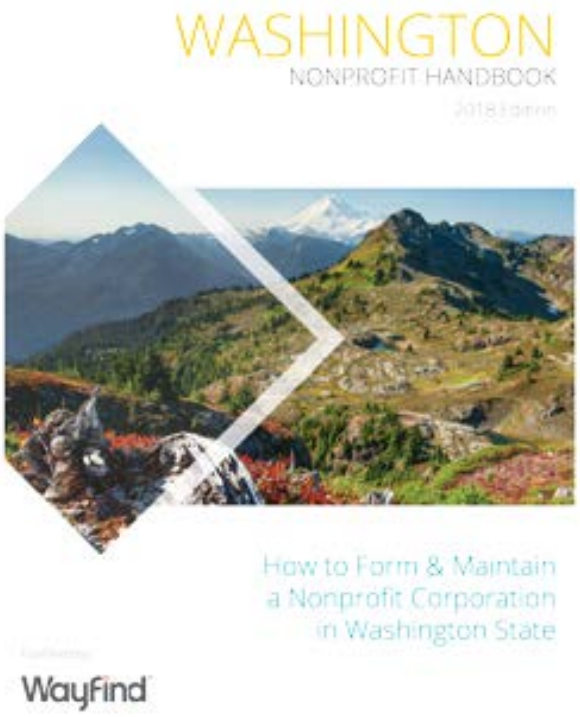
k. Shared Services, Facilities, and Personnel

Which organization's employees will be responsible for overseeing the project? How will they be paid and who will supervise them? Will either party have access to or use of the other's facilities or equipment? Any agreement to share services or facilities between a tax-exempt organization and a private partner must be at arm's-length and must justify the reason for the sharing arrangement, for example economies of scale.

As should be apparent from the foregoing list, there are many issues to be resolved in forming a partnership. Although the foregoing list is a good point of departure for discussing a potential collaboration, consider consulting with an attorney and/or accountant before embarking on any such enterprise to ensure that the organization's legal and financial interests are protected in writing.

Skilled advisors will also be able to tell you whether it makes sense to create a separate entity (usually a subsidiary of your organization) to enter into the agreement with a partner. The rules governing subsidiary organizations are complex, and a number of different types of subsidiary organizations can be created (for example, a corporation, partnership or limited liability company) depending on the specific circumstances of the organization and what it is hoping to accomplish. If properly formed and maintained, a subsidiary can be used to

shield the organization from potential tax liability and from jeopardizing its tax-exempt status were the partnership to engage in activities that do not further the organization's charitable purpose, and it can also protect the organization from contractual and other types of liability by shielding the organization's other assets.



Part 10 Employment Issues

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PART 10. EMPLOYMENT ISSUES

CHAPTER 61. Application of Employment Law to Nonprofits

An increasingly complex labyrinth of common law and statutory requirements at the federal, state, and local levels governs the employer-employee relationship. As a general rule, nonprofit organizations are not exempt from these laws. The array of employment law compliance issues facing nonprofit employers is far too extensive and complex to cover in detail in these materials. This part, however, highlights areas of employment law with which every nonprofit employer should be familiar. For specific advice, consult an attorney.

Another resource nonprofit employers may want to consider retaining is one of several organizations that provide human resources support. For a fee, such organizations can in effect serve as an external human resources department. Because they are knowledgeable of employment practices, they can help maintain proper personnel files, assist with tailoring of benefits and employer policies, and advise on employee relations matters that do not require legal advice.

CHAPTER 62. Classification of Workers

a. "Volunteer" Versus "Employee"

Because nonprofit organizations often rely on volunteers to perform responsibilities that might be performed by employees in a for-profit organization, it is extremely important that the nonprofit employer understands how "volunteers" differ from "employees" under the law. Generally speaking, a person is considered a volunteer if he or she performs services freely for an organization without any expectation of, or receipt of, compensation for his or her services.

The Washington Minimum Wage Act ("WMWA"), RCW 49.46, expressly exempts from its coverage volunteer work for nonprofit organizations.[1]

[1] Nonprofit employers are also subject to the federal Fair Labor Standards Act ("FLSA") if they have at least two employees and an annual business volume of $500,000, or operate as hospitals, health care providers, schools or preschools. The FLSA definition of "volunteer" is substantially similar to the definition under Washington law. Note that the guidance from the federal Wage and Hour Division also clarifies that individuals may not "volunteer" for any commercial activities run by a nonprofit organization, such as a gift shop. For more information, see https://www.dol.gov/whd/regs/compliance/whdfs14a.pdf.

The statute provides as follows:

> "Employee" includes any individual employed by an employer
>
> **but shall not include:**
>
> . . . .
>
> (d) Any individual engaged in the activities of an educational, charitable, religious, state or local governmental body or agency, or nonprofit organization where the employer-employee relationship does not in fact exist or where the services are rendered to such organizations gratuitously.

RCW 49.46.010(3) (emphasis added).

The Washington Department of Labor and Industries has issued an Administrative Policy Statement listing the criteria for whether workers are truly volunteers exempt from the WMWA:

- Individuals will be considered volunteers only where their services are offered freely and without pressure or coercion, direct or implied, from an employer.
- Individuals who volunteer or donate their services, usually on a part-time basis, for public service or for humanitarian objectives, not as employees and without contemplation of pay, are not considered employees of the entities that received their services.
- [I]f [volunteers] are paid for their services beyond reimbursement for expenses, reasonable benefits or a nominal fee, they are employees and not volunteers. Individuals do not lose their volunteer status if they receive a nominal fee or stipend.
- An individual will not be considered a volunteer if he or she is otherwise employed by the same agency or organization to perform similar or identical services as those for which the individual proposes to volunteer.

Minimum Wage Act Applicability, Admin. Policy No. ES.A.1, at 3 (rev. ed. 2014), http://www.lni.wa.gov/workplacerights/files/policies/esa1.pdf.

Under the WMWA, any individual providing services as a volunteer who then receives wages for the same type of services is no longer exempt, and must be paid at least minimum wage and overtime pay for hours worked in excess of 40 hours per workweek. In that case, an employee-employer relationship is deemed to exist, and unpaid employment is unlawful.

However, individuals do not lose their volunteer status if they receive a nominal fee or stipend. A nominal fee is not a substitute for wage compensation and must not be tied to productivity. An individual who volunteers to provide periodic services on a year-round basis may receive a nominal monthly or annual fee without losing volunteer status. An employer should make sure that any "volunteering" is truly voluntary.

Nonprofits often are tempted to allow employees to volunteer for the organization. Although non-exempt employees of a nonprofit may in narrow circumstances volunteer for the organization without violating wage-hour rules, this is a risky proposition. The nonprofit can be held liable for unpaid wages and penalties if the volunteer activity is deemed regular work. For that reason, a prudent practice for nonprofits is to bar non-exempt employees from volunteer activities and pay them for all time spent on tasks related to the organization. For example, a non-exempt program staff member may want to volunteer and help check in attendees at a fundraising event. If the employee has nothing to do with fundraising and is not required to attend the fundraiser as part of her job, it may be permissible to allow her to volunteer at the fundraiser if all of the requirements below are met. However, almost every employee of a nonprofit has a range of responsibilities that may not have clear boundaries. In this example, it would be safer to pay the employee for her time at the fundraiser.

Any nonprofit that permits non-exempt employees to volunteer for the organization must avoid any implication that volunteering is a requirement of the job. An employer whose non-exempt employees also volunteer should make sure that:

- The services are entirely voluntary (without contemplation of pay), there is no coercion to volunteer, and no penalty for not volunteering;
- The activities are predominately for the employee's benefit;
- The employee does not replace another employee while volunteering;

- The activity does not take place during the employee's regular working hours; and

- The volunteer time is insubstantial in relation to the employee's regular hours.

Whether using employee volunteers or regular volunteers, nonprofit employers should strongly consider drafting a short form that a volunteer must sign before he or she begins volunteering. The employee volunteer form should incorporate the first, second and fourth points above, and the non-employee volunteer form should include point 1 above.

Many nonprofit organizations also hire unpaid interns. It is generally permissible for nonprofits to have unpaid interns so long as the individuals qualify as "volunteers" (i.e., are free from control and have no expectation of payment) or they meet all six criteria listed below to be exempt from minimum wage law:

- The internship, though it includes actual operation of the facilities of the employer, is similar to training that would be given in an educational environment.

- The internship experience is for the benefit of the intern.

- The intern does not displace regular employees, but works under close supervision of existing staff.

- The employer that provides the training derives no immediate advantage from the activities of the intern, and on occasion its operations may actually be impeded.

- The intern is not necessarily entitled to a job at the conclusion of the internship.

- The employer and the intern understand that the intern is not entitled to wages for the time spent in the internship.

If, however, an intern is paid more than a nominal stipend or expense reimbursement, then he or she will be considered an employee who is entitled to wages and overtime pay in accordance with the WMWA. *See* Wash. State Dep't of Labor & Indus., Unpaid Internships 101, http://www.lni.wa.gov/IPUB/700-173-000.pdf (last visited Mar. 2, 2018); see also Chapter 72 for a discussion regarding ownership of intellectual property created by volunteers.

b. Independent Contractor versus Employee

A person who performs services for an organization with an expectation or understanding that they will be paid for services is in most circumstances deemed to be an employee. This is virtually always the case if the individual is providing services that are part of the organization's regular business and mission. Independent contractor relationships are an exception to the general presumption of employment and arise when an organization retains the services of an outside person or business to perform some specific task at a designated price. An example would be a nonprofit organization's retention of a painter to refurbish its offices or a computer consultant to install new software.

Unfortunately, the employee/independent contractor distinction is frequently misunderstood, with the consequence that organizations and individuals who work for them believe that they may choose whether to be considered employees or independent contractors. This is not the case. Legal standards determine which classification applies to any given relationship. Because of an increasing focus on enforcement of legal standards and the costly consequences of misclassification (claims for wages, tax violations, etc.), the following information outlines the rigorous standards for establishing an independent contractor relationship and demonstrates why most individuals working for a nonprofit are employees.

The tests for determining an individual's status vary according to the applicable law. Under both federal and state law governing minimum wages and overtime, the Fair Labor Standards Act ("FLSA") and Washington Minimum Wage Act ("WMWA"), respectively, courts use an "economic reality" test to determine whether the worker is an employee. For most other purposes, such as income tax withholding, courts apply the "right of control." While a person could be deemed an employee for purposes of the FLSA but not for other purposes, such cases are rare. Employers should carefully review these factors to ensure that its independent contractors are appropriately classified.

(i) "Right of Control" Test

The test for determining whether a worker is an employee for purposes of income tax withholding, social security tax contributions and ERISA coverage is whether the employer has "the right to control the manner and means by which the work is accomplished."

An individual is considered an employee when the person or entity for whom he or she performs services has the right to control and direct the services, the result to be accomplished, and the details and means by which that result is accomplished. It is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if the employer has the right to do so. However, if an individual is subject to the control or direction of another merely as to the result to be accomplished and not as to the means and methods for accomplishing the result, he or she is an independent contractor.

A court will consider the following factors in determining whether the "right of control" test is met:

- **The Skill Required to Perform the Work.** Workers perform highly skilled work are more likely to be considered independent contractors than workers who perform comparatively low-skilled work.

- **Who Provides the Tools and Materials to Accomplish the Work.** If the hiring party provides the tools and materials, this favors a conclusion that the worker is an employee. If the worker provides his own tools and materials, this favors a conclusion that the worker is an independent contractor.

- **Whether the Work Is Performed at the Employer's Business.** If a worker must perform the work at the hiring party's place of business, this favors a conclusion that the worker is an employee.

- **The Duration of the Relationship Between the Parties.** The longer the duration of the parties' relationship, the more likely it is that the worker will be considered an employee.

- **Whether the Worker Has the Right to Hire and Pay Assistants.** If the worker cannot hire assistants, this may support a conclusion that the worker is an employee.

- **Whether the Hiring Party Has the Right to Assign Additional Work to the Worker.** If the hiring party has the right to assign extra work to the worker, this supports a conclusion that the worker is an employee, regardless of whether the hiring party actually exercises that right.

- **Method of Payment.** Payment by payroll check, payment on a salary basis, or payment for hourly work would tend to support a conclusion that the worker is an employee.

- **Whether the Work Is Part of the Regular Business of the Hiring Party.** If the work performed is part of the hiring party's regular business, the worker is more likely to be considered an employee.

- **The Extent of the Worker's Discretion Over When and How Long to Work.** The less discretion the worker has over when, how, and for how long, the more likely it is that the worker will be considered an employee.

- **Whether the Hired Party Is in Business.** A worker hired as an independent contractor who does not have any indicia of being in business (does not have a business license, tax ID number, etc.) is more likely to be considered an employee.

- **Whether the Worker Receives Employee Benefits.** If a worker receives benefits usually given to employees, the worker is more likely to be considered an employee.

- **How the Parties Treat the Worker for Tax Purposes.** How the parties themselves characterize their relationship is relevant, but not a controlling factor. If the facts otherwise indicate that the worker is an employee, an agreement between the parties to the contrary is not sufficient to alter the employee's status.

The "right of control" test requires all of these factors to be considered and weighed. No one factor is decisive and there is no shorthand formula or magic phrase that can be applied to find the answer. After considering all of these factors, if a person is not found to be an employee, he or she will be considered an independent contractor.

(ii) "Economic Realities" Test

For purposes of the Washington Minimum Wage Act (the "WMWA") and Fair Labor Standards Act (the "FLSA") the proper test for determining whether a worker is an employee or independent contractor is the "economic dependence" test rather than the right of control test described above. The economic dependence test asks "whether, as a matter of economic reality, the worker is economically

dependent upon the alleged employer or was instead in business for himself." *See Anfinson v. FedEx Ground Package Sys. Inc.*, 174 Wn.2d 851, 871, 281 P.3d 289 (2012) (citation omitted). Although the facts may be applied differently in each case, in general, the following non-exhaustive list of factors are considered in determining the proper classification:

- The degree of the alleged employer's right to control the manner in which the work is to be performed;
- The alleged employee's opportunity for profit or loss depending upon his managerial skill;
- The alleged employee's investment in equipment or materials required for his task, or his employment of helpers;
- Whether the service rendered requires a special skill;
- The degree of permanence of the working relationship;
- Whether the service rendered is an integral part of the alleged employer's business.

CHAPTER 63. Antidiscrimination Laws

a. Prohibitions

Under federal, state, and local law, a nonprofit employer may not refuse to hire an applicant, treat an employee, or fire an employee because of the race, color, religion, sex, disabling condition, age or national origin. The Washington Law Against Discrimination (the "WLAD") protects the same groups as federal law, which also prohibits discrimination on the basis of marital status and sexual orientation. In addition to these categories, the Seattle Municipal Code also prohibits employment discrimination on the basis of sexual orientation, gender identity, marital status and political ideology, as well as on the basis of race, gender, national origin, religion, and disabling condition. Other localities may have their own requirements, so a nonprofit should be sure to check on the specific regulations applicable to its location.

In very rare circumstances, Title VII of the Civil Rights Act of 1964 ("Title VII") allows employers to consider the gender, national origin, or religion of an applicant as a bona fide occupational qualification ("BFOQ") for a specific position. The BFOQ standard is difficult to demonstrate and requires that all, or substantially all,

persons in the excluded class would be unable to efficiently perform the duties and the essence of the operation would be undermined by hiring anyone in that excluded class. A nonprofit employer should consult an attorney before failing to hire an otherwise qualified individual on the basis of a BFOQ.

Another limited carve-out from the non-discrimination laws exists for religious organizations. In particular, under Title VII, religious organizations are permitted to give employment preference to members of their own religion but only for institutions whose "purpose and character are primarily religious." Factors include: whether the organization's articles of incorporation state a religious purpose; whether its day-to-day operations are religious (e.g., are the services the entity performs, the product it produces, or the educational curriculum it provides directed toward propagation of the religion?); whether it is nonprofit; and whether it is affiliated with, or supported by, a church or other religious organization. This exception is not limited to religious activities of the organization. The WLAD also has a provision exempting religious employers.

It should also be noted that, while non-discrimination generally requires equal treatment of applicants and employees, two specific categories of protection—religion and disability—may require different treatment in order to accommodate individual needs. Accommodation of religious practices may mean deviating from regular work schedules or requirements. The same is true in the case of disability, discussed separately below.

b. Coverage of Employers

Whether any or all of these laws will directly govern a particular nonprofit organization will depend on the size of the organization. Title VII applies to all employers engaged in an industry affecting commerce who have 15 or more employees, as does the federal Americans with Disabilities Act ("ADA"). The definition of "affecting commerce" has been construed broadly, and many nonprofit organizations have found themselves on the wrong side of a Title VII lawsuit. The federal Age Discrimination in Employment Act governs employers of 20 or more employees.

The WLAD applies to the employment practices of employers of eight or more employees[2] and the Seattle Municipal Code applies to employers with four or

[2] Even an employer too small to be covered directly by Title VII or the WLAD should be cautious in basing an employment decision on a characteristic otherwise protected by the statutes. Note that

more employees. As a general rule, volunteers do not count toward any of these totals.

c. Assessing Job Qualifications

For practical business reasons, it is in an employer's best interests to hire the most qualified applicant for a position, regardless of the applicant's race, gender, national origin, age, sexual orientation, or other protected category. Similarly, an employer generally evaluates and rewards employees based on their ability to perform the job in question. If an applicant believes that he or she has not been hired or any employee claims an adverse job action because of a discriminatory reason, the claimant bears the burden of proving that his or her membership in a protected class motivated the employer's decision or action.

Even so, the employer's motivation may be called into question if it appears that the claimant was not appropriately assessed against the skills and abilities required by the job. It is a good idea to develop a job description for each position within the organization, including essential functions of the position, required skills and capabilities, and any other traits deemed important for successful performance. So long as a nonprofit employer establishes such standards and uses them to evaluate applicants for employment and employee job performance, a claimant will have difficulty proving an unlawful motive for an adverse action. By the same token, an employer that ignores its standards for job success—or has none—may be found to have improperly acted based on the protected status of an applicant or employee.

d. Disability Discrimination

(i) Hiring Issues

Under the ADA, it is illegal to ask whether an applicant has any disabilities. An employer may describe particular skills required on the job, and ask whether the applicant can perform those tasks with or without reasonable accommodation. An employer may also ask an applicant to demonstrate how he or she will perform job tasks.

Washington courts have recognized a public policy tort claim by an employee fired because of age, even where the employer had fewer than eight employees.

TIP:

An employer may not ask an applicant whether he or she needs reasonable accommodation to perform the task. That question requires the applicant to disclose his other disability and the need for reasonable accommodation.

Generally, an employer may not ask about the kinds of accommodation that may be required until after the applicant is hired. However, if an employer reasonably believes that an applicant will need reasonable accommodation to perform the job functions, the employer may ask that applicant certain limited questions. For example, if the applicant arrives at the interview in a wheelchair, the employer can have a reasonable belief that the applicant is disabled and may need an accommodation. In the situation where the employer has a reasonable belief that the applicant will need an accommodation, the employer may ask whether he or she needs reasonable accommodation and what type of reasonable accommodation would be needed to perform the functions of the job. The employer could ask these questions if: (1) the employer reasonably believes the applicant will need reasonable accommodation because of an obvious disability; (2) the employer reasonably believes the applicant will need reasonable accommodation because of a hidden disability that the applicant has voluntarily disclosed to the employer; or (3) an applicant has voluntarily disclosed to the employer that he or she needs reasonable accommodation to perform the job. For example, if an individual with diabetes applying for a receptionist position voluntarily discloses that she will need periodic breaks to take medication, the employer may ask the applicant questions about the reasonable accommodation, such as how often she will need breaks and how long the breaks must be. Of course, the employer may not ask any questions about the underlying physical condition. *See* Equal Emp't Opportunity Comm'n, Notice No. 915.002, Enforcement Guidance: Preemployment Disability-Related Questions and Medical Examinations (Oct. 10, 1995), http://www.eeoc.gov/policy/docs/preemp.html. An employer is allowed to make a contingent offer of employment to an applicant and then determine whether providing a reasonable accommodation would cause undue hardship to the business.

(ii) Failure to Accommodate: Disabling Conditions

Both the ADA and the WLAD require employers to reasonably accommodate disabled employees. According to the Equal Employment Opportunity Commission's (the "EEOC") ADA guidelines, an accommodation is generally any

change in the work environment or in the way things are customarily done that enables an individual with a disability to enjoy equal employment opportunities. The guidelines provide that there are three categories of reasonable accommodation:

- Accommodations that are required to ensure equal opportunity in the application process;
- Accommodations that enable employees with disabilities to perform the essential functions of the positions held or desired; and
- Accommodations that enable employees with disabilities to enjoy benefits and privileges of employment equal to those enjoyed by employees without disabilities.

The guidelines also provide a non-exhaustive list of common types of accommodation:

- Making existing facilities used by employees readily accessible to and usable by individuals with disabilities; and
- Job-restructuring; part-time or modified work schedules; reassignment to a vacant position; acquisitions or modifications of equipment or devices; appropriate adjustments or modifications of examinations, training materials, or policies; the provision of qualified readers or interpreters; and other similar accommodations for individuals with disabilities.

(iii) Undue Hardship

According to the ADA and EEOC regulations amplifying the ADA:

A determination of undue hardship should be based on several factors, including:

- The nature and cost of the accommodation needed;
- The overall financial resources of the facility making the reasonable accommodation; the number of persons employed at the facility; the effect on expenses and resources of the facility;

- The overall financial resources, size, number of employees, and type and location of facilities of the employer (if the facility involved in the reasonable accommodation is part of a larger entity);

- The type of operation of the employer, including the structure and functions of the workforce, the geographic separateness, and the administrative or fiscal relationship of the facility involved in making the accommodation to the employer; and

- The impact of the accommodation on the operation of the facility.

See 42 U.S.C. section 12111(10)(B) (1994); 29 C.F.R. section 1630.2(p)(2) (1997). These factors are important in the nonprofit arena because of the often-limited resources of nonprofit employers.

Common mistakes in the accommodation process include:

- Failing to follow up whenever the employee makes known a condition that is affecting his or her ability to perform the job. There is no requirement that the employee use the term "disability" or make a formal request for "accommodation."

- Not asking the employee for medical confirmation of the condition.

- Failing to maintain accurate job descriptions that describe all essential functions and other requirements of the job.

- Failing to analyze job requirements.

- Making snap judgments about an employee's condition and/or limitations. Decisions on accommodation should be the result of dialogue with the employee and careful consideration of medical information.

- Not asking the applicant or the employee (and his or her health care provider) for suggestions on reasonable accommodation. The reasonable accommodation process is an interactive process.

- Failing to include a human resources staff person in the process (if the organization has such resources).

(iv) Medical Records and Sharing of Information

Employers that receive medical information on employees or applicants are required by the ADA to keep such information and records securely and separate from regular personnel files. All such information and records should be treated as confidential and shared only to the extent necessary for supervisors and managers to understand the extent of an employee's limitation and needed accommodations, for first aid and safety personnel who may need to provide emergency treatment of the employee's condition, and for government officials investigating compliance.

(v) WLAD "Disability" Definition

Nonprofit employers should note that the definition of "disability" is broader under the WLAD than it is under the ADA. In 2007, the Washington State Legislature amended the WLAD to define "disability" as "a sensory, mental, or physical impairment" that is "medically cognizable or diagnosable," "[e]xists as a record or history," or is "perceived to exist whether or not it exists in fact"; and "impairment" includes:

> (i) Any physiological disorder, or condition, cosmetic disfigurement, or anatomical loss affecting one or more of the following body systems: Neurological, musculoskeletal, special sense organs, respiratory, including speech organs, cardiovascular, reproductive, digestive, genitor-urinary, hemic and lymphatic, skin, and endocrine; or
>
> (ii) Any mental, developmental, traumatic, or psychological disorder, including but not limited to cognitive limitation, organic brain syndrome, emotional or mental illness, and specific learning disabilities.

RCW 49.60.040(7).

The statute recognizes a disability in a broad range of circumstances. Under the law, "a disability exists whether it is temporary or permanent, common or uncommon, mitigated or unmitigated, or whether or not it limits the ability to work generally or work at a particular job or whether or not it limits any other activity within the scope of this chapter." RCW 49.60.040(7)(b).

e. Sexual Orientation Discrimination

A prohibition on sexual orientation discrimination was added to the WLAD in 2006. The statute defines "sexual orientation" broadly to include "heterosexuality, homosexuality, bisexuality, and gender expression or identity." The phrase "gender expression or identity" means "having or being perceived as having a gender identity, self-image, appearance, behavior, or expression, whether or not that gender identity, self-image, appearance, behavior, or expression is different from that traditionally associated with the sex assigned to that person at birth." RCW 49.60.040(26).

f. Harassment

As early as 1980, the EEOC issued guidelines specifying sexual harassment as a form of sexual discrimination prohibited by Title VII. In 1985, the Washington State Supreme Court recognized for the first time that failure to correct a hostile work environment caused by sexual harassment constituted discrimination in violation of the WLAD. The following year the U.S. Supreme Court addressed a claim of sexual harassment brought pursuant to Title VII for the first time. The Court unanimously held that a claim of sexual harassment is actionable under Title VII where a hostile environment is created by such harassment, even though the harassment has no tangible economic impact on the plaintiff's employment.

The concept of unlawful harassment has since expanded far beyond gender-based claims. The Washington Supreme Court has confirmed that the WLAD provides employees with a cause of action for disability-based hostile work environment harassment. Federal courts have upheld hostile work environment harassment claims against employers based on same sex sexual harassment and harassment based on religion, race and national origin, and claims arising out of harassment based on sexual orientation. Even so, harassment offenses are most commonly associated with conduct based on sex.

A prudent employer should have in place:

- A clear anti-harassment policy informing all employees that workplace harassment based on sex, race, religion, age or any other protected classification will not be tolerated and will result in disciplinary action. The policy should provide a clear complaint procedure, including an option enabling the complaining employee to bypass the alleged harasser as well. It should also assure that employees who do make claims of harassment will be protected from retaliation;

- Documented distribution of the employer's anti-harassment policy. Many employers require employees to individually sign a statement to confirm receipt; and

- Training programs to ensure that both managers and employees understand what constitutes harassment, and how the employer's harassment complaint procedure operates.

g. Discharge in Violation of Antidiscrimination Statutes

Claims that a discharge violated an anti-discrimination statute generally follow a disparate treatment theory (i.e., "you fired me because I'm a woman"). The essence of the disparate treatment claim is that the employer treated an employee less favorably because of that individual's race, sex, national origin, religion, age, marital status, sexual orientation or disabling condition.

Although it is the claimant who has the ultimate burden of proving discrimination, as a practical matter an employer must be able to articulate a legitimate nondiscriminatory reason for discharging the employee. If the employer fails to do so, it risks losing the case. The claimant may also challenge the validity of the employer's explanation to demonstrate that discrimination must have influenced the decision.

Some courts have found that an employer's failure to follow its own established procedures is evidence that the employer's explanation for the discharge is just a pretext for discrimination. Giving inconsistent reasons for the discharge similarly raises questions. For these reasons, it is important to follow established procedures and to be honest and consistent in communicating the reasons for the action.

Warnings and Corrective Action
Nothing in the federal, state or local antidiscrimination laws requires an employer to warn an employee that misconduct and lack of performance will lead to termination of employment. Likewise, nothing in the federal, state or local antidiscrimination laws requires an employer to document past misconduct or lack of performance prior to firing an employee. Nonprofit employers, like for-profit employers, should, however, always be aware of the jury factor: jurors expect employers to "Be Fair." Jurors sometimes consider a failure to warn or a lack of documentation as evidence that the reasons advanced for discharging an employee are not the true reasons. If jurors do not believe the employer, they may conclude that the employer's "legitimate nondiscriminatory reason" is a pretext for unlawful discrimination. In addition to the jury factor, today many employers, including nonprofit employers, have personnel policies that provide varying shades of "progressive discipline." Progressive discipline plans generally provide that employees will receive oral counseling or written reprimands for all but the most serious infractions prior to discharge. Employers that ignore an established progressive discipline scheme expose their organizations to liability because, as noted above, courts allow plaintiffs to introduce evidence of failure to follow established procedures as evidence that the employer's legitimate nondiscriminatory reason for an adverse employment action is pretextual in nature.

CHAPTER 64. Overtime Compensation

a. The Law

The Fair Labor Standards Act (FLSA) (see Chapter 62) establishes minimum wage, overtime pay, recordkeeping, and child labor standards affecting full-time and part-time workers in the private sector and in federal, state, and local governments. As noted above, the FLSA covers employers that have at least two employees and earn an annual business volume of at least $500,000 per year, or that are hospitals or businesses providing medical or nursing care for residents, school and preschools, and government agencies. Even if these factors do not apply, there may be individual coverage of employees who are individually engaged in interstate commerce, produce goods for commerce, or work in activities closely related and directly essential to the production of goods for commerce. Based on the two definitions for FLSA coverage, many nonprofits are exempt from the FLSA's requirements. The WMWA, however, applies to all employers in the State of Washington. Even when there is no enterprise coverage, individual coverage applies where both the FLSA and the WMWA require, among other things, that employers pay non-exempt employees overtime for all hours worked over 40 in a

workweek. The overtime rate is one-and-one-half times an employee's regular rate of pay. While the WMWA generally mirrors the requirements of the FLSA, in some respects the WMWA is more protective of employees than the FLSA. Employers covered by both statutes must comply with the law that is more generous to the employee. Note that for many years, the minimum wage set by the WMWA (and adjusted annually) has been higher than the federal minimum wage. Also keep in mind that some cities in Washington, including Seattle and Tacoma, have higher minimum wage rates than Washington State, and the municipal rate may vary based on the employer's size. For more information on the current minimum wage rate in Washington, see Wash. State Dep't of Labor & Indus., Minimum Wage, http://www.lni.wa.gov/WorkplaceRights/Wages/Minimum/ (last visited Mar. 2, 2018).

b. Classifying Employees

(i) Classification of Exempt and Nonexempt Employees

By and large the most common mistake that employers make in the administration of wage and hour laws is misclassifying employees as exempt from the requirements of the FLSA and the WMWA. This mistake can be costly as both recordkeeping and overtime requirements differ for exempt and non-exempt employees.

To avoid misclassification, employers should start with the assumption that every employee is covered by minimum wage and overtime requirements, and work back from that starting point. The FLSA was enacted in 1938, during the height of this country's Great Depression. The overtime premium was designed to incentivize employers to hire additional employees rather than lengthening the hours of existing employees. Given this statutory mandate, FLSA exemptions were narrow from their inception, and, although now seen more as a protection for workers, continue to be narrowly tailored.

(ii) The Big Three "White Collar" Exemptions

The most common exemptions under the FLSA and the WMWA are the so-called "white-collar" exemptions. They are also the most misunderstood exemptions. Bona fide executive, administrative, professional and computer employees are exempt from the overtime requirements of both the FLSA and the WMWA, but that leaves open the question of who is a bona fide executive, administrative or professional employee.

The FLSA does not define "executive, administrative, or professional" for purposes of the exemptions, but the U.S. Department of Labor ("DOL") has promulgated administrative regulations defining the scope of those exemptions. As the DOL acknowledged in a proposal to amend these regulations, the exemptions have long "engendered considerable confusion . . . regarding who is, and who is not, exempt."

A DOL fact sheet lists the tests which must be met to qualify for an employee exemption.[3] The following summarizes such tests for qualifying an executive employee, administrative employee, learned professional employee, creative professional employee, and computer employee.

To qualify for the **executive employee exemption**, all of the following tests must be met:

- The employee must be compensated on a salary basis (as defined in the regulations) at a rate not less than $455 per week;
- The employee's primary duty must be managing the enterprise, or managing a customarily recognized department or subdivision of the enterprise;
- The employee must customarily and regularly direct the work of at least two or more other full-time employees or their equivalent; and
- The employee must have the authority to hire or fire other employees, or have particular weight given to their suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees.

To qualify for the **administrative employee exemption**, all of the following tests must be met:

- The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate not less than $455 per week;

[3] See Dep't of Labor, Wage & Hour Div., Fact Sheet #17A (rev. July 2008), https://www.dol.gov/whd/overtime/fs17a_overview.pdf. As noted in the fact sheet, beginning January 2018, the DOL is undertaking rulemaking to revise the regulations that define the FLSA exemptions, including possibly increasing the $455-per-week salary threshold.

- The employee's primary duty must be the performance of office or nonmanual work directly related to the management or general business operations of the employer or the employer's customers; and

- The employee's primary duty must include the exercise of discretion and independent judgment with respect to matters of significance.

To qualify for the **learned professional employee exemption**, all of the following tests must be met:

- The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate not less than $455 per week;

- The employee's primary duty must be the performance of work requiring advanced knowledge, defined as work that is predominantly intellectual in character and that includes work requiring the consistent exercise of discretion and judgment;

- The advanced knowledge must be in a field of science or learning; and

- The advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction.

TIP:

The exemption does not cover an employee who holds a professional degree but who performs a job that is not professional in nature or to which the degree he holds is not applicable.

To qualify for the **creative professional employee exemption**, all of the following tests must be met:

- The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate not less than $455 per week; and

- The employee's primary duty must be the performance of work requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor.

(iii) Computer Employee Exemption

Another addition to the "big three" white collar exemptions is the exemption for highly paid computer system analysts and programmers.

To qualify for the **computer employee exemption**, the following tests must be met:

- The employee must be compensated **either** on (a) a salary or fee basis (as defined in the regulations) at a rate not less than $455 per week or (b) an hourly basis at a rate not less than $27.63 an hour;

- The employee must be employed as a computer systems analyst, computer programmer, software engineer or other similarly skilled worker in the computer field performing the duties described below;

- The employee's primary duties must consist of:

  a) The application of systems analysis techniques and procedures, including consulting with users, to determine hardware, software or system functional specifications;

  b) The design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications;

  c) The design, documentation, testing, creation or modification of computer programs related to machine operating systems; or

  d) A combination of the aforementioned duties, the performance of which requires the same level of skills.

(iv) Working Employees "Off the Clock"

The definition of "employ" under the FLSA includes "to suffer or permit to work." Consequently, if an employer either requires or allows a nonexempt employee to work hours without recording them on his or her time record and receiving pay for them, there will be a pay violation. If the unrecorded hours push an employee's total hours over 40 for the workweek, there will also be an overtime violation. Nonprofit employers should pay special attention to rules governing any "volunteer" hours by their employees (see *supra* Chapter 62).

(v) "Comp Time" Not Allowed

Nonprofit employers, often short on resources and long on missions to accomplish, may be tempted to offer compensatory time or "comp time" in lieu of overtime pay. According to the Washington Department of Labor & Industries, the WMWA does not prohibit offering comp time to an employee who requests it in lieu of overtime pay. However, the FLSA prohibits the practice for all employees, except certain public sector employees such as firefighters. Nonprofit employers should resist setting up any form of comp time, whether formal or informal, for non-exempt employees.

CHAPTER 65. Employee Leave Laws

a. The Family and Medical Leave Act

The Family Medical Leave Act ("FMLA") is discussed first because it is the most commonly known leave requirement. However, many nonprofit employers will not be covered by the FMLA because they have too few employees. A private employer is covered by the FMLA if it employs 50 or more employees for each working day during each of 20 or more calendar workweeks in the current or preceding calendar year. The 20 workweeks need not be consecutive. Private elementary and secondary schools are covered regardless of the number of employees they employ so some nonprofits could be included by this provision.

An employee of an employer subject to the FMLA is eligible for FMLA leave if three conditions are met at the time the leave commences:

- The employee has been employed by the employer for at least 12 months at the time the leave commences;
- The employee has been employed for at least 1,250 hours of service during the 12-month period immediately preceding the commencement of the leave; and
- The employee is employed at a work site where 50 or more employees are employed by the employer within 75 miles of that worksite.

If an employee is eligible for FMLA leave, the employee is entitled to take leave for any of the following reasons:

- For the birth of a child, and in order to care for a newborn child;

- For the placement with the employee of a son or daughter for adoption or foster care;

- To care for the employee's spouse, child or parent with a serious health condition;

- Because of a serious health condition that makes the employee unable to perform one or more of the essential functions of his or her job ("essential functions" is defined according to the ADA); or

- Because of "any qualifying exigency" arising out of the fact that the spouse, son, daughter, or parent of the employee is on active military duty, or has been notified of an impending call to active duty status in support of a contingency operation.

FMLA regulations define one or more of the following circumstances as "qualifying exigencies":

- **Short-Notice Deployment.** To address any issue that arises from the fact that a covered military member is notified of an impending call or order to active duty in support of a contingency operation seven or less calendar days prior to the date of deployment.

- **Military Events and Related Activities.** To attend any official ceremony, program, or event sponsored by the military that is related to the active duty or call to active duty status of a covered military member, or to attend family support or assistance programs and informational briefings sponsored or promoted by the military, military service organizations, or the American Red Cross that are related to the active duty or call to active duty status of a covered military member.

- **Childcare and School Activities.** To arrange for alternative childcare when the active duty or call to active duty status of a covered military member necessitates a change in the existing childcare arrangements, or to provide childcare on an urgent, immediate need basis, or to enroll a child in or transfer to a new school or day care facility when enrollment or transfer is necessitated by the active duty or call to active duty status of a covered military member; or to attend meetings with staff at a school or a daycare facility, such as meetings with school officials regarding disciplinary measures, parent-teacher conferences,

or meetings with school counselors when such meetings are necessary due to circumstances arising from the active duty or call to active duty status of a covered military member.

- **Financial and Legal Arrangements.** To make or update financial or legal arrangements to address the covered military member's absence while on active duty or call to active duty status; and to act as the covered military member's representative before a federal, state, or local agency for purposes of obtaining, arranging, or appealing military service benefits while the covered military member is on active duty or call to active duty status, and for a period of 90 days following the termination of the covered military member's active duty status.

- **Counseling.** To attend counseling provided that the need for counseling arises from the active duty or call to active duty status of a covered military member.

- **Rest and Recuperation.** To spend time with a covered military member who is on short-term, temporary rest and recuperation leave during the period of deployment.

- **Post-Deployment Activities.** To attend arrival ceremonies, reintegration briefings and events, and any other official ceremonies or programs sponsored by the military for a period of 90 days following the termination of the covered military member's active duty status.

- **Death of a Covered Service Member.** To address issues that arise from the death of a covered military member while on active duty status.

- **Additional Activities.** To address other events that arise out of the covered military member's active duty or call to active duty status provided that the employer and employee agree that such leave shall qualify as an exigency and agree to both the timing and duration of such leave.

An eligible employee of a covered employer is also entitled to up to 26 weeks of FMLA leave in a single 12-month period to care for a spouse, son, daughter, parent, or next of kin who is a covered service member recovering from a serious

illness or injury sustained in the line of duty while on active duty. To be a "covered service member," the relative must:

- Be a member of the armed forces, National Guard, or reserves;
- Suffer from an illness or injury incurred on active duty that *may* render him or her medically unfit to perform the duties of his office, grade, rank, or rating (i.e., a "serious injury or illness"); and
- Be undergoing medical treatment, recuperation, or therapy, be in outpatient status, or be on the temporary disability retired list as a result of the serious injury or illness.

FMLA military caregiver leave is available during "a single 12-month period" during which an eligible employee is entitled to a combined total of 26 weeks of all types of FMLA leave.

b. Washington Family Leave Act

The Washington Family Leave Act ("WFLA") includes job protection and leave benefits similar to those provided under the FMLA. The WFLA also covers employers with at least 50 employees (each working day during each of 20 or more calendar workweeks in the current or preceding calendar year) and provides eligibility to an employee of a covered employer who has worked at least 1,250 hours during the 12 months prior to the requested leave. Although most provisions of the WFLA mirror those of the FMLA, leave under the WFLA "is in addition to any leave for sickness or temporary disability because of pregnancy or childbirth." *See* RCW 49.78.390. This means that a pregnant employee in Washington will be able to use WFLA/FMLA allowance on top of any leave for periods of maternity-related disability. Often the total leave may exceed 12 weeks.

c. Washington Paid Sick Leave

As of January 1, 2018, employers in Washington are required to provide paid sick leave for all employees who are not exempt from the WMWA. There is no minimum employee headcount threshold; even an employer with only one employee working in the state must allow that employee to accrue and use paid sick leave. All nonexempt employees are covered, even temporary, part-time, and seasonal employees.

(i) Accrual

- Employees must accrue paid sick leave at a minimum rate of 1 hour for every 40 hours worked.
- For employees already employed on or before January 1, 2018, paid sick leave will accrue for all hours worked beginning on January 1, 2018. Employees hired after January 1, 2018 will begin accruing paid sick leave as soon as they begin working.
- Paid sick leave must be paid to employees at their normal hourly compensation.
- Employees are entitled to use accrued paid sick leave beginning on the 90th calendar day after the start of their employment.
- Unused paid sick leave of up to 40 hours may be carried over to the following year.
- Employers are allowed to provide employees with more generous carry-over and accrual policies.

(ii) Usage

An employer must allow an employee to use paid sick leave for the following reasons:

- An absence resulting from an employee's mental or physical illness, injury, or health condition; to accommodate the employee's need for medical diagnosis, care, or treatment of a mental or physical illness, injury, or health condition; or an employee's need for preventive medical care;
- To allow the employee to provide care for a family member with a mental or physical illness, injury, or health condition; to provide care for a family member who needs medical diagnosis, care, or treatment of a mental or physical illness, injury, or health condition; or to provide care for a family member who needs preventive medical care;
- When the employee's place of business has been closed by order of a public official for any health-related reason, or when an employee's child's school or place of care has been closed for such a reason; and

- For absences that qualify for leave under the state's Domestic Violence Leave Act ("DVLA"). For more information on the DVLA, see https://lni.wa.gov/WorkplaceRights/LeaveBenefits/FamilyCare/DomViolence/default.asp.

A covered "family member" includes:

- A child, including a biological, adopted, or foster child, stepchild, or a child to whom the employee stands in loco parentis, is a legal guardian, or is a de facto parent, regardless of age or dependency status;
- A biological, adoptive, de facto, or foster parent, stepparent, or legal guardian of an employee or the employee's spouse or registered domestic partner, or a person who stood in loco parentis when the employee was a minor child;
- A spouse;
- A registered domestic partner;
- A grandparent;
- A grandchild; or
- A sibling.

Employers must allow employees to use paid sick leave in increments consistent with the employer's payroll system and practices, not to exceed one hour, unless they obtain a variance from the Department of Labor and Industries.

The law also protects employees from retaliation for exercising their rights under the Minimum Wage Requirements and Labor Standards Act. This includes filing a complaint for wages owed, lawfully using paid sick leave or exercising protected rights.

It is also important to keep in mind that some cities in Washington, including Seattle, also have sick leave laws which may impose different requirements in some instances. Consult with an attorney before adapting an existing PTO policy to comply with local or state sick leave laws.

More information on Washington's sick leave law, including sample sick leave policies, can be found at http://www.lni.wa.gov/WorkplaceRights/LeaveBenefits/VacaySick/PaidSickLeave.asp.

d. Pregnancy/Maternity Leave Under the WLAD

In addition to WFLA requirements, Washington State Human Rights Commission regulations also require covered employers to grant employees leave for sickness or disability due to pregnancy or childbirth. (*See* WAC 162-30-020(4)(a) ("An employer shall provide a woman a leave of absence for the period of time that she is sick or temporarily disabled because of pregnancy or childbirth. Employers must treat a woman on pregnancy related leave the same as other employees on leave for sickness or other temporary disabilities."). Thus, even employers with too few employees for WFLA coverage must provide employees with leave for conditions related to maternity and childbirth. As noted above, the WLAD covers employers with 8 or more employees.

e. Washington Military Family Leave Act

The Washington Military Family Leave Act ("WMFLA"), RCW 49.77, allows an employee whose spouse is a member of the United States armed forces, National Guard, or reserves who has been notified of an impending call or order to active duty, or who has been deployed, or who is on leave from deployment, a total of 15 days of unpaid leave per deployment.

The employee may take the 15 days of leave before the deployment of the military spouse or when the military spouse is on a leave from the deployment. For each new deployment of the military spouse, the employee may take another family military leave of up to 15 days.

The employee must give notice to his or her employer of the intent to take the family military leave within five business days of receiving official notice of the call or order to active duty or deployment, or within five business days of official notice of the military spouse's upcoming leave from the deployment. To be eligible, the employee must work an average of at least 20 hours per week for the employer. Family military leave is only available during a period when Congress has declared war, the President has declared war by executive order, or military reserves have been called to active duty. The law covers any employer with one or more employees.

f. Washington Domestic Violence Leave Act

The Washington Domestic Violence Leave Act ("WDVLA"), RCW 49.76, provides leave for employees who are victims of domestic violence, sexual assault, or stalking. The law also allows for leave for an employee with a family member (child, spouse, parent, parent-in-law, grandparent, or person with whom the employee has a dating relationship) who is a victim of domestic violence, sexual assault, or stalking. Domestic violence/sexual assault leave may be taken in blocks or intermittently, and the amount of leave is unspecified except that an employee's time off is restricted to a "reasonable" amount.

The WDVLA permits leave to be taken for the following purposes:

- To seek law enforcement or legal assistance or to prepare for or participate in any legal proceeding related to domestic violence, sexual assault, or stalking;

- To seek health care treatment for physical or mental injuries from domestic violence, sexual assault, or stalking, or attend to such health care treatment for a family member;

- To obtain (or assist a family member in obtaining) services from a domestic violence shelter, rape crisis center, or other social services;

- To obtain (or assist a family member in obtaining) mental health counseling related to domestic violence, sexual assault, or stalking; or

- To participate in safety planning, to temporarily or permanently relocate, or to take other actions to increase the safety of the employee or family member relating to domestic violence, sexual assault, or stalking.

Employees must give notice to their employers of the need for this leave no later than the end of the first day the employee takes the leave. Employers may require verification to support the need for the leave, which can take the form of police reports, court documents, or the employee's own written statement of the need for the leave. The law covers any employer with one or more employees.

g. Washington Family Care Act

The Washington Family Care Act ("WFCA") enables an employee to use his or her choice of sick leave or other available paid time off to care for:

- A child of the employee with a health condition that requires treatment or supervision; or

- A spouse, parent, parent-in-law or grandparent of the employee who has a serious health condition or an emergency condition.

An employee using paid time under the WFCA must comply with the terms of any collective bargaining agreements or employer policies applicable to use of the leave, except for any terms relating to the choice of leave. The law covers any employer with one or more employees. Employees are eligible for WFCA leave if they are currently employed.

h. Leave Required by Local Jurisdictions

Some cities in Washington, including Seattle and Tacoma, have their own sick leave laws, which may impose different requirements than Washington's law in certain circumstances. As a general rule, where there is a conflict between the local and state regulations, the regulation that is more favorable to the employee applies. Nonprofit organizations should be sure to check for any local leave requirements.

Tacoma

An amended version of Tacoma's paid sick leave law took effect on January 1, 2018, to align more closely with Washington's sick leave law. Tacoma's law differs in the following respects:

- Tacoma law also covers overtime-exempt employees;

- Leave may be used for additional reasons, including if a child's school or place of care is closed by a public official or for bereavement leave; and

- A written policy is required if an employer opts to use a PTO policy for paid sick leave that applies to all hours.

Tacoma's paid sick leave ordinance applies to employees who work in Tacoma, including part-time, seasonal and temporary staff, and overtime-exempt employees working at least 80 hours in Tacoma. For further guidance on Tacoma's sick leave law, see https://www.cityoftacoma.org/cms/one.aspx?objectId=75860.

Seattle

Seattle also amended its Paid Sick and Safe Time ("PSST") ordinance after the state law was implemented, effective January 14, 2018. As in Tacoma, non-exempt employees in Seattle are entitled to accrue paid sick leave. A major difference between the Seattle and Washington laws is the rate of accrual. Under the Seattle ordinance, employees accrue paid sick leave at different rates based on the size of the employer or "Tier size," as outlined in the chart below. For further guidance on Seattle's PSST ordinance, see http://www.seattle.gov/laborstandards/ordinances/paid-sick-and-safe-time.

General Information	Small (Tier 1) Employer	Medium (Tier 2) Employer	Large (Tier 3) Employer
Full Time Equivalents (FTEs)	One employee and up to 49 FTEs	50–249 FTEs	250 or more FTEs
Accrual of PSST per hours worked	1 hour per 40 hours	1 hour per 40 hours	1 hour per 30 hours
Carry over of unused PSST (per year)	40 hours	56 hours	72 hours *108 hours for employers with PTO

Note that the Seattle PSST ordinance requires leave for any employee who works within Seattle city limits, even on an occasional or part-time basis—regardless of where the employer is located.

CHAPTER 66. Employee Handbooks

a. Should You Have One?

An employee handbook is a compilation of policies and procedures that an employer decides to use in running its business and wishes to communicate to its employees. There are many positive reasons to have an employee handbook and few negative ones, provided the handbook is properly written. An employee handbook allows you to communicate policies and procedures in a comprehensive and consistent way and helps to ensure that all employees receive copies of important policies such as those prohibiting sexual harassment. Having employees sign a receipt for the handbook provides an efficient method to document employee receipt of all pertinent policies and procedures.

There is one significant concern about having an employee handbook. In Washington, unless otherwise agreed by the employer and employee, employment

is deemed to be terminable "at will." This means that an employee may resign at any time for any or no reason, and the employer may discharge the employee at any time for any reason that is lawful or no reason at all. Washington courts have held that in certain limited circumstances an employee may enforce handbook provisions that contain promises of specific treatment in specific circumstances. There are ways to avoid this result, but employers are well advised to get legal advice before providing a handbook to employees.

b. Preserving the "At Will" Employment Relationship

To preserve the "at will" employment relationship, employee handbooks should reserve discretion to the employer to handle any particular employment situation as it determines to be warranted. Such handbooks should avoid statements that employees may be discharged or disciplined only "for cause" or "just cause" or after a certain process or procedure. The handbook should not guarantee any particular period of employment or suggest that employment is "permanent" or "guaranteed." A handbook should contain a prominent disclaimer that makes clear that the employee handbook and all provisions in the handbook are general guidelines and do not constitute a contract or an assurance of continued employment. The disclaimer should include a statement that the employee acknowledges and understands that his employment is terminable at will. The disclaimer should define the term "at will." The disclaimer should also state that the employee understands that the employer may change the handbook and its provisions at any time. If there was a previous handbook or set of policies, the disclaimer should state that such handbook is no longer in effect. Finally, it should be expressly stated which management person, if any, has the authority to change an employee's at-will status and that this may only be done by specific written agreement. It is recommended that an employer have each employee read, sign and date an acknowledgement of receipt of the handbook and an acknowledgement of the disclaimer.

c. Matters to Include in an Employee Handbook

The following matters are suggested employer policies and procedures to include in an employee handbook:

- Employment-at-will status;
- Equal employment/nondiscrimination policies;
- Harassment prevention policy and specific complaint procedures;

- Work hours, lunch period, rest breaks, flextime policies;
- Overtime eligibility, authorization and reporting;
- Policies and procedures relating to use of vacation, sick leave, bereavement leave, military leave, jury duty, etc.;
- Procedures for using family and medical leave (if applicable);
- General employee conduct policies including attendance, use of alcohol and drugs, nonexclusive examples of conduct that may result in discipline, and nonexclusive examples of the types of discipline that may be imposed;
- General descriptions regarding the availability of employee benefits (medical and dental insurance, life insurance, disability insurance and retirement plans);
- Holidays that are observed;
- Safety policies;
- Social media policies;
- Emergency procedures;
- Employee use of employer email and Internet access; and
- Employee use of employer phones and other equipment.

CHAPTER 67. Other Employer Obligations

a. Other Federal Requirements

(i) EIN

An employer identification number ("EIN"), also known as a federal employer identification number, is used to identify the tax accounts of all employers, including nonprofit organizations. Employers are required to use the EIN on all of the items that the employer sends to the IRS and the Social Security Administration.

(ii) Verification of Worker Identity and Eligibility to Work

Employers are required to verify that each new employee is legally eligible to work in the United States. This includes completing the U.S. Citizenship and Immigration Services ("USCIS") Form I-9, Employment Eligibility Verification. Employers can obtain this form from USCIS offices or by visiting the USCIS website at http://www.uscis.gov. Employers must maintain completed Forms I-9 in their files for three years after the date of hire or one year after the date employment ends, whichever is later.

(iii) Federal Income Tax Withholding and Social Security Contributions

Employers are required to pay Social Security and Medicare taxes (commonly referred to as "FICA taxes") on income paid to their employees. An employer is required to pay 6.2% in Social Security tax and 1.45% in Medicare tax on each employee's gross earnings (up to specified amounts). The employee must contribute the same amount. And while many nonprofit organizations are exempt from federal corporate income tax under section 501(c)(3) of the Internal Revenue Code (the "Code") and thus do not have to pay federal corporate income tax themselves, they must still withhold federal income tax from the pay of their employees.

It is extremely important to properly withhold and timely deposit the employee's and employer's share of taxes owed. Failure to make such deposits will subject the employer to civil fines and penalties, and possibly criminal liability. In addition to making the required deposits, employers are required to complete a federal tax return showing the amounts withheld and deposited. This tax return, called a Form 941, must be timely completed and filed with the IRS. Failure to file the form or late filing will result in civil penalties. For more information on payment, withholding and filing requirements, see IRS Publication 15, (Circular E), Employer's Tax Guide (2018), at http://www.irs.gov/publications/p15, and IRS Publication 15-A, Employer's Supplemental Tax Guide (2018), https://www.irs.gov/pub/irs-pdf/p15a.pdf.

(iv) Federal Unemployment Taxes

Employers also are required to pay Federal Unemployment Taxes ("FUTA") for each employee. The employer pays the full amount of this tax and may not deduct any portion of the tax from its employee's wages. An employer that is exempt from income tax under section 501(c)(3) of the Code is also exempt from

FUTA. For more information requirements, see IRS Publication 15, (Circular E), Employer's Tax Guide (2018), http://www.irs.gov/publications/p15, and IRS Publication 15-A, Employer's Supplemental Tax Guide (2018), http://www.irs.gov/pub/irs-pdf/p15a.pdf.

(v) Occupational Safety and Health

Both federal and state law require employers to maintain a safe, healthful workplace for employees. The Occupational Safety and Health Act ("OSHA") is the federal law. It is mirrored by the Washington Industrial Safety and Health Act ("WISHA"), which is enforced by the Washington Department of Labor & Industries. Both OSHA and WISHA require employers to track workplace injuries or illnesses. Prompt reporting of such instances to the State sets in motion any workers' compensation processing required by the circumstances.

(vi) Affordable Care Act

The Affordable Care Act ("ACA") contains benefits and responsibilities for employers depending on their size and structure. An employer's size is determined by the number of its full-time employees, including full-time equivalents. The structure and requirements of the ACA are the subject of much debate in Congress, and changes may occur. For more information on current ACA requirements that may apply, please visit https://www.irs.gov/affordable-care-act/employers.

b. State Requirements: Workers' Compensation and Unemployment Compensation

In Washington, employers must complete a Master Business Application with the State of Washington. *See* Chapter 9. The application allows an employer to obtain a business license and register with all state agencies for which registration is required. By completing the Master Business Application an employer registers for workers' compensation with the Department of Labor and Industries and unemployment insurance with the Employment Security Department, and both agencies will send the employer information about employee quarterly report forms. Depending on the nature of the organization's activities, an employer may also need to register with the city or county in which it is conducting its business. For additional information, see http://www.dol.wa.gov/business.

c. Posting Requirements

Nearly every statute or ordinance—federal, state or local—designed to protect employees contains a provision requiring employers to have an official poster in a location accessible to employees that describes the provisions of the particular law. Even if an employer is otherwise in compliance with substantive requirements of an employment law, it may be in violation if posters are not present in the workplace.

CHAPTER 68. Setting Executive Compensation

One of the most important tasks facing the board of directors of a nonprofit is setting the compensation for the executive director or chief executive officer and other senior management. A salary which is set too low may fail to attract the talent necessary to best achieve the goals of the entity. But there also are clear dangers to approving an excessive compensation package. Executive compensation that is unreasonably high can result in penalties imposed by the Internal Revenue Service ("IRS"), as well as distrust by members, potential donors and the general public. Moreover, setting appropriate compensation is a fiduciary function, involving decisions regarding the appropriate use of entity assets.

The IRS recommends that nonprofits follow a three-step process in setting executive compensation that is reasonable. Following and documenting compliance with such a process creates a rebuttable presumption that the compensation package is reasonable, shifting the burden of proving otherwise to the IRS. In addition, 501(c)(3) organizations required to describe the process used to approve executive compensation and provide compensation information regarding executives in the annual filing of the Form 990. The three steps are summarized as follows:

1. The board should arrange for a comparability review by an independent body. In this case, an independent body can be a committee of the board, provided that the person to be receiving the compensation is not a member of the committee.

2. The independent body should review comparable salary and benefits data. Data is comparable if it reflects nonprofit entities of similar size and mission, and the same geographic region.

3. The independent body should document (a) the persons who participated in the review, (b) the independence of the participants,

(c) the process used to determine the compensation, and (d) the decision (for example, via Board resolution).

See https://www.irs.gov/charities-non-profits/charitable-organizations/rebuttable-presumption-intermediate-sanctions. It should be noted that the executive compensation package includes the value of employee benefits, deferred compensation, and fringe benefits as well as salary.

If an executive is deemed to have received an excessive benefit, such as an unreasonably large compensation package, the IRS can impose sanctions under section 4958 of the Internal Revenue Code. Such sanctions can include repayment of the excessive benefit and imposition of an excise taxes on the executive who receives the excessive benefit and the persons responsible for approving or failing to prevent the excessive benefit. Those same parties could also face personal liability for breach of fiduciary duty. Payment of excessive compensation can also be deemed to constitute prohibited private inurement, a violation for which the IRS is authorized to revoke an entity's federal nonprofit status.

An additional hurdle was added by the recent Tax Cuts and Jobs Act, which imposes an excise tax on annual compensation in excess of $1 million or severance payments in excess of three times the executive's average annual compensation for the previous five years.

In consideration of the duties of the board and significant potential liabilities, it is recommended that the board of a nonprofit adopt the following best practices with respect to executive compensation:

- Establish a compensation committee (or other independent body) authorized to set executive compensation.
- Utilize the IRS' procedures to establish a rebuttable presumption of reasonable compensation, utilizing appropriate comparability data and considering the full range of compensation and benefits.
- Adopt a comprehensive conflicts of interest policy (the IRS requires an explanation from any nonprofit that does not have such a policy).
- Adopt a written compensation policy, stating the entity's goal of linking compensation to performance, strategy, values, and mission, and referencing comparable peer groups, and target market position with respect to salary level.

- Have the executive compensation approved by the full board (except for conflicted members).

- Review the executive's performance no less frequently than annually to determine whether goals and expectations are being met.

CHAPTER 69. Employee Benefits And Executive Deferred Compensation

a. Introduction

The term "employee benefits" refers to a broad category of non-cash benefits offered by an employer to its employees. Such benefits can include tax-deferred retirement accounts, group insurance, health care benefits and various other benefits. Although no employer is required to offer any such benefits to employees, nonprofit must consider offering a competitive benefits package in order to attract and retain the staff needed to accomplish its goals.

In considering which benefits to offer, a nonprofit employer must consider the direct and indirect costs. In addition to any employer contributions that are contemplated, costs will include, depending on the type of plan, drafting, annual administration (internal, external, or both), annual legal compliance such as testing and reporting and disclosure (internal, external, or both), liability insurance, and potential claims. Failure to satisfy the applicable compliance rules can result in financial penalties and lawsuits. Accordingly, a nonprofit employer should consider its ability to bear the financial burden of a plan, its willingness to be exposed to risk, its ability to administer (or pay to administer) the plan, as well as evaluate the type of benefits offered by employers likely to be competing for the same talent.

One characteristic that nearly all employee benefit plans share is that they are subject to federal regulation pursuant to both the Internal Revenue Code ("the Code") and the Employee Retirement Income Security Act of 1974 ("ERISA"). As a general matter, the relevant provisions of the IRC are designed to result in no income tax, or delayed income taxation, on employees with respect to the benefits provided. The conditions imposed to obtain the desired tax result include, depending on the type of plan, nondiscrimination rules, funding rules, contribution limits, and vesting schedules.

Plans subject to ERISA must satisfy rules pertaining to reporting and disclosure, vesting, protection of assets, plan administration, and fiduciary responsibility. It should be noted that ERISA applies to most types of employee

benefit plans, and compliance is not elective. If a program of benefits is subject to ERISA, compliance with the statute is required.

b. Retirement Benefits

An employer can provide retirement benefits under one or more of a variety of plans. Excluding special arrangements for executives, all of the retirement benefit plan alternatives allow for money to be set aside for employees currently (in a trust, custodial or insurance arrangement), but not available or subject to income tax until distributed. The types of plans available to provide retirement benefits to a broad classification of employees include defined benefit plans (i.e. a classic pension plan), money purchase defined contribution plans, profit sharing plans, simplified employee pensions, 401(k) plans, and 403(b) plans. The types of plans differ as to characteristics such as funding rules, contribution limits, whether contributions are made by the employer, the employee or both. With the exception of 403(b) plans, all of these plans are available to for profit employers as well.

All of these retirement programs are subject to ERISA, although the applicable statutory requirements may vary depending on the type of plan and classification of employees covered. A few key attributes of the retirement plans most commonly utilized by nonprofit employers follows:

- 403(b) and 401(k) Plans: Probably the most common choices for nonprofit employers, these plans provide for employee pre-tax deferrals of salary, and, if the employer chooses, additional employer contributions. Employees can be allowed to choose the investment funds to which their accounts are allocated from the choices allowed by the employer. The plans are similar in most respects, but deferrals under a 401(k) plan are subject to a nondiscrimination test not applicable to 403(b) plan, and an additional catch up contribution opportunity can be provided under a 403(b) plan. The tax requirements for 403(b) plans are set forth in section 403(b) of the Code. The primary tax qualification rules for 401(k) plans are set forth in sections 401 and 415 of the Code.

- Simplified Employee Pensions: Instead of establishing and maintaining a separate retirement plan, an employer can make contributions to the individual retirement accounts of its employees. Such arrangements are available only to employers with 100 or fewer

employees who do not provide another retirement plan and who do not hire employees under lease agreements.

- Profit Sharing Plans: These plans provide for an annual employer contribution in an amount determined by the employer. The amount can vary and be determined each year depending on the employer's financial ability. The primary applicable tax qualification rules are set forth in sections 401 and 415 of the Code.

- Money Purchase Defined Contributions Plans: These plans provide for a stated employer contribution each year. Some plans are designed to require employee contributions as well. Because of the annual funding requirement and the emphasis on employer funding, these plans are less common with nonprofit employers. The primary applicable tax qualification rules are set forth in sections 401, 412, and 415 of the Code.

- Defined Benefit Pension Plans: Defined benefit plans provide a retirement benefit expressed pursuant to a formula which takes into consideration the employee's compensation and years of service. The annual funding for the future benefit is actuarially determined. Defined benefit plans can be expensive to fund and administer, and are not commonly offered by nonprofit employers. The primary applicable tax qualification rules are set forth in sections 401, 412, and 415 of the Code.

c. Welfare and Fringe Benefits

Many employers offer benefit plans which, while not retirement benefit plans, are subject to ERISA and/or the IRC. Examples of such plans are:

- Medical, dental and vision plans
- Health reimbursement and flexible spending accounts
- Disability insurance and group accident and sickness plans
- Long-term care insurance plans
- Housing assistance plans
- Volunteer Employee Beneficiary Associations

- Unemployment, vacation, paid time off and holiday pay plans
- Severance pay plans
- Apprenticeship and training programs
- Scholarship funds
- Prepaid legal services

It also should be noted that some of such plans may be subject to laws in addition to ERISA and the IRC. For example, health benefit plans are subject to the Affordable Care Act if the employer has 50 or more full time employees, welfare plans utilizing insurance policies are subject to state insurance laws, and state labor laws apply to certain arrangements. Employers considering offering such benefits should seek advice regarding regulatory requirements and carefully consider their financial and administrative capacity to offer such benefits.

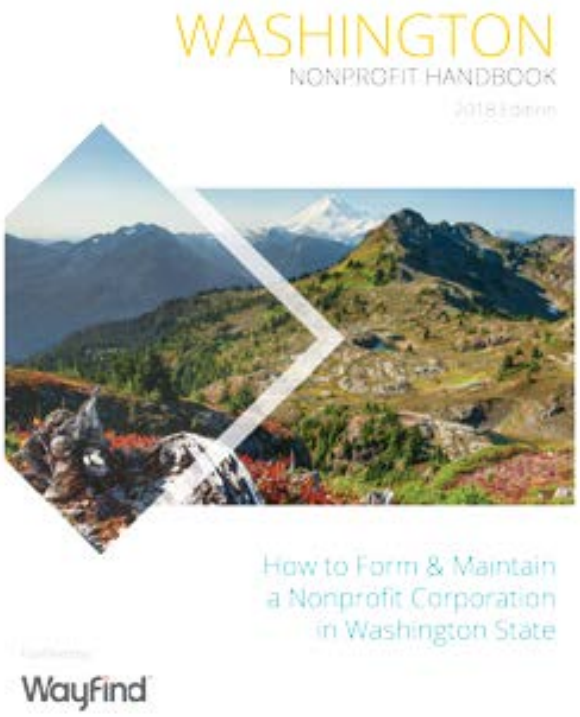
d. Executive Deferred Compensation

Attracting and retaining appropriate executive talent can be a particular challenge for nonprofit entities. In addition to appropriate salary and participation in the menu of employee benefits offered to employees generally, employers often consider establishing a deferred compensation arrangement. Under such an arrangement, the employer agrees to pay the executive money in the future in return for current service. Subject to certain conditions, the deferred compensation is not included in the executive's income tax until a later date. As with other aspects of employee benefit plans, the subject of deferred executive compensation is complicated and employers are advised to seek the advice of experts. However, the following information may assist an employer in evaluating its alternatives.

- A nonprofit employer can establish a plan under section 457(b) of the Code. Such plans are called 457(b) plans, and can be offered only to highly compensated employees with significant executive duties. In many respects these plans operate similarly to 401(k) plans and 403(b) plans, but there are key differences including the fact that any assets set aside for the payment of benefits remain the property of the employer, subject to the claims of the employer's general creditors, until paid.

- An employer can create an arrangement, either in a separate plan document or as a provision of an employment agreement, agreeing to pay compensation to an executive at some future date or upon the occurrence of a future event, such as retirement. Such an arrangement is subject to rules under section 409A of the Code regarding the timing of deferrals and distributions. Section 409A of the Code also precludes an employer from setting aside assets to pay the deferred compensation benefits in a vehicle protected from the claims of the employer's creditors. In addition to the rules under IRC section 409A, when such an arrangement is implemented by a nonprofit employer, it is subject to additional rules under section 457(f) of the Code. Among other requirements, section 457(f) of the Code provides that the amounts credited to an executive's account under the plan are includable in the executive's taxable income when they are vested. This provision results in the plan providing a "golden handcuff" in the sense that the executive has an incentive to keep working for the employer in order to ensure receipt of the deferred compensation, but also results in uncertainty for the executive as the assets are not protected in a trust and remote from the employer's creditors.

- These executive compensation arrangements are subject to certain provisions of ERISA, but are exempt from many of the more burdensome provisions.



Part 11 Intellectual Property Considerations

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PART 11. INTELLECTUAL PROPERTY CONSIDERATIONS

CHAPTER 70. Application of Intellectual Property Law to Nonprofits

Intellectual property law can be a very detailed and esoteric topic, but here we will only focus on a few intellectual property issues that nonprofit corporations commonly encounter. Before doing that, however, we will generally describe five basic types of intellectual property: patents, copyrights, trademarks, trade secrets, and publicity rights.

Patents

Patents are a form of protection with three main categories: utility, design, and plant. In general, (i) utility patents protect new and useful machines, manufactured goods, processes, or compositions of matter, and any improvements to any of the foregoing; (ii) design patents protect original and ornamental designs for a manufactured good; and (iii) plant patents protect distinct and new varieties of plants. Although there are some nonprofit corporations that may be very involved with patents (such as university foundations or hospitals), most nonprofit corporations will not be applying for or obtaining patent rights, so we will not discuss them here. If interested, a nonprofit corporation can obtain more information on patents from the patent section of the U.S. Patent and Trademarks Office website at https://www.uspto.gov/patents-getting-started/general-information-concerning-patents.

Copyrights

Copyrights are a form of protection that protect "original works of authorship". Items protected by copyright include written text (such as books and blogs), photographs, videos, graphics, music, and computer software. A copyright owner can prevent a third party from, among other things, copying, distributing, or creating new or adapted versions of the work (also called "derivative works"). As soon as a person creates an original work of authorship he or she has a copyright in it – nothing more needs to be done. However, additional rights can be obtained by registering the copyright with the U.S. Copyright Office. Also, a copyright must be registered in order to sue a third party for copyright infringement of such work. More information on copyrights and how they may be registered is available from the website for the U.S. Copyright Office at https://www.copyright.gov/.

It is important to remember that a work is protected by copyright even if you have purchased a copy of the work, or it is publicly available. Thus, when you

purchase a book, you only own that particular copy, and have not purchased the copyrights to the book itself. This means you cannot make copies of the book and distribute them, or otherwise infringe the copyright owner's rights. Likewise, even though a picture or video clip may be publicly available on the Internet, you cannot copy and use them.

As soon as a nonprofit corporation's employee creates an original work, the nonprofit corporation has a copyright in it – nothing more needs to be done.

Trademarks

Trademarks are logos, business or product names, tag lines, or other items that identify the source of origin for a good. Similarly, a service mark is like a trademark except that it identifies the source of origin for a particular service rather than a particular good. For ease of discussion, any reference to "trademarks" in this Part will mean both trademarks and service marks. A nonprofit corporation has a potential claim against any third-party that subsequently uses the same or similar trademark in such a way that consumers are likely to be confused between the nonprofit corporation and such third-party, and/or their respective goods or services. Since every nonprofit corporation probably has one or more trademarks, a more detailed explanation of trademarks is set forth in the subsequent following Chapter.

Trade Secrets

A trade secret is any information that derives economic value from not being known (e.g., product formulas, detailed information on suppliers or customers, ways of doing business, etc.). A nonprofit corporation has a potential claim against a third-party that acquires or uses its trade secret without consent. In order to show that something is a trade secret, a nonprofit corporation must show that the information was secret and that reasonable efforts were made to keep it secret. Donor or other unique organizational mailing lists could be protected as a trade secret. Such efforts will probably include having employees and contractors sign a confidentiality agreement (sample confidentiality agreements available online at https://wayfindlegal.org/tools/legal/).

Publicity Rights

Washington, as well as various other states, allow an individual to prevent others from using his or her name, voice, signature, photograph, likeness, or other personally identifiable characteristics. These are often referred to as "Publicity

Rights or "Personality Rights". The scope of this protection varies from state to state, and the details will not be discussed here. A basic rule of thumb is that a nonprofit corporation should not use the name, picture or other characteristics that identifies any living or deceased individual without that individual's proper consent, even if such use is not being done for profit. Washington law explicitly states that an infringement of this right can occur in connection with not-for-profit fundraising or solicitation of donations. *See* https://wayfindlegal.org/tools/legal/ for a sample photo release.

A Word about Fair Use

Some nonprofit corporations mistakenly believe that they have leeway to use the intellectual property of others without permission because they are not "for-profit" enterprises. They often think they have a broad "fair use" right that is similar to the one teachers have in certain situations. This understanding is false, but we will not go into all the details here. A very basic principle is that there is trademark fair use and copyright fair use.

In trademark fair use, a nonprofit corporation is permitted to use a trademark owned by another party if it is necessary to describe the owner's goods or services (for example, "we use Microsoft Office software"). However, (i) the nonprofit corporation may only use so much of the trademark as is necessary to identify the good or service, (ii) the logos of the owner should not be used, and (iii) the trademark should not be used in a manner that suggests the owner endorses or sponsors the nonprofit corporation.

In copyright fair use, there is no hard and fast rule, and each situation must be analyzed on a case-by-case basis. One must evaluate the purpose of the use, the nature of the work being used, the amount of the work being used, and the effect of the use on the potential market for the work. A use of a copyrighted work without permission is not "fair use" merely because the purpose was to help a nonprofit corporation. In today's world, where copyright owners can use internet bots, web crawlers, and other automated technologies to more easily determine when their photos, articles, and videos are being used, it is highly recommended that nonprofits always obtain permission first. Even if the nonprofit may potentially have a fair use argument, the time and effort it takes to respond to, and argue with, the copyright owner may not be worth it.

CHAPTER 71. Trade Names and Trademarks

There is often confusion surrounding the difference between a trade name and a trademark. A trade name is the name of the business, but a trade name is usually also a trademark because it indicates the source of origin for the goods or service provided by the business. For example, Microsoft Corporation is a trade name, and "Microsoft" is also a trademark.

Rather than trying to understand the differences between a trade name and a trademark, it is easier if a nonprofit corporation just assumes its trade name will also function as a trademark, and picks a trade name with trademark law in mind.

Under trademark law, a nonprofit corporation can be sued for trademark infringement if it uses a trademark that is the same as the trademark of a senior user, or so similar that people are likely to confuse the nonprofit corporation and the senior user, and/or their respective goods and services. Thus, if a nonprofit corporation begins using a business name without conducting any prior research, and later finds that there is another entity with senior rights in the same or similar name, the nonprofit corporation may have to change its name, reprint materials, change signage, and incur other expenses.

In order to avoid this, it is important for a nonprofit corporation to do preliminary research before finally deciding on a business name. This usually involves at least three things: (i) searching the database available at the U.S. Trademark Office website, (ii) performing some general searches using the internet, and (iii) investigating to see whether an appropriate domain name is available.

Initially, a nonprofit corporation should go to the U.S. Patent and Trademark Office's trademark site at http://www.uspto.gov/main/trademarks.htm. The site allows the nonprofit corporation to use the Trademark Electronic Search System (TESS) to see whether a particular trademark has been applied for or registered. The site also contains various background information related to trademarks.

If TESS does not indicate that the same or a similar trademark has been applied for or registered, a nonprofit corporation should then conduct additional searches on Google, Bing or other internet search engines to see if an entity with the same or similar name already exists.

Finally, since a nonprofit corporation will probably want a website, it should see if an appropriate domain name is available, and then register such domain.

This can be done at sites such as www.GoDaddy.com, www.tucows.com, or www.GoogleDomains.com.

A nonprofit corporation should be forewarned that it is often very difficult to find an appropriate business name/trademark (so much so that this difficulty has been the subject of a Dilbert cartoon). At times, it may be very frustrating because all the desired choices will seemingly be taken. A nonprofit corporation can increase its chances of finding a suitable name by choosing arbitrary or fanciful terms (e.g. made up words like "Dasani" or real words like "Apple" that have no connection to the good or service).

After completing the above searches and identifying a few potential names that seem to be available, a nonprofit corporation should consider consulting with an experienced attorney. The attorney may point out problems that were not otherwise obvious, or may indicate that a situation that appeared risky to the nonprofit corporation is not very problematic. In any event, it is best to have several alternative names to discuss with the attorney. Nonprofit corporations should avoid becoming too "attached" to one name before conducting the above investigations. It can be a frustrating and expensive lesson for a nonprofit corporation to launch a new business without the proper investigation, as it may subsequently receive a "cease and desist" letter from a prior user that forces the nonprofit corporation to change its name and all materials that contain the old name.

It should be emphasized that the analysis of whether a nonprofit corporation's proposed name may have potential problems is an art rather than a science and requires experience in this area. A nonprofit corporation may have a problem even if its name is not identical to another entity and even if the Washington Secretary of State's Office approves the nonprofit corporation's name. Thus, it is highly recommended that an experienced attorney assist with this analysis.

The above research can be done while the nonprofit corporation's articles of incorporation are being prepared, and the eventual name chosen can be inserted prior to the articles of incorporation being filed. Once the articles of incorporation are filed, a Washington Master Business Application must also be filed (as discussed in Chapter 10). The Master Business Application contains a section where the nonprofit corporation can register its trade names. Although it may not be mandatory, this section should be used to register the nonprofit corporation's trade names because registration by this method is inexpensive and can be done

simultaneously with filing the other information initially required by the Master Business Application. Usually, the nonprofit corporation's corporate name is also a trade name. In some cases, the acronym of a nonprofit corporation's corporate name may also be an additional trade name. For example, the acronym "ACLU" may be an additional trade name for the American Civil Liberties Union. As noted above, these trade names are also usually trademarks.

In the United States, nonprofit corporations accrue rights in a trademark as soon as the trademark is used in commerce in connection with the nonprofit corporation's business. These are called "common law" trademark rights, and no registration is required. Once trademark use has started, generally the only people who can require a nonprofit corporation to stop using its trademarks are those who can show that they began using the same or similar marks before the nonprofit corporation. That is why conducting thorough searches is so important. It gives the nonprofit corporation confidence that it has a good defensive legal position, and that there are likely no prior users.

From a legal point of view, it is always better if a nonprofit corporation supplements its common law rights, and also registers its trademarks under state and/or federal laws.

A nonprofit corporation may register a Washington State trademark through the Washington Secretary of State's website. Information can be found at https://www.sos.wa.gov/corps/Trademarks.aspx. State trademark registration may prevent other entities with similar goods or services from subsequently obtaining a Washington State registration for the same mark, because either the registered trademark will be included in searchable databases and will discourage other parties from filing for such mark, or the Secretary of State may refuse to register a similar mark for similar goods or services. It also allows a nonprofit corporation to bring a claim against a subsequent user for state trademark infringement, in addition to a claim for common law trademark infringement.

Nonprofit corporations may obtain more expansive trademark rights by registering the trademark at the federal level with the U.S. Patent and Trademark Office. The application for this registration is now usually submitted online from the U.S. Patent and Trademark Office website at http://www.uspto.gov/main/trademarks.htm. While federal trademark registration is always recommended, the costs for such registration are more substantial than state registration, and the application review process is more rigorous and time consuming. Therefore, whether a nonprofit corporation should in fact undertake federal registration

requires a cost/benefit analysis that depends on the corporation's resources and goals. A knowledgeable attorney can help the nonprofit corporation with this decision.

Unfortunately, there is no government agency or private party charged with enforcing a nonprofit corporation's trade name or trademark rights. Thus, a nonprofit corporation will bear the costs of such action. Such enforcement may require the corporation to hire an attorney and may be relatively expensive and thus not a viable option. For many nonprofit corporations with limited resources, it will be important to remember that, even if they obtain state and/or federal registration, there is no guarantee that another party will not subsequently use a similar trademark, or that another party will willingly stop such use. Because of this situation, some argue that from a pragmatic point of view, the expanded rights provided by state and federal trademark registrations are not as important to cash-strapped nonprofit corporations that are mainly worried about their defensive position. Although such registrations are always recommended if budgets permit, they may be more useful to the nonprofit corporation that wants to strengthen its offensive position, so that it has a better case when pursuing third parties to have them stop using the same or similar trademarks.

CHAPTER 72. Ownership of Intellectual Property

There are many complicated rules regarding the ownership of intellectual property, and a nonprofit corporation should seek the assistance of an attorney if it has any specific questions, or if it is in a field that uses or develops intellectual property extensively. In general, a nonprofit corporation should have a written agreement with each of its employees and independent contractors regarding who owns the intellectual property they may create. There is a somewhat counterintuitive rule of law that holds that if a nonprofit corporation does not have an agreement with an independent contractor regarding the transfer of intellectual property ownership, then the intellectual property such independent contractor creates (such as a brochure, a logo, or a web site) might be owned by the independent contractor—even if the nonprofit corporation paid the independent contractor to create it.

It can be very surprising for a nonprofit corporation to find that it may not be able to freely modify and redistribute a brochure or web site that it paid for because it did not have a proper intellectual property assignment from the independent contractor who created it. Moreover, an “independent contractor” in this case is not just an unrelated design firm or web site developer; it might be

anyone that the nonprofit corporation does not provide employee benefits to or pay social security taxes for. Thus, "volunteers" or "interns" who spend time at the nonprofit corporation on a regular basis will probably fall within this category, and will be considered independent contractors and should sign intellectual property assignments.

It is best to have a custom intellectual property agreement created for each specific situation, but often a nonprofit corporation does not have the time or money to have one drafted. There are three types of common intellectual agreements that are applicable to nonprofits:

- The independent contractor letter agreement is for a situation when a nonprofit corporation hires an independent contractor to perform some services (such as creating a brochure or logo). It includes language that transfers the intellectual property created to the nonprofit corporation and also includes a confidentiality provision so that the independent contractor has an obligation to protect the nonprofit corporation's trade secrets. Independent contractor agreements can of course be much more complicated and contain many other provisions; this is just a very simple template.

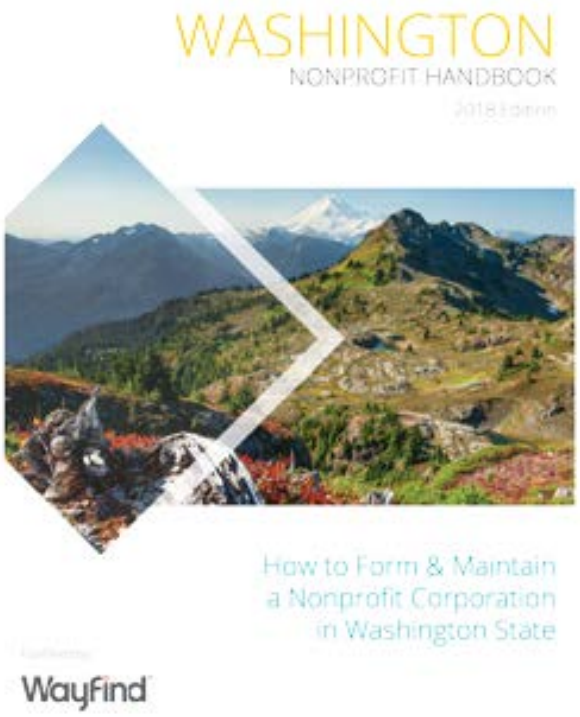
- The intellectual property and confidentiality agreement is a document that could be signed by all new employees as a condition of being hired. By signing the agreement, the new employee expressly assigns all intellectual property to the nonprofit corporation and agrees to protect the nonprofit corporation's trade secrets (as noted above, in order to bring a trade secret misappropriation case a nonprofit corporation will need to show that it took reasonable efforts (such as entering into these types of agreements) to protect its trade secrets). If a nonprofit corporation would also like existing employees to sign an agreement like this, it should carefully discuss the situation with an attorney. The nonprofit corporation may have to take additional steps to better insure that the agreement can be enforced against existing employees. A sample intellectual property and confidentiality agreement is available at https://wayfindlegal.org/tools/legal/.

  The sample intellectual property and confidentiality agreement can also be signed by independent contractors who have not signed an independent contractor agreement. Note that the sample intellectual property and confidentiality agreement does not have a description of

services, deadlines, and other provisions that the sample independent contractor letter agreement has, and thus may be more suitable for volunteers, consultants, interns and other individuals who are not employees of the nonprofit corporation but who provide assistance without being retained for a specific project.

- The sample release agreement is for a situation when a nonprofit corporation is creating a training or educational video, is taking photos of people that it would like to use, or is otherwise involved in a project where many people are involved and it is too cumbersome to have them sign something like the sample independent contractor letter agreement or the sample intellectual property and confidentiality agreement. Ordinarily, a nonprofit corporation might use a "model's release" for this type of situation, but the sample release is designed to be a model's release, plus a release for anyone else that is involved in the production (for example, directors, producers, photographers, crew members or anyone else who is seen in, or helps with the creation of, the work should sign the release since they all potentially will have intellectual property rights in the work). The sample release agreement should be modified to fit the particular situation, and if any of the people involved are minors the form should be signed by their parents or legal guardians. A sample release agreement is available online at https://wayfindlegal.org/tools/legal/.

As with other sections of this Handbook, this Part on Intellectual Property has only provided a very brief and simplified description of some of the issues that a nonprofit corporation might face. It has described how certain things might be done by a nonprofit corporation in a relatively independent and inexpensive manner. Unfortunately, "one size fits all" advice and form agreements can never cover all the potential issues, so it is always best for a nonprofit corporation to consult with a knowledgeable attorney.



Part 12 Personal Information Security And Online Privacy Issues For Nonprofit Organizations

Chapter 73 Personal Information Security
Chapter 74 Internet Advertising and Privacy Laws

PART 12. PERSONAL INFORMATION SECURITY AND ONLINE PRIVACY ISSUES FOR NONPROFIT ORGANIZATIONS

CHAPTER 73. Personal Information Security

Almost every organization collects personal information from individuals, whether from employees, volunteers, donors, or recipients of services. This personal information may be necessary or useful for your organization's activities, such as payroll processing and sending solicitation requests. Use of personal information, however, comes with the responsibility to keep that data safe. Sensitive information such as social security numbers, credit card numbers, financial account numbers, date of birth, health information, and other data can be used to commit financial fraud and identity theft.

To protect individuals against such threats, federal laws and many states require organizations to protect personal information, and in some cases, to notify individuals if information is improperly disclosed. Note that this Chapter is intended to cover only commonly applicable personal information security guidelines and requirements. Not all data protection laws are covered here. If you handle financial information, health information, driver's license numbers and social security numbers, other laws and regulations may apply.

The topic of personal information is complicated because many existing laws only address commercial entities, who are not the only agencies or organizations that are responsible for handling and safeguarding personal information. Does this mean that nonprofits should not worry? First, the law in this area is unclear. For example, a nonprofit may not be covered under a law if it provides its own fundraising, but may be covered if it uses an outside commercial party. Second, laws may exclude certain tax exemption types of nonprofits (such as a 501(c)(3)) but may apply to all other nonprofit designations. Third, the topic of personal information has become very important and a nonprofit's reputation can be put at risk if personal information is not handled properly. Arguably, reputation risk alone is the most important reason why nonprofits should make the topic of personal information critical to their operations and act as if the laws apply regardless of whether they do or not (see http://blog.charitynavigator.org/2015/04/donor-privacy-policies.html for why Charity Navigator, the largest evaluator of charities, includes an assessment of the nonprofit's privacy policy in its evaluations).

a. Protecting Information

The Federal Trade Commission ("FTC") and a few states outside of Washington specifically require organizations to take measures to protect information. Under Section 5 of the Federal Trade Commission Act, 15 U.S.C. sections 41-58, the FTC has instituted numerous actions against entities who failed to adequately secure personal information, including at least one nonprofit corporation. Of the states that have data protection laws, most prescribe broad requirements to "reasonably secure" sensitive personal information. Massachusetts has enacted very detailed security regulations covering sensitive personal information; including encryption requirements (*see* 201 Mass. Code. Reg. 17.00—effective March 1, 2010). Nevada also has enacted specific encryption requirements for sensitive personal information sent electronically or stored on mobile devices. *See* NRS 603A—effective January 1, 2010.

This section gives a general overview of what your organization can do to help protect and secure personal information. Additional tips and guidance can be found on the FTC's website at http://www.ftc.gov/infosecurity/.

(i) Data Minimization

Organizations can best protect information by not having it in the first place. Avoid collecting unnecessary information by eliminating unnecessary fields in forms. Reduce the amount of data you have by storing information in redacted or truncated form, for example, by using only the last four digits of credit cards in databases. Delete information that you no longer need.

(ii) Securing Data

Data in physical form is a common source of identity theft. Keep physical documents safe by limiting access to areas where personal information is kept to only those individuals who have a legitimate "need to know." Require employees and volunteers to lock documents containing sensitive data in file cabinets or drawers for storage.

Protection of data in electronic form is best handled by information technology personnel and professionals with expertise in data security. Every individual in your organization, however, should know what they can do to help keep electronic data secure. For example, avoid storing sensitive data on portable devices such as CDs, DVDs, USB flash devices, laptops, and phones. Strongly consider encrypting data you must keep on such portable devices and, if practical,

any place you store sensitive data. At minimum, use some form of security technology using strong password protection. Encrypt sensitive data you send over the internet, including data sent via e-mail. Make sure web pages that collect sensitive information over the internet use Secure Sockets Layer (SSL) security. A site is secure if the letter "s" follows "http" in the site URL. In other words, if the webpage URL starts with "http," it is not secure. If it starts with "https," SSL security is used.

Use and regularly update firewalls, antivirus and antispyware software to protect systems and computers connected to the internet. Finally, make sure that the vendors you use also protect any personal information you allow them to process or store on your behalf. Organizations may be held responsible for the actions of its vendors. Require all vendors to notify the organization of any breaches and consider reserving the right to audit their activities.

(iii) Data Disposal

Many state laws, including RCW 19.215, specifically require that you properly dispose of sensitive data. In Washington, "sensitive data" includes financial information and health information. Information that is improperly disposed of can end up in the hands of dumpster divers or other types of identity thieves. Under Washington law, proper destruction involves "shredding, erasing, or otherwise modifying personal information in records to make the personal information unreadable or undecipherable through any reasonable means."

Make sure all employees shred or properly incinerate any paper documents. Disposal in recycling bins is not a secure way to dispose of documents. When disposing of old computer equipment, wipe the hard drives of data using appropriate wiping utility programs. If such technology is not economically feasible, you can also remove the hard drive and physically destroy it by simply smashing it.

b. Security Breach Notification

Laws in several states, including RCW 19.255, require your organization to notify individuals in the event of a data security breach. The laws in each state vary, but many states have similar requirements. The breach notification law in Washington requires an organization to notify affected individuals where there has been a breach of computerized data in the form of a name in combination with sensitive information such as social security number, credit card data, financial account number, or driver's license number. Some states also require notification

where the compromise involves paper data. Some states also add other data elements such as date of birth, medical information, or mother's maiden name.

Washington requires notification in the form of a physical writing to the affected individuals. Organizations may provide substitute notice by publication or e-mail in the event of larger breaches. Washington, like many states, also requires notification to major credit reporting agencies in the event of breaches of a certain size. A few other states also require reporting to consumer protection agencies.

Other requirements and certain exceptions apply under the notification laws. Notably, Washington and most other states do not require notification when the lost or stolen data has been encrypted. If you have the type of data that could trigger notification laws, keeping that data encrypted could help you avoid the requirements under these laws.

Because timing of notifications is usually an element under state laws and commonly the subject of investigation by state agencies, one of the most important things for an organization to do in the event of a breach is to act quickly to secure technical and legal advice to respond to a breach and notify individuals as soon as possible.

CHAPTER 74. Internet Advertising and Privacy Laws

The internet has become an important tool for nonprofit organizations that allows nonprofits to more easily solicit donations, publish information via websites, provide e-newsletters to members, and much more. Nonprofit organizations must comply with important laws governing internet advertising and privacy as well as ensure that any online solicitations comply with state and federal regulations.

One of the most important things all nonprofit organizations should do is to embrace transparency and accountability. Today, donors are using the internet to keep tabs on the charities they support and to find out more about the ones they are considering supporting. Organizations can make it easy for them by ensuring that all relevant data about itself is easily accessible. If your organization files a Form 990 or has an annual audited financial statement, consider making this information available on your website or providing a direct link to your GuideStar (https://www.guidestar.org) or similar listing.

The internet allows us to obtain a wealth of information about consumer behavior when visitors utilize a website, purchase items, or make online donations. Any website can easily obtain consumer information by simply monitoring the

visitors to the website, collecting reactions to ads placed on other websites, or adding members to your distribution lists. Types of information obtainable include how many people viewed your ad, what percentage of people clicked on the ad, what percentage of people purchased your product after seeing the ad, which pages on your website are visited most often, the names of other websites your customers have visited, and customers' e-mail addresses and other personal information.

On one hand, this data allows you to better serve your visitors, target your message, and simplify the experience for users of your website. On the other hand, misuse of all this information can potentially lead to fraud, violations of consumer privacy, or identity theft. As a result, consumers are increasingly wary of providing personal information, and more laws are being passed to protect their rights.

a. General Legal Requirements

Even before the ascendancy of the internet, privacy laws had been passed by the U.S. government to protect the privacy of consumers' personal information and shield consumers from fraudulent, deceptive, or misleading advertising practices. These same laws apply to the internet.

The FTC publishes guidelines to help businesses apply these laws to practices on the internet. Specifically, the FTC has published "Advertising and Marketing on the Internet: Rules of the Road" (available at https://www.ftc.gov/tips-advice/business-center/guidance/advertising-marketing-internet-rules-road).

This publication has a simple message for all internet advertisers: "Advertising must tell the truth and not mislead consumers. In addition, claims must be substantiated." The FTC recommends that businesses and organizations:

- Place disclosures on the same webpage as the claim they apply to, and when necessary, provide adequate visual cues to indicate that a consumer must scroll down on the page to view the disclosure;
- When hyperlinking to disclosures, make the link obvious and noticeable, label the link accurately and indicate its importance, place the link near relevant information, ensure that the link takes consumers directly to the disclosure, and monitor link usage to ensure its effectiveness;
- Display disclosures prior to purchase or prior to donation; and

- Ensure that an advertisement's "text, graphics, hyperlinks, or sound do not distract consumers' attention from the disclosure."

If you sell other companies' products on your website, be aware that the FTC may also hold you responsible for misleading ads and product descriptions, even when those materials are provided by the manufacturer.

b. Children's Online Privacy Protection Act

Nonprofit organizations that collect information from, or is attractive to, children under thirteen, should be aware of the Children's Online Privacy Protection Act, which requires that businesses and organizations "obtain verifiable parental consent for the collection, use, or disclosure of personal information from children." 15 U.S.C. section 6502(b)(1)(A)(ii). Even if your site is not targeted at children, you could be subject to requirements under this law if you collect age or date of birth information during online registration and do not block children from registering.

c. Health Insurance Portability and Accountability Act ("HIPAA")

Nonprofit organizations that are hospitals or its foundation, must be aware of HIPAA. Specifically, in the case of healthcare fundraising, hospitals cannot target segmented fundraising mail to former patients without their express written consent. For instance, if a person goes into the hospital as a cardiac patient, the hospital's fundraiser or foundation cannot target that former patient as having been in the cardiac care unit without his or her written permission.

d. Your Organization's Privacy Policy

(i) Online Privacy Protection Act (California State Law)

Owners of websites anywhere in the country should be aware of the provisions of California's Online Privacy Protection Act of 2003 (codified in Cal. Bus. Code sections 22575 - 22579), which went into effect July 1, 2004. It requires an owner of a commercial website or online service ("operator") that collects personally identifiable information through the internet about individual California resident consumers to conspicuously post its privacy policy. An individual's personally identifiable information includes his or her name, address, e-mail address, phone, social security number, identifying information that enables physical or online contact with such individual, and other information collected and maintained in personally identifiable form in combination with the preceding

identifiers. An individual nonprofit organization's website collecting such information may or may not be regarded a commercial website. Some important factors may be whether the organization's website promotes any unrelated business activities, includes any paid advertising, or solicits new members who may receive in return for their dues some commercial benefit not related to the organization's exempt purpose.

Accordingly, an organization should carefully consider whether it would be advantageous to comply with the Online Privacy Protection Act's requirements.

Under the Online Privacy Protection Act, the privacy policy must do the following:

- Identify the categories of (a) personally identifiable information collected through the website or online service about individual consumer visitors, and (b) third-party persons or entities with whom the operator may share such information;

- Provide a description of the process for an individual consumer to review and request changes to his or her personally identifiable information collected through the website or online service, if the operator maintains such a process;

- Describe the process by which the operator notifies consumers who use or visit its website or online service of material changes to the operator's privacy policy; and

- Identify its effective date.

(ii) Preliminary Considerations in Drafting Your Privacy Policy

All organizations should consider developing a privacy policy for conspicuous posting on their website.

A privacy policy:

- Explains to individuals how your organization will collect, use, and secure any information you obtain about them;

- Demonstrates a level of responsibility to your members and donors, forming a bond of trust that will increase their confidence in you and willingness to do business with you;

- Helps your organization meet legal requirements; and
- Functions as a guideline for making business and organizational decisions.

A search of the internet will show organizations that can assist your organization by recommending privacy policies and security technologies, reviewing your privacy practices, and providing endorsements. Your county BAR associations (see http://www.wsba.org/legal-community/county-bar-associations) are a good resource for referrals to lawyers who specialize in privacy law. Wayfind (www.wayfindlegal.org) and 501 Commons (www.501commons.org), two organizations which support nonprofits, are good resources for privacy or security trainings and referrals. The International Association of Privacy Professionals also has many resources and trainings available (see https://iapp.org/resources/).

Should you copy a privacy policy from another website or use a sample policy? Before using a sample privacy policy or copying one, review it carefully and understand your organization's practices to make sure that every statement in the privacy policy accurately reflects what your organization is really committed to doing.

There are certain pieces of key information to be included in your privacy policy. Once you have established this policy, it should be posted on your website and shared with all individuals involved with your organization (including consultants or contractors).

(iii) What Information Is Collected and How

Your privacy policy should clearly state what consumer information you collect from anyone who visits your website (or communicates with your organization in any other manner). There are two broad types of consumer information:

- Personally identifiable information ("PII") is the most sensitive type of information because it can be used to identify an individual. PII includes a person's legal name, e-mail address, physical mailing address, social security number, phone number, medical records, and bank account numbers or other financial data. Consumers feel most secure when the only PII you collect is information they provide to you directly, such as by filling out a form on your website.

- Non-PII is anonymous information that cannot be used to identify an individual. Non-PII is often used to track how visitors navigate your website, which pages were viewed most often, what other websites they have visited, and similar data. You should also identify the technologies and methods your organization uses to collect PII and non-PII. Disclosing the methods used to collect this information can increase trust and confidence in your organization and help individuals decide whether to share their information with you.

(iv) How Collected Information Is Used

Your privacy policy should describe exactly how you will and will not use the information you collect. Use this as an opportunity to sell them on your website's features and services. For instance, some organizations use cookies to track what articles are read so that they can suggest related articles.

Because e-mail spam is such a problem, the first question individuals usually have for an organization is "Will you give my e-mail address to anyone else?" Individuals are usually most comfortable when their e-mail addresses are used only by the organization they directly give them to. However, there are many situations where organizations can benefit from sharing e-mail addresses. Whether you plan to share information or not, it is vital that your privacy policy accurately describes your practices and, in the process, reassures individuals so they will continue to provide the information you need to successfully provide services you offer.

(v) How Consumers Can Opt Out

Generally speaking, it is a best practice that PII only be collected with the individual's consent. If PII is collected without the consumer's consent, your privacy policy should clearly explain how the consumer can opt out of your data collection process. The actual steps for opting out depend on the type of information you collect and the technologies you use to do it.

If you allow third-party advertising companies, such as 24/7 Real Media or DoubleClick, to run advertisements on your site, you should consider telling consumers about these companies' information collection process and, if offered, how to opt out of such data collection. However, you do not have to provide the exact instructions: simply point individuals to the appropriate page on the third party's website. Alternatively, if the third-party advertiser is a member of the Network Advertising Initiative ("NAI"), point your customer to the NAI opt-out page at http://optout.networkadvertising.org.

(vi) How Collected Information Is Kept Secure

The security section of your privacy policy should describe how you ensure that all consumer information is protected from unauthorized disclosure and theft. If you share information with third parties, what steps do you take to ensure that they keep the information secure? Avoid describing the level of security in absolutes. There is no such thing as absolute assurance of security.

(vii) With Whom You Share Collected Information

It is not necessary that you list in your privacy policy every single company, organization, business partner, or entity that you might share collected information with. You should, however, mention types of entities you will share information with, such as other nonprofit organizations, business partners, credit card companies, and government agencies. For each type of entity, list the type of collected information you would share and under what circumstances.

(viii) Date Stamp Your Privacy Policy and Provide Contact Information

Privacy policies change over time. It is important to include the effective date of the policy and information on how changes will be handled and posted. Additionally, provide a contact point for anyone who has questions or comments about your policy or practices. A physical address and an appropriate e-mail address should be provided to the consumers. It is important that their questions be acknowledged and responded to in a timely fashion.

e. CAN-SPAM for Nonprofits

No legitimate nonprofit organization wants to be known for sending spam out to potential donors. The federal law regulating spam is the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003, 15 U.S.C. sections 7701-7713 (2003) (the "CAN-SPAM" Act). The CAN-SPAM Act is a federal law regarding the sending of commercial e-mail. And the law (and its steep penalties) potentially applies to activities of nonprofit organizations.

Under the CAN-SPAM Act, e-mails containing transactional or purely informational content are generally not covered. Examples of transactional content would include confirmation of registration or receipt of a donation, invoice and account information, and notice of expiration of services. Commercial e-mails that promote a product or service would trigger CAN-SPAM requirements. There are

certain actions that anyone engaged in sending commercial content in e-mails must do in order to comply with the rules of the CAN-SPAM Act:

(i) Use a Valid Header

Make sure the "from" line in the e-mail accurately and clearly reflects the sender. Use appropriate e-mail addresses such as "products@nonprofit.org," "programs@nonprofit.org," or "memberservices@nonprofit.org" to identify your organization. To donors and members, this also provides a level of comfort because they know and trust the organizations they support.

(ii) Use a Valid Subject Line

There currently are no labeling requirements for the subject line ("ADV" for advertisement, for example). What is required is that the subject line not mislead recipients as to the content of the message. For example, if your e-mail message is designed to solicit membership, the subject line should not be "I got your message," "Hello from a friend" or other similar statements. Rather, use a subject line that is more truthful, such as "Invitation to join ABC Organization" or "Special offer for new members."

(iii) Provide Clear and Conspicuous Notice of the Opportunity to Opt Out

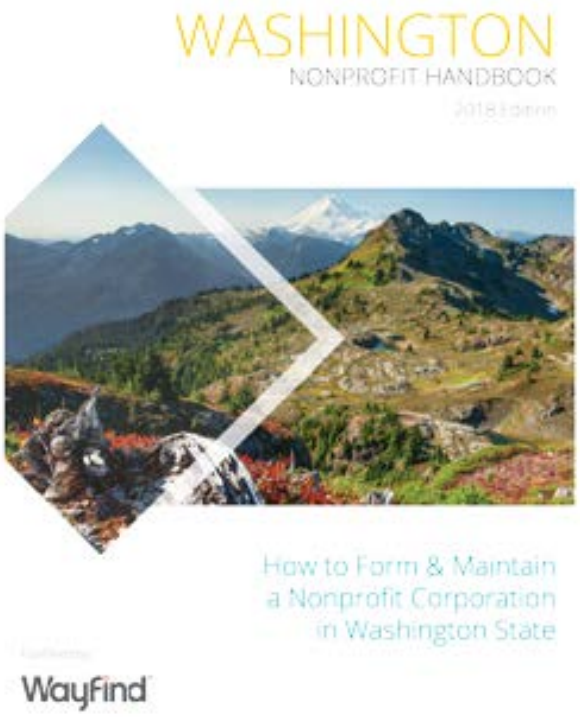
Notice of the opportunity to opt out of future commercial e-mails must be in every e-mail message containing a commercial solicitation offer, and must be provided to all individuals receiving the message, whether or not they have opted in to receive commercial or solicitation e-mail offers.

(iv) Provide a Functioning Opt-Out Mechanism in Every Commercial E-mail Message

A functioning opt-out mechanism can be a return e-mail address or other internet-based mechanism that can receive opt-out requests for at least 30 days after the transmission of the original message. The keys here are that the mechanism must be internet-based and it must function. Also, the sender may not send subsequent offers more than ten business days after a recipient has requested to not receive further advertisements or offers. Further, if the recipient has opted out, the sender may not rent, exchange, or otherwise transfer or release the e-mail address of the recipient.

(v) Provide a Valid Physical Postal Address of the Sender

A valid physical postal address must be included in every e-mail. A street address or post office box would be considered a valid physical postal address. Solicitations via e-mail are also considered to be covered under the rules established in the Charitable Solicitations Act ("CSA"). *See* Chapter 45 for more information about CSA rules.



Part 13 Financial

Chapter 75 Internal Controls
Chapter 76 Restricted Funds And Accounting Issues Specific To Nonprofits (To Be Added By Dec. 31, 2018)

PART 13. FINANCIAL

CHAPTER 75. Internal Controls

Nonprofit board members have a duty to assure the effective, responsible use of a nonprofit's resources. This financial oversight includes understanding organizational risks and setting the policies and procedures designed to prevent fraud and assure accurate reporting to the Internal Revenue Service (IRS) and Secretary of State.

a. What is Fraud?

Understanding what fraud is and how to avoid it is crucial to the nonprofit's status, reputation, and longevity. Fraud is the wrongful or criminal deception intended to result in financial or personal gain. With respect to organizational finances, there are three basic types of fraud:

- Outright asset theft (fraud *against* the organization)
- Deceptive financial reporting (fraud *by* the organization)
- Improper use of the organization's name, reputation or confidential information (fraud *through* the organization)

b. What Factors Allow Fraud to Occur?

Understanding the factors that lead to fraud, is critical to preventing fraud from occurring. The three most common factors that contribute to fraud are:

- **Motivation:** An individual who commits fraud is motivated by personal economic reasons. Typical motivations include financial distress, substance abuse, gambling, overspending, or other destructive behaviors.
- **Rationalization:** The person committing fraud usually has a reason or rationalization to justify the fraud. Typical rationalizations include perceived injustice in compensation or appreciation or 'value' of volunteer services; the idea that the fraudulent act is equivalent to "borrowing" from the organization; or the belief that the organization does not 'need' the assets nor will it miss them.)

- **Opportunity:** The person committing fraud must have the opportunity or access to resources. For example: a volunteer or employee that has exclusive access to assets and information may believe a fraud can be committed and successfully concealed. Opportunity is the one factor that the nonprofit organization can control.

c. What Can A Nonprofit Organization Do To Prevent Fraud?

By establishing practices and procedures called internal controls, nonprofits can remove perceived opportunities for employees or volunteers to commit fraud. Effective internal control systems have the additional benefit of increasing the efficiency of operations; safeguarding assets against loss and unauthorized use or disposition; improving reliable financial reporting, and ensuring compliance with applicable laws and regulations.

d. Components of a Successful Internal Control Structure

1. Control Environment: The control environment is the foundation of standards, processes, and structures that enable an organization to carry out internal controls. The Board of Directors and senior management are responsible for establishing the tone of the control environment from the top; by modeling and enforcing expected standards of conduct, they create a culture of transparency and integrity.

A. Principles to keep in mind when creating a control environment

- The control environment demonstrates commitment to high standards, integrity and ethical values;
- The Board of Directors exercises oversight responsibility over the financials of the organization;
- The Board of Directors and senior management establishes structure, authority, and responsibility;
- The Board of Directors and senior management is committed to the competence of personnel;
- The Board of Directors and senior management enforces accountability for practices and procedures relating to the management and oversight of financial and accounting systems;

- Standards of conduct are documented in an employee manual and in Board policies.

B. Governance Policies

Instituting governance policies that prevent the opportunity for an individual to make a decision that may be influenced by personal interest, is central to creating an internal control system. Here is a list of suggested policies:

- Executive Compensation Policy – This policy describes the process of setting executive compensation. It is important to ensure there is integrity to this process to avoid the conflict of senior management making decisions about their own compensation. (*See* Chapter 68 on Setting Executive Compensation.)

- Conflict of Interest Policy – This policy describes the process of managing conflicts of interest for board members and key employees.

- Record Retention Policy – This policy describes the process of determining when to destroy organizational records. Managing financial records effectively is essential to proving or disproving fraud.

- Whistleblower Policy – This policy describes the process of employees' ability to report potential wrongdoing by others involved in the organization (supervisors, management, other employees, board members) without fear of retaliation.

- Gift Acceptance Policy – This policy describes the process and criteria of determining whether the organization should accept a gift.

- Investment & Spending Policies – These financial policies describe processes and criteria in making decisions on investment or spending.

2. Risk Assessment: Risk is defined as the possibility that an event will occur and adversely affect the achievement of objectives. Risk assessment involves a dynamic and iterative process for identifying and assessing risks to the achievement of objectives. To assess risk accurately, the objective being accessed must be specific.

A. Practical considerations when assessing risk

- Does management keep the Board up to date on significant changes in programs, financials and staffing? A well-informed board is key to quality board decisions. Accessing the information flow between management and staff is a key factor in accessing risk.

- Does the Board give adequate time and attention to financial oversight? Financial oversight is the cornerstone of avoiding fraud. The Board must have quality information and sufficient time to exercise its financial oversight responsibilities. Risk assessments should consider if there is adequate time at board meetings to discuss the financials, and whether there is a finance committee with oversight responsibilities and expertise.

- If there is a Finance Committee, what are their responsibilities, and do they have adequate information, time and expertise to carry out their responsibilities?

- Does the organization use a risk assessment worksheet along with the Finance/Audit Committee? A risk assessment worksheet could include:

    - Identify risks relevant to the control objective and ask "what could go wrong?"

    - Identify controls and other actions that eliminate or mitigate each risk;

    - Use judgment that incorporates what is in the best interests of the organization to assess whether risk is too much, too little, or just right;

    - Revisit and revise at least annually.

3. Information and Communication: Management should use relevant and quality information from both internal and external sources to support the functioning of other components of internal control. Communication is the continual, iterative process of providing, sharing, and obtaining necessary information.

A. Practical considerations when designing the information and communication system:

- Are financial reports internally distributed regularly and on a timely basis?

- Are financial reports provided regularly and on a timely basis to the Board? The Board of Directors has the responsibility of financial oversight to ensure transparency, integrity of the financials, and to ensure that the organization is financially sound. It is critical that the Board of Directors receive and have adequate time to review financial reports.

- Are financial reporting due dates monitored to ensure compliance? Nonprofit organizations have financial reporting requirements to both the IRS and the Secretary of State, as well as employment tax agencies. If nonprofits do not meet their reporting requirements they may be subject to fines, interest and other penalties.

- Does the Board (or Finance/Audit Committee) meet with the external auditor and hold management accountable to address control deficiencies reported? The ability for the Board or Finance Committee to meet with an external auditor, separate from management is a common internal control that functions as a check and balance on the control of the organization's finances.

- Does the organization have a clear and well-communicated whistleblower policy and reporting mechanism that encourages the reporting of wrongdoing without fear of retaliation?

4. Monitoring: Ongoing evaluations, separate evaluations, or some combination of the two are used to ascertain whether each of these five components of internal control is present and functioning.

A. Practical Considerations when designing the monitoring system

- Who would notice if control activities stopped being performed? Board and staff must be engaged in the internal control system, or it will not be effective.

- Is the importance of the control activity properly communicated? It is critical for leadership of the organization to set the tone and create a culture of integrity.

- Are the results of monitoring activities connected with the risk assessment process (i.e. the feedback loop)? To be effective, evaluations must be conducted and reviewed by staff and Board.

- External auditors *cannot* be part of your internal control structure. External auditors are a check and balance of the internal workings of the organization, and should not be part of the internal control structure.

5. Control Activities: Control activities are the actions established that mitigate risk. Control activities are performed at all levels of the entity, at various stages within business processes, and incorporated through the organization's technology. The activities may be preventative or detective in nature and may encompass a range of manual and automated activities such as authorizations and approvals, verifications, reconciliations, and business performance reviews. Segregation of duties is one of the key concepts that will be included in developing the control activities, and is discussed below.

e. What is Segregation of Duties?

A key to the internal control activities is the segregation of duties. Segregation of duties is the concept of having more than one person involved in completing a task in order to prevent fraud and error.

When creating internal controls that segregate duties, consider who has access to financial systems, where they are in the system and when they have access. Key areas of access can include: bank account access, organizational credit cards, blank check stock, cash/checks received, accounting system, donor database, payroll system, and approval authority. In each of these areas, create internal controls where more than one person has to be involved to have access to these areas or conduct financial tasks.

Examples of duties to segregate to the extent possible:

- Inflows (Contributions, Revenue, Receipts)

    - Authorizing/approving bills

- Handling/custody of cash and receipts
- Recording accounting transactions
- Reconciling accounting records
- Accessing the donor database

- Disbursements (Vendors, Credit Cards, Reimbursements, Payroll)
  - Approval/authorization of all the categories listed above
  - Recording transactions in the accounting system
  - Authorizing disbursements (including check signing/electronic funds transfer)
  - Handling/custody of checks
  - Reconciling accounting records

When you cannot fully segregate duties due to small staff size or cost considerations, consider implementing mitigating or compensating controls. Examples include:

- Managers or board members review financial statements and other detailed reports on a regular and timely basis;
- Managers or board treasurer review reports of the detailed transactions;
- Managers select transactions for review of supporting documents;
- Managers periodically conduct counts of physical inventory, equipment, and other assets and compare them with the accounting records;
- Managers from time to time review reconciliations of account balances such as cash, A/P, and A/R, or perform them independently;

Note: "Manager" is defined as someone other than the person with the concentration of duties who is also:

- Knowledgeable about the subject matter;

- Has the ability and willingness to question the person with concentration of duties.

Additional Resources:

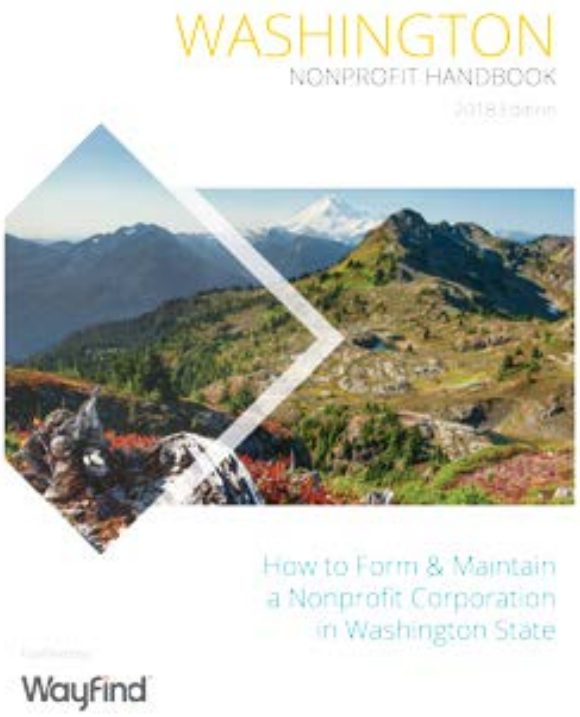
There is a framework that is used worldwide to assist boards and management to develop internal control systems for their organizations. Visit www.coso.org for additional information.

"What Board Members Need to Know About Not-for-Profit Finance and Accounting" by Jacobson Jarvis https://jjco.com/resources/jjco-booklets-useful-links/

"Controls for Small Organizations: A Guide for Board Members" by Putnam Barber & Robert Fleming http://www.sos.wa.gov/_assets/charities/Controls%20For%20Small%20Nonprofits.pdf

"Finance Unlocked for Nonprofits" by Washington Nonprofits https://www.wanonprofitinstitute.org/finance/

CHAPTER 76. Restricted Funds and Accounting Issues Specific to Nonprofits (To be added by Dec. 31, 2018)



Part 14 Ceasing Operations

Chapter 77 Considerations Before Ceasing Operations
Chapter 78 Merger or Consolidation of a Nonprofit Corporation
Chapter 79 Dissolving a Nonprofit Corporation
Chapter 80 Bankruptcy
Chapter 81 Endowment Funds

Note: *Part 14. Ceasing Operations* has not been revised since 2009. *Part 14* will be updated when the Washington State Legislature revises the Washington Nonprofit Corporation Act.

PART 14. CEASING OPERATIONS

CHAPTER 77. Considerations Before Ceasing Operations

A time may come when the directors or members of a nonprofit determine that it is no longer feasible or desirable to keep the corporation operating in its current state. In some instances, ceasing operations is not necessary; the directors may find less extreme approaches to correcting problems. For example, if the board of directors finds that a nonprofit corporation is no longer able to fulfill its mission, the board might consider broadening or narrowing the scope of the corporation's purpose and/or reducing or changing its activities. Likewise, if the directors are ready to step away from a nonprofit, it may be possible to elect a new board of directors with the energy and resources to manage the corporation. If these options are not realistic then the directors must decide the best approach to ceasing operations. The options include merger, consolidation, dissolution, or, in the event of financial difficulties, bankruptcy. This Part provides a general overview and discussion of each procedure and some considerations for the board of directors (or members if the organization has voting members) when faced with the decision to cease operations. The material will focus on mergers and dissolutions (both voluntary and involuntary) but will also highlight bankruptcy and involuntary liquidation.

The decision to cease operating is an important one. Like all aspects of their actions as directors, the steps to cease operating must be undertaken with a focus on the best interests of the corporation. Before undertaking a merger or dissolution the board and, if the corporation has voting members, members should ask themselves what is best for the corporation and the public it serves. Several of such questions, which will help a board or members decide which approach to take in ceasing operations, are included here.

- Do current members/directors wish to keep operating the nonprofit?
- Is there an organization that might be interested in acquiring the assets of the nonprofit?
- Is there an organization with a similar purpose available as a potential merger partner?
- Are there significant designated charitable assets or significant liabilities associated with the nonprofit?

- Is there dissension that might require court intervention?
- Is there an organization that might be interested in taking over the nonprofit?

The directors may decide that greater efficiency in carrying out the corporation's objectives could be obtained by merging or consolidating with another corporation. The directors may decide that bankruptcy and liquidation is necessary to make arrangements with creditors, or the directors may determine that the most sensible course is dissolution of the entity. A merger or consolidation may be appropriate where another corporation with a similar purpose exists. If the organization has substantial liabilities, however, merger may not be a good (or available) option and dissolution will be the preferred route. In each case, the Board must pay attention to applicable laws and to restrictions on gifts received by the nonprofit. Normally, the directors or members control the operations. There are, however, certain instances when the corporation will be subject to involuntary dissolution or liquidation.

CHAPTER 78. Merger or Consolidation of a Nonprofit Corporation

a. Generally

This Chapter focuses on the legal mechanics of a merger or consolidation of two or more nonprofit corporations. There is much more to the process, however, than the legal formalities. Identifying a suitable partner for a merger or consolidation, bringing together the cultures of the different organizations, and handling public relations are just a few of the many business issues involved in a merger or consolidation. Directors and, if applicable, members should consider the potential economic, organizational, and strategic benefits and detriments of merging or consolidating before any decision is made.

Washington law permits nonprofit corporations to merge with each other or to form a new corporation by consolidating with each other. The law also permits nonprofit corporations formed in this state to merge or consolidate with nonprofit corporations formed outside of Washington. Merger and consolidation are similar, but differ in one crucial way. In a merger, two or more corporations join together, with one of those corporations emerging at the end of the process as the surviving corporation. In other words, one of the corporations continues to exist, while the other is merged into it. In a consolidation, by contrast, two or more corporations join together to form a new corporation. Each of the consolidating corporations ceases to exist, creating a new corporate entity by the act of combining. In this

case, a new application for tax-exempt status will need to be prepared and submitted to the IRS.

When two corporations merge or consolidate, the surviving entity (or the new entity in the case of a consolidation) will normally receive any bequests designated for the merged organization. For example, Nonprofit A and Nonprofit B merge with B surviving. Although A no longer exists, any bequests designated for A in wills or trusts would pass to B as A's successor in merger. If A were to simply dissolve and distribute its assets to B, any bequests designated for A would not pass to B. This succession is a reason to look favorably at merging instead of dissolution, but keep in mind that in our merger example, B also assumes all of A's debts and liabilities, even contingent ones. Where liabilities are a concern, merger or consolidation may not be as desirable an option.

b. Effecting a Merger or Consolidation

The officers of the merging or consolidating corporations may spend many hours negotiating and documenting the terms of the merger or consolidation. However, the merger or consolidation is not legally in effect, until certain steps have been taken and specific documents filed with the Washington Secretary of State. Mergers and consolidations are governed by the Washington Nonprofit Corporations Act, which should be reviewed and followed at all stages of the process. In addition, the articles and bylaws of the organizations should be reviewed for additional requirements, such as approval of an affiliated organization.

(i) Plan of Merger or Consolidation

The process for performing a merger begins with each corporation adopting a plan of merger. That plan must identify:

- The names of the corporations planning to merge;
- The name of the corporation into which they will merge;
- The terms and conditions of the merger;
- A statement of any changes in the articles of the surviving corporation to be affected by the merger; and
- Such other provisions as are deemed necessary or desirable.

Corporations planning to consolidate begin similarly by adopting a plan of consolidation containing similar information.

(ii) Board of Directors or Membership Approval

The plan of merger or consolidation must then be approved by the boards of directors of each corporation and, if one or both of the corporations has voting members, by their respective corporate membership. For a corporation that has members with voting rights, the board of directors must present the plan to the members at an annual or special meeting. Approval of the plan requires the assent of at least two-thirds of the votes of members present or represented by proxy (if proxy voting is permitted) at a meeting in which a quorum exists. Any merging or consolidating corporations that do not have members with voting rights must approve the plan by vote of a majority of the directors then in office at a meeting of the board in which a quorum exists.

(iii) Articles of Merger or Consolidation

Upon approval of the plan of merger or consolidation by each of the corporations, articles of merger or articles of consolidation must be prepared, executed by an authorized officer and filed with the Secretary of State together with the appropriate filing fee. The articles of merger or consolidation must include the plan of merger or consolidation and a description of the process used by each corporation to approve the plan. If the Secretary of State determines that the articles of merger or consolidation conform to law and that all fees have been paid, the Secretary files the documents and issues a certificate of merger or certificate of consolidation. The merger or consolidation becomes effective upon the filing of the articles of merger or consolidation or at a later date as provided in the plan of merger or consolidation, which later date must be within 30 days of the filing of the articles of merger or consolidation.

(iv) Foreign Corporations

The merger or consolidation procedure differs from the procedure described above if one or more of the corporations included in the merger or consolidation was not incorporated in Washington. Washington corporations involved in such a transaction are required to follow the procedures outlined above. Each “foreign” or non-Washington corporation must follow the law of the state in which it was incorporated. If the surviving corporation or new corporation will be a “foreign” corporation, then the corporation must (a) obtain a certificate of authority prior to transacting business in Washington, (b) file an agreement that it may be served with

process in Washington, and (c) appoint the Secretary of State as its agent to accept service of process.

(v) Completion of the Merger or Consolidation

Once the merger or consolidation is in effect, the several corporations become a single corporation. The separate existence of the corporations that do not survive the transaction cease. The surviving corporation obtains all the rights and duties that the Act provides and is also responsible for all the liabilities and obligations of each of the corporations involved in the merger or consolidation. In the case of a merger, Washington law deems the articles of incorporation of the surviving corporation to be amended in the manner stated in the plan of merger, and in the case of a consolidation, the articles of incorporation of the new corporation are deemed to consist of the statements contained in the plan of consolidation and that are required or permitted by the Act to be set forth in articles of incorporation.

(vi) Merger and Consolidation Distinguished From an Asset Sale

As a final note, merger and consolidation should be distinguished from transactions in which a corporation simply sells or transfers its assets. The process of effecting a merger or consolidation involves changing the actual corporate entities involved. In contrast, if a nonprofit corporation continues to exist but sells or otherwise disposes of all or substantially all of its assets, other than through the ordinary course of business, a separate set of statutory rules apply. In such asset disposition transactions, approval is required by either the corporation's members having voting rights or, if none, by a majority of the corporation's directors then in office, in each case at a meeting in which a quorum is present.

CHAPTER 79. Dissolving a Nonprofit Corporation

Washington law provides several methods for dissolving a nonprofit corporation. A corporation can be dissolved voluntarily, by action of its own directors and members, administratively by the Washington Secretary of State for failure to comply with filing requirements of that office, or in very limited circumstances, by a superior court judicial decree.

a. Voluntary Dissolution

When the directors and members of a nonprofit believe it is in the best interests of the corporation to discontinue as a legal entity, certain actions may be

taken in order to dissolve the nonprofit corporation. This process is referred to as voluntary dissolution and is summarized below.

(i) Resolution to Dissolve

The first step in a voluntary dissolution is the adoption of a resolution by the board of directors supporting corporate dissolution. If the corporation has members with voting rights, then the voting members must also adopt a resolution to dissolve at either an annual or special meeting. Each member with voting rights must be provided with notice of that meeting between 10 and 50 days in advance, either personally or by mail, facsimile or electronic mail, subject to the requirements of the Act. The resolution of dissolution must be approved by a two-thirds vote of the members present or represented by proxy (if proxy voting is permitted) at a meeting in which a quorum is present. If the corporation has no members with voting rights, then a resolution adopted by a majority of the directors in office suffices to dissolve the corporation.

(ii) Notice of Adoption of a Resolution to Dissolve

Once the dissolution resolution has been adopted, the corporation must cease to conduct its affairs except as necessary to wind up. In addition, the Act requires a notice of the proposed dissolution be provided to each known creditor of the corporation, to the attorney general with regard to any assets held for a charitable purpose, and to the Washington State Department of Revenue. This notice should contain the plan of distribution described below. The notice to the Department of Revenue must request a clearance certificate which certifies that the corporation does not owe any taxes to the state.

(iii) Plan of Distribution

Once a resolution to dissolve has been approved, a plan, called the plan of distribution, that details how the corporation's assets will be distributed must be prepared. Like the resolution to dissolve, the plan must be approved by the members having voting rights, if any, or if there are no such members then by a majority vote of the directors in office, in each case at a meeting in which a quorum is present.

The Act outlines the order of distribution of a nonprofit corporation's assets upon dissolution. The plan of distribution must comply with these statutory requirements. First, the corporation must apply its assets toward satisfying all of its liabilities and obligations prior to distributing assets elsewhere. The corporation's

liabilities and obligations include all corporate debts, including, presumably, payroll, withholding and state taxes. Withholding is particularly important to pay in a timely manner because of the ability of the IRS to seek payment from directors personally.

Second, if the corporation holds any assets subject to a condition requiring their return or transfer upon dissolution, then any such assets must be returned or transferred in accordance with that condition.

Third, if the corporation holds any assets subject to limitations designating their use only for charitable purposes, then those assets must be disposed of as required by the donor's instructions or transferred to another corporation, society or organization exempt from federal taxation under section 501(e)(3) of the Code engaged in activities similar to those of the dissolving corporation. Before transferring any assets that fall into this category, the corporation must notify the Office of the Attorney General by registered or certified mail, at its Olympia office, of the proposed disposition of such assets. The notice must be mailed at least 20 days before the meeting at which the corporation plans to adopt the plan of distribution. The corporation may not adopt a plan regarding such assets without the approval of either the attorney general or of a court of competent jurisdiction in an action to which the attorney general is a party. However, if the attorney general fails to object within 20 days of the corporation's mailing of the plan of distribution to its office, then state law deems the Office of the Attorney General to have given its approval.

Fourth, the corporation may distribute any of its remaining assets in accordance with its articles of incorporation or bylaws, to the extent that those documents provide for the distribution of assets. If the corporation's articles of incorporation or bylaws do not specify how assets should be distributed, then these remaining assets are distributed according to the terms of the plan of distribution. The plan of distribution must also meet the requirements of federal tax law.

(iv) Articles of Dissolution and Certificate of Dissolution

The final step of voluntary dissolution is filing articles of dissolution with the Secretary of State. Until articles of dissolution are filed, the nonprofit can revoke the dissolution process as explained in the next section. The corporation must distribute its assets in accordance with the plan of distribution prior to filing the articles of dissolution. The articles of dissolution must be signed by one of the corporation's officers and must set forth the following statutorily required information:

- Identification of the corporation by its legal name;

- The date of the meeting of the corporation's members adopting the dissolution resolution and a statement that the members adopted the resolution by a two-thirds vote at a duly called meeting at which a quorum was present or unanimously consented to dissolution in writing. If the corporation has no members with voting rights, the articles of dissolution must so state, and provide the date of the meeting at which the board of directors approved the dissolution;

- A statement that all of the corporation's debts, obligations and liabilities have been paid or provided for otherwise. In connection with this statement, the corporation must obtain a clearance certificate from the Department of Revenue demonstrating that the corporation does not owe any taxes to the state and must attach a copy of this certificate to the articles of dissolution;

- A statement that the corporation's assets have been appropriately distributed; and

- A statement that either there are no lawsuits pending against the corporation or that adequate provision has been made for satisfaction of any judgment resulting from a pending suit.

If the Secretary of State finds that the articles of dissolution conform to law, the Secretary will accept the articles for filing and issue a certificate of dissolution. At that point, the corporation is dissolved.

(v) Revocation of Voluntary Dissolution

The corporation may revoke its dissolution at any time prior to the issuance of a certificate of dissolution by the Secretary of State. Like the decision to dissolve, the decision to revoke dissolution is made by resolution and must be approved by the corporation. Revocation of the dissolution resolution requires the approval of the corporation's members if members have voting rights, or a majority vote of the corporation's board of directors in office. Any vote by the members requires the support of two-thirds of the members present or represented by proxy (if proxy voting is permitted) at a duly called meeting at which a quorum is present. Upon the adoption of a resolution revoking the earlier dissolution resolution, the corporation may again conduct its affairs normally.

b. Involuntary Dissolution

The Act provides that a nonprofit corporation may also be dissolved involuntarily, either by administrative action of the Secretary of State or judicially by the superior court.

(i) Administrative Dissolution

The privilege of operating as a nonprofit corporation carries with it certain operating requirements, including filing requirements with the Secretary of State. Nonprofit corporations that fail to strictly adhere to these requirements or that cease operation without filing articles of dissolution risk being dissolved by administrative action. Administrative dissolution may occur even where the board of directors or members do not wish to cease operations of the corporation.

Washington law requires the Secretary of State to administratively dissolve any corporation that:

- Has failed to file or complete its annual report within the time required by law;
- Has failed for 30 days to appoint or maintain a registered agent in Washington; or
- Has failed for 30 days, after change of its registered agent or registered office, to file in the office of the Secretary of State's Office a statement of such change.

If any of these conditions occur, the Secretary of State mails written notice to the corporation to provide it with an opportunity to correct the problem and avoid dissolution. If the corporation fails to correct the problem, the Secretary of State dissolves the corporation. A corporation that has been administratively dissolved may apply to the Secretary of State for reinstatement as an active corporation by bringing all of its filings up to date and by paying any back fees and a reinstatement fee.

The possibility of administrative dissolution should provide nonprofit corporations with substantial incentive to comply with the legal requirements of maintaining a corporation. Small and relatively informally operated nonprofit corporations often fail to comply with corporate filing requirements, sometimes with serious consequences. While the Secretary of State must notify a corporation prior to an administrative dissolution and give the corporation an opportunity to

cure the problem, the Secretary of State is only required to send this notice to the corporation's registered office. Consequently, if the corporation has not maintained an accurate, current filing with the Secretary of State as to its registered office, then the corporation may not receive the notice. Nonetheless, the administrative dissolution will be valid.

The loss of corporate status may jeopardize the organization's federal tax-exempt status because that status is dependent upon the existence of the corporation. In addition, the corporation may find that, during its dissolution period, another entity took its name. Corporate names must be distinguishable from those of other entities on file with the Secretary of State. If, during an administrative dissolution period, another corporation reserves or adopts the same or similar name, then the dissolved corporation may be required to change its name as a condition of reinstatement.

A corporation's opportunity to reinstate as a matter of right is limited to the first three years after the date of dissolution. If more than three years have elapsed, then the corporation can seek reinstatement only through a special application process. This late reinstatement option, however, requires a statement under oath by a responsible corporate officer describing the reasons why the corporation failed to make its legally required filings. The Secretary of State can reinstate the corporation only if each of following conditions exists:

- There are sufficient exigent or mitigating circumstances;
- The corporation has acted in good faith;
- The failure to reinstate would cause disproportionate harm to the corporation; and
- Reinstatement would not be contrary to the public interest.

(ii) Judicial Dissolution

Under rare circumstances, the superior court can dissolve a nonprofit corporation by decree. In an action commenced by the attorney general, the superior court has the authority to dissolve the corporation if the corporation has either procured its articles of incorporation through fraud or has continued to exceed or abuse the authority conferred upon it by law. There are no reported cases in Washington's appellate courts of any proceeding under this statute. This

lack may be explained by the fact that the statutory threshold is rather high and that judicial dissolution may be sought only if the statutory conditions are met.

c. Effect of Dissolution

Once a nonprofit corporation has been dissolved, its claim to exist as an entity distinct from its members, officers or directors continues only to the extent provided by state law. In the case of a voluntarily dissolved corporation, state law provides that upon adoption of a resolution of dissolution by the members or board of directors, as applicable, the corporation must cease to conduct its affairs, except in so far as may be necessary to "wind up" the corporation's affairs.

The administrative dissolution of a corporation by the Secretary State causes the existence of the corporation to immediately cease, subject only to the corporation's right of reinstatement. The board of directors of the administratively dissolved corporation, however, continues to hold title to the corporation's property as trustees for the benefit of the corporation's creditors and members, if any. This provision prevents a gap in ownership of the corporation's assets given the likelihood that, because a corporation's dissolution was involuntary, no distribution plan for the corporation's assets existed at the time of dissolution.

State law preserves any rights or remedies that a third party may have against a corporation, if properly pursued by any such party within two years after dissolution. In other words, when a corporation dissolves, it may still be sued by any party to whom the corporation owes money, or is otherwise liable due to some event that occurred prior to dissolution, within two years following dissolution. The corporation or its members, board of directors and officers retain the authority to, and are advised to, defend such actions.

Corporate dissolution may also create an issue as to whether individuals who incur liability while acting on behalf of a dissolved corporation are entitled to the protection of the corporate form. One of the principal benefits of incorporation is the limitation on individual liability that follows from it. Individuals who continue to act on behalf of the dissolved corporation, with or without knowledge of the dissolution, may be personally liable for their actions. While Washington courts have not addressed this issue in the context of a nonprofit corporation, the Washington Supreme Court has addressed this issue regarding a for-profit corporation. In that case, the Washington Supreme Court concluded that the individual acting on behalf of the dissolved corporation was not personally liable for

his actions. Nevertheless, the possibility of personal liability should present individuals with a powerful incentive to avoid administrative dissolution.

CHAPTER 80. Bankruptcy

A thorough discussion of the bankruptcy process is beyond the scope of this Handbook. Instead, this Chapter highlights some of the issues specific to nonprofits in the bankruptcy process. A nonprofit considering bankruptcy will almost certainly need to seek legal assistance before filing a bankruptcy petition. It can be a complicated procedure, and once a petition has been filed, there are restrictions placed on a debtor. For example, payment of attorneys' fees and nonroutine business transactions all require the consent of the court after a Chapter 11 petition is filed. Moreover, at least one commentator has warned that an entity in reorganization may no longer be tax-exempt when it comes out of the process. Evelyn Brody, *The Charity in Bankruptcy and Ghosts of Donors Past, Present, and Future*, 29 Seton Hall Legis. J. 471 (2005). Finally, if the goal of the directors is reorganization under the bankruptcy code, the board should consider how a bankruptcy filing will impact donors. Will they rally in support or will they give their money elsewhere?

Although for-profit corporations can be made the subject of involuntary bankruptcy proceedings, creditors of nonprofit corporations cannot force these into involuntary proceedings. However, a nonprofit may file for voluntary bankruptcy under either Chapter 7 or Chapter 11 of the bankruptcy code. Chapter 7 is titled Liquidation. As the name implies, the assets of the debtor are gathered and distributed to pay creditors. In a Chapter 7 proceeding, the organization is controlled by an independent bankruptcy trustee who will generally not be knowledgeable of the organization's business and will do nothing but sell off the assets and make distributions to creditors. Chapter 11 is titled Reorganization. Chapter 11 is a mechanism by which a financially distressed organization may be able to emerge financially viable once more. Under Chapter 11, the debtor normally becomes a debtor in possession and can continue operating in its normal course of business under its existing management. A debtor in possession is also allowed to develop its plan of reorganization, the plan describing how creditors are to be paid. However, Chapter 11 is a difficult, time-consuming, and expensive process and there are very few examples of Chapter 11 reorganizations of nonprofits.

Once a petition is filed, an automatic stay is imposed. The stay prevents creditors from taking any actions to enforce pre-petition liens. The stay does not

apply to regulatory enforcement by a governmental unit. Actions that have been allowed to continue despite a bankruptcy petition have included the revocation of a nonprofit's charter and revocation of tax-exempt status. *In the matter of Jesus Loves You, Inc.*, 40 B.R. 42 (Bankr. M.D. Fla. 1984); *Universal Life Church, Inc. v. United States*, 128 F.3d 1294 (9th Cir 1997).

Once a petition is filed, a bankruptcy estate is created consisting of all of the debtor's property and interests in property. The Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") amended the bankruptcy code to require that the distribution of property from federally tax-exempt organizations comply with non-bankruptcy law. One issue, then, for nonprofits in the bankruptcy context is the identification of the bankruptcy estate. For example, the treatment of restricted gifts, endowments, pledges and other forms of gifts and donations carrying limitations on their use may not be clear. The restrictions may prevent the funds from becoming part of the bankruptcy estate. If restricted gifts and other assets survive the bankruptcy, the courts can use the doctrine of *cy pres* to distribute the gifts in a way that carries out the intent of the donor. Under the *cy pres* doctrine, assets are used for another charitable purpose that most closely lines up with the donor's intent when the original purpose becomes impossible, impracticable, or illegal.

Directors and officers should follow the restrictions placed on gifts to the corporation. Ignoring restrictions was costly to the Allegheny Health, Education and Research Foundation. The directors and officers of that foundation paid $94 million to settle claims brought by the attorney general. Other risks include exposing otherwise restricted gifts to creditor claims. (Brody, *supra* at 487-88; Robert White, *Charities in Distress: Selected Issues*, ABI-CLE (July 13-16, 2006).

BAPCPA also amended the bankruptcy code to allow a greater role for the state and attorney general in bankruptcy proceedings where charitable assets are at stake. Daniel J. Callaghan, *An Overview of the Role of the Attorney General in Bankruptcy Proceedings Involving Charitable Organizations*, ABI-CLE 207 (July 13-16, 2006). Several provisions of BAPCPA are applicable to the bankruptcy of health care facilities (both profit and nonprofit) including special procedures to protect patient privacy and an exception to the automatic stay for the Secretary of Health and Human Services. Nonprofit health care facilities should take special care to ensure that they are complying with the new bankruptcy requirements.

CHAPTER 81. Endowment Funds

Endowment funds require special consideration when ceasing operations. These funds are restricted as to their use by the nonprofit. Typically, endowment funds are designated so that the recipient nonprofit may use the income from the fund while preserving the principal. Special steps must be followed to release endowment fund restrictions before the funds can be distributed.

Washington has adopted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), RCW 24.55. UPMIFA governs the management and investment of institutional funds, including endowment funds, by an institution. An institution governed by UPMIFA includes any entity or organization, other than an individual, that operates exclusively for a charitable purpose. *See* RCW 24.55.010(4). A charitable purpose is broadly defined to include relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose the achievement of which is beneficial to the community. *See* RCW 24.55.010(1). An institutional fund means a fund held by an institution exclusively for charitable purposes, subject to certain exceptions. *See* RCW 24.55.010(5). An endowment fund is all, or part, of an institutional fund that is not wholly expendable on a current basis under restrictions set out in a gift instrument. *See* RCW 24.55.010(2).

In order to release restrictions imposed on endowment funds:

- The nonprofit may ask the donor to consent (on record) to the release or modification of a restriction.

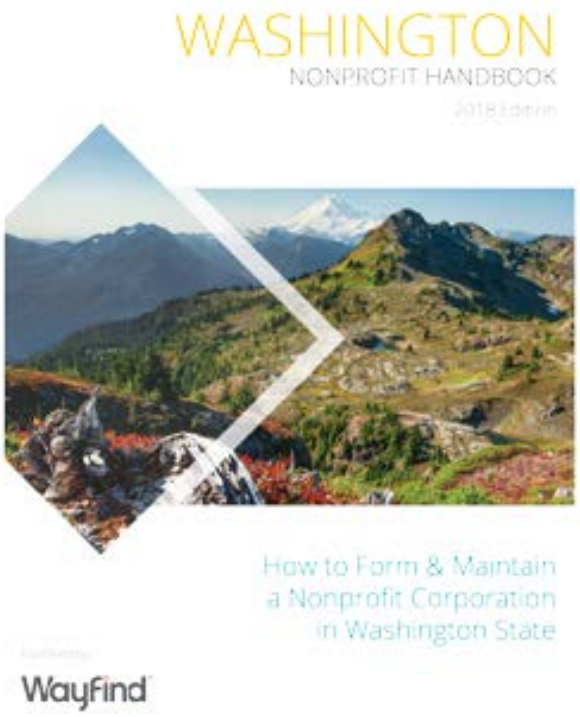
- A nonprofit may petition a court with jurisdiction (generally the superior court) to release or modify a restriction. The Attorney General must be notified and given the opportunity to be heard on the matter.

- If (a) the fund has a total value of less than $95,000 (increasing by $2,500 on July 1 of each year after 2018), (b) it has been more than 20 years since the fund was established, and (c) the nonprofit uses the property in a manner consistent with the charitable purposes provided for in the gift instrument, the nonprofit may release or modify a restriction if the nonprofit determines that a restriction on the management, investment, or purpose of a fund is unlawful, impracticable, impossible to achieve, or wasteful. The nonprofit must

give 60 days notification to the Attorney General prior to the release or modification of the restriction. *See* RCW 24.55.045.

Even if a release of the restrictions imposed on the fund is obtained, the endowment fund may not be used for purposes other than charitable purposes.

Directors and other persons responsible for managing and investing institutional funds should pay particular attention to restricted gifts. Some restrictions designate a successor charity in the event the primary beneficiary ceases to exist or fails to use the funds as required. Directors and other persons responsible for managing and investing institutional funds are subject to a specific standard of conduct and failure to follow the conditions imposed on restricted gifts may result in unexpected consequences for directors and other responsible persons, including personal liability. *See* RCW 24.55.015.



Appendices

Appendix A Biographies Of Handbook Authors And Lead Editors
Appendix B Glossary

APPENDIX A

Biographies of Handbook Authors and Lead Editors

Judy Andrews

Judy Andrew's practice focuses on nonprofit corporation law and tax-exempt organizations. For 30 years, she has represented nonprofit organizations on corporate and tax exemption issues including incorporation and determination of tax-exempt status, legal obligations of directors, organizational structure and roles of board and staff, conversion, merger and affiliation issues, and federal tax-exemption issues. In addition, she has worked as bond counsel and underwriter's counsel on many special fund revenue bond and nonrecourse revenue bond financings. In 1992, Judy spearheaded the writing, editing and publishing of the handbook "How to Form a Non-Profit Corporation in Washington State," as chair of the Community Involvement Committee of the King County Bar Association Young Lawyers' Division. She has served on the editorial committees of the second and third editions of the handbook. She is a frequent speaker on nonprofit corporate and federal tax topics. Judy is an adjunct professor at Seattle University School of Law. She also gives workshops on the formation and maintenance of 501(c)(3) organizations for attorneys and members of the public. Judy is of counsel at The Apex Law Group. She was appointed by the Secretary of State to serve on the Secretary of State's Charities Advisory Council.

Judy Andrews, Lead Editor, authored Chapter 23. Applying with the Form 1023EZ, Chapter 48. Requirements for Deducting Contributions, and co-authored Chapter 59. Fiscal Sponsorships.

Nancy Bacon

Nancy Bacon leads the development and implementation of Washington Nonprofits' learning and engagement programs. Weaving together her interest in education and nonprofit management, Nancy creates and supports programs that strengthen the ability of people working within nonprofits to better make a difference in their communities across Washington State. Nancy received a B.A. in Economics and German Literature from Swarthmore College and a Master of Public Administration from the University of Washington's Evans School of Public Affairs. She created and directed the World Affairs Council's award-winning Global Classroom program and has worked with a range of nonprofit organizations as they developed their internal capacity and external community to better serve their mission. She occasionally blogs on topics related to adult education.

Nancy Bacon co-authored Chapter1. What is a Nonprofit?, and Chapter 2. Are You Sure Want to Do This?

Putnam Barber
Putnam Barber is a retired leader of nonprofit organizations and a former member of the Secretary of State's Charities Advisory Council. He has taught courses on nonprofits at Seattle University and the University of Washington and written several published papers about the history and scope of the regulation of charitable solicitations. He has also served on several boards of directors for Washington state and national nonprofits.

Putnam Barber authored Chapter 19. Sarbanes-Oxley – Document Retention and Protections for Whistleblowers, Chapter 47. Nonprofit Mailings, and Chapter 50. Liquor and Cannabis at Nonprofit Events.

Joanna Plichta Boisen
Joanna Plichta Boisen is chair of the firm's Nonprofit & Tax-Exempt Organizations group and focuses her practice on the unique issues facing these organizations, including qualification for tax exemption, maintaining tax-exempt status and navigating board governance issues. Her clients include family and corporate private foundations, community foundations and social service and arts organizations. Joanna also directs the firm's nationally recognized and award-winning Pro Bono Practice, which she founded in 2005. She manages Foster Pepper's wide-ranging pro bono cases and projects and is responsible for the firm's corporate social responsibility initiatives.

Joanna Plichta Boisen, Lead Editor, co-authored Chapter 58. Working with Others, Chapter 59. Fiscal Sponsorships, and Chapter 60. Joint Ventures And Other Contractual Collaborations.

Jeff Brennan
Jeff Brennan worked in the telecommunications field for over 30 years. His areas of responsibility ran from sales and marketing to responsibility for launching a new wireless network and running a wireless region in the Northwest. Jeff has an Associate Degree in Radio Communications Technology from the Community College of the Air Force, a BA and MBA in Management from Angelo State University in West Texas, and a Law Degree from Seattle University. Jeff is a member of the Washington State Bar Association. He currently focuses on business and privacy law and holds Certified Information Privacy Professional credentials for both the U.S. and Europe from the International Association of

Privacy Professionals. On a national level, Jeff chairs the privacy committee of the Identity Ecosystem Steering Group (IDESG), a public-private partnership focused on fostering the creation of privacy-enhancing trusted digital identities.

Jeff Brennan authored Part 12. Personal Information Security and Online Privacy Issues for Nonprofit Organizations.

Howard Donkin

Howard Donkin, CPA, is the Jacobson Jarvis Tax Partner with more than 20 years of experience in serving the not-for-profit community. He is focused on helping nonprofits address tax related issues, including exemption status, unrelated income, compliance and penalty abatement. Howard is a member of the Washington Society of Certificated Public Accountants (WSCPA), Past Chair, Not-for-Profit Committee and NFP Tax Sub-Committee and Member, Legislation Task Force. He is a member of the AICPA Exempt Organization Technical Resource Panel where he studies not-for-profit issues on a national level. Locally, he volunteers his time to Bellevue Rotary Community Grants Committee and the Bellevue Botanical Garden Society Finance Committee. Howard is the Chair of the Secretary of State, Charity Advisory Council and a frequent speaker at the WSCPA Nonprofit Conference, the NAIS Conference, Wayfind Nonprofit Law Institute and others.

Howard Donkin authored Chapter 34. Federal Filing Requirements and Chapter 35. Public Disclosure of Exemption Application and Form 990 Returns.

Lorri Dunsmore

Lorri Dunsmore is a partner at Perkins Coie. She has over 24 years of experience representing individuals, businesses and tax-exempt organizations in a variety of charitable, wealth transfer, business succession and federal tax matters. Lorri regularly works with individuals and tax-exempt organizations to address a wide range of tax and state law issues impacting charitable giving, formation of nonprofits and addressing the specialized needs of tax-exempt organizations including private foundation excise taxes, excess benefit transactions, lobbying restrictions, fundraising law compliance, commercial co-ventures and joint ventures. She has spoken and written about numerous issues related to nonprofit governance and compliance matters and has worked with a variety of tax-exempt organizations to provide training for board members and officers. Lorri's practice also includes advising clients on the formation, operation, management and transfer of family business entities. She works closely with families to implement business succession and wealth transfer strategies. Lorri has experience advising

privately held corporations, limited liability companies and professional corporations on issues ranging from formation to dissolution.

Lorri Dunsmore co-authored Part 4. Obtaining Recognition as a Code Section 501(c)(3) Organization.

Scott Galloway

Scott Galloway is of counsel at Foster Pepper PLLC and focuses his practice on ERISA, employee benefits, executive compensation, fiduciary, and investment law. He has substantial experience with respect to investment of pension and retirement assets. Scott advises large and small employers with respect to the tax, Title I, Title IV, labor, ADEA and securities law issues involving pension, profit-sharing, 401(k), stock bonus, stock option, deferred compensation, and medical and other welfare benefit plans, as well as executive compensation planning. Scott has substantial experience advising tax-exempt entities, including credit unions, tribal governments and hospitals with respect to the unique issues presented by such organizations' tax-qualified plans and executive compensation and severance arrangements. Scott also has an interest in legal issues affecting recording artists and the music industry, and advises recording artists, labels, and public relations firms with respect to contractual and development matters.

Scott Galloway authored Chapter 68. Setting Executive Compensation and Chapter 69. Employee Benefits and Executive Deferred Compensation.

Bruce Goto

Bruce Goto is an intellectual property attorney in the Seattle office of Fox Rothschild LLP. He assists clients with developing brand strategies and registering trademarks, and has substantial experience with cloud computing, information technology, and the development and licensing of various types of intellectual property. He has been recognized year after year as a leading lawyer in Chambers USA, Best Lawyers of America, and Washington Super Lawyers.

Bruce Goto authored Part 11. Intellectual Property Considerations.

Mark Hugh

Mark Hugh is the principal of Mark Hugh PLLC, a firm devoted to serving clients with state and local tax issues. His work includes planning and tax reporting reviews for a variety of organizations. He is the author and instructor of *Washington Business Tax and New Developments, State Tax Nexus and New Developments*. He is also the author and instructor of *Washington Ethics and New Developments*, a Washington State Board of Accountancy approved course for regulatory ethics, and

Oregon Ethics and New Developments, an Oregon Board of Accountancy approved course for regulatory ethics. He is a CPA, a graduate from the University of Washington, and holds a master's degree in federal income taxation from Golden Gate University. Mark is currently a member of the Washington State Board of Accountancy, the government body that initially qualifies and monitors the quality of CPA's and CPA firms in Washington.

Mark Hugh authored Part 8. Washington State Taxes and Nonprofit Corporations.

Sarah Kuipers

Sarah Kuipers is senior counsel in the tax practice of Kowan & Cordon LLC. Sarah serves as lead counsel on behalf of investors, developers and syndicators for all types of tax incentivized transactions, including syndicated fund structures, low income housing tax credit developments, historic rehabilitations, and renewable energy developments. In her tax practice, Sarah has had extensive experience working with nonprofits in the housing, education, arts, and healthcare sectors. Sarah serves as board member and treasurer of Hugo House, a nonprofit organization for writers and readers in Seattle.

Sarah Kuipers co-authored Chapter 58. Working With Others and Chapter 60. Joint Ventures and Other Contractual Collaborations.

Jamie Lanier

Jamie Lanier, an associate at Lane Powell, focuses her practice on estate planning, probate, and trust administration for high net worth individuals and families. She also works with fiduciaries and beneficiaries regarding non-judicial resolution of trust and estate disputes. In addition, Jamie advise tax-exempt organizations regarding formation and compliance issues.

Jamie Lanier authored Part 6. International Activities and Grantmaking.

David Lawson

David Lawson is a member of Davis Wright Tremaine's Tax-Exempt Organizations group. David is the Recorder of the Nonprofit Corporations Committee of the Washington State Bar Association's Business Law Section, and the Secretary of the Board of Directors of Wayfind. He is a frequent writer and speaker on topics related to tax exemption, charitable programs, and philanthropy, and offers training courses on legal compliance topics to nonprofit organizations and their officers and directors. He represents nonprofit and for-profit clients on tax exemption, charitable programs, and philanthropy, in a practice encompassing nonprofit corporate governance, tax advice for exempt organizations, state

charitable trust and solicitation compliance, corporate transactions involving nonprofits, and health care. David's practice includes a special focus on emerging issues at the intersection of nonprofits and technology, including charitable crowdfunding, technology-focused charitable programs, and standards-setting organizations.

David Lawson co-authored Part 5. Maintaining Federal Tax-Exempt Status for Your 501(c)(3) Organization.

Danny Lisa

Danny Lisa has been a special agent with the Washington State Gambling Commission since 2003. He is also an instructor at the Basic Law Enforcement Academy in Burien and he teaches the Gambling Investigations class to police recruits.

Danny Lisa authored Chapter 49. Fundraising Involving Gambling.

Lindsay McAleer

Lindsay McAleer is an associate in Perkins Coie's Labor & Employment practice. She focuses her practice on employment litigation and counseling. Lindsay has experience defending complex wage-and-hour class action cases, claims brought under the False Claims Act, and claims of employment discrimination, retaliation, and harassment and arising under federal and state laws. She also provides counseling to clients and works with clients to draft employment handbooks and policies, employment contracts, and arbitration and separation agreements. Prior to attending law school, Lindsay taught fifth and sixth grade and coached middle school girls basketball in Phoenix, Arizona. Her pro bono interests include juvenile justice reform, drug sentencing reform, and prisoners' rights advocacy, in addition to providing employment counseling to nonprofit organizations.

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Tony McCormick is of counsel with Perkins Coie's Trust & Estate Planning practice. Tony counsels his clients in both the tax and non-tax aspects of estate planning, with a specific focus on estate planning strategies to efficiently minimize taxes through the creation of wills, trusts, business entities, and charitable organizations and the use of gifts, sales, and other wealth-transfer strategies. Tony's practice also includes advising individuals and tax-exempt organizations on the wide range of legal issues affecting charitable giving, the formation of nonprofit organizations,

and the organizational steps required to maintain a charitable organization's tax-exempt status.

Tony McCormick co-authored Part 4. Obtaining Recognition as a Code Section 501(c)(3) Organization.

Jodi Nishioka

Jodi Nishioka joined Wayfind in 2011. She has worked for over 20 years on behalf of low-income communities, particularly women, children and immigrant/refugee communities. She started her career as an attorney advocating for immigrant domestic violence survivors and single mothers fighting for child support in legal aid organizations in Boston and Honolulu. Jodi continued her work on behalf of disenfranchised communities within state and city governments in Hawaii and Seattle and later with grassroots nonprofit organizations. Currently, Jodi enjoys her work at Wayfind because it combines her legal skills with her dedication to improving the status of low-income communities. She believes in Wayfind's mission of increasing community development and capacity through its support of nonprofits and microenterprise businesses. Jodi is also on the Board of Directors of JustLead Washington.

Jodi Nishioka, Lead Editor also co-authored Part 1. Introduction.

Willa Osborn

Willa Osborn is the Pro Bono Fellow at Foster Pepper and will begin classes at the University of Washington School of Law in the fall of 2018. Willa is dedicated to improving access to justice for vulnerable populations across the state, with a particular interest in serving those who suffer from mental illness. As Pro Bono Fellow, she has coordinated a range of pro bono programs at the law firm and provides administrative and advisory support to local nonprofits.

Willa Osborn authored the accompanying Glossary and served as Production Editor.

Cory Sbarbaro

Cory Sbarbaro is founder and principal of Turnpoint Consulting. Cory brings extensive management, leadership, and teaching experience with a pragmatic, sensible approach to his consulting engagements with nonprofit and social purpose corporations. His areas of expertise include interim leadership, executive transitions, mergers, organizational assessment, strategy development, and governance. Since launching Turnpoint in 2003, Cory has served as an interim executive for nine organizations, provided counsel to more than 100 boards of

directors, and guided dozens of organizations through complex organizational transitions. In 2007, Cory co-created the Nonprofit Executive Leadership Institute at the University of Washington, and he continues to serve as lead instructor for the program.

Cory Sbarbaro co-authored Part 3. Governance and Operations.

Lisa Schaures

Lisa Schaures is an attorney with Schwabe, Williamson & Wyatt, P.C. Lisa partners with growing businesses, social ventures, and nonprofits to guide them through everyday general counsel matters and major events. During her more than 10 years of practice, Lisa has handled governance, conflict of interest, tax, expansion, succession planning, and other general counsel matters effectively and with sensitivity to each client's uniqueness. Lisa received her JD from the University of Oregon, her Master of Laws in Taxation from University of Washington School of Law, and her Bachelor of Arts from Washington State University. She was named to the 2018 "Best Lawyers In America" list, and from 2013-2017, Lisa was named to the Washington "Rising Stars" list for Nonprofit Organizations.

Lisa Schaures authored Chapter 45. Charitable Solicitation in Washington and Chapter 46. Charitable Solicitation Outside of Washington and Internet Solicitations.

Erin Welch

Erin Welch, CPA is an Audit & Consulting Partner at Jacobson Jarvis, a firm exclusively focused on Nonprofits. Erin is committed to helping her not-for-profit clients achieve their missions by better understanding their financial statements and systems. Her goal is to help her clients improve by providing insight, training, resources, and suggestions and by being an approachable advisor whenever they need her. Erin has been working with nonprofit organizations since 2000 and is actively involved in the nonprofit sector as a board member, finance committee member, treasurer, and trainer. Erin specializes in board training, financial health assessments, implementing/improving internal controls, basic NFP financial statement training, financial statement audits & reviews, compliance audits, and communicating financial information in a way everyone can understand.

Erin Welch authored Chapter 75 Internal Controls.

Nancy Williams

Nancy Williams is of counsel at Perkins Coie. She has counseled and represented employers in the areas of labor and employment law for more than 35 years. Her areas of experience include litigation, equal employment opportunity, discipline

and discharge, and a wide variety of other employment issues. Nancy has been an active contributor and leader in civic, cultural and professional organizations, including the American Bar Association and Washington State Bar Association. She served as a trustee for the King County Bar Association and is currently an active participant in its Labor and Employment Law Section.

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LaVerne Woods is a partner in Davis Wright Tremaine's Seattle office and chairs the firm's Tax-Exempt Organizations group. LaVerne is a past Chair of the American Bar Association Section of Taxation Exempt Organizations Committee and of the Washington State Bar Association's Business Section Nonprofit Corporations Committee. She is a past Chair and current Vice Chair of the Board of Advisors of the New York University School of Law National Center on Philanthropy and the Law, and is an Advisor on the American Law Institute's Restatement of the Law of Charitable Organizations project. She has taught in the University of Washington School of Law's Graduate Program in Taxation and is listed in Best Lawyers in America and in Washington Law & Politics' "Super Lawyers." LaVerne represents nonprofit organizations in matters such as qualification for tax exemption, mergers and restructuring, joint ventures and entrepreneurial activities, intermediate sanctions, creation of "friends of" and supporting organizations, unrelated business income tax, conversions to and from tax-exempt status, advocacy, charitable solicitations, endowment management, and tax-exempt bond financing. She advises for-profit corporations on their corporate philanthropy and helps private foundations establish grantmaking compliance programs and provides grant-making training workshops. LaVerne is an honors graduate of Yale University and Harvard Law School.

LaVerne Woods co-authored Part 5. Maintaining Federal Tax-Exempt Status for Your 501(c)(3) Organization.

APPENDIX B

Glossary

"At Will" Employment

An employment status which is presumed in Washington State unless otherwise agreed upon by the employer and employee. The "at will" employment relationship means that an employee may resign at any time for any reason and, likewise, the employer may discharge the employee at any time for any reason.

1980 United States-Canada Income Tax Convention

Commonly referred to as the "Convention", this treaty provides for reciprocal recognition of exemption for religious, scientific, literary, educational or charitable organizations under limited certain circumstances. As such, exempt organizations in either Canada or the U.S. must automatically receive recognition of exemption without application in the other country.

1992 United States-Mexico Income Tax Treaty

Otherwise known as the "Treaty", this agreement provides for reciprocal recognition of exemption and reciprocal deduction of charitable contributions, subject to limitations to the income arising in the other country.

501(c)(3) Organization

An entity that is exempt from federal income tax under section 501(c)(3) of Title 26 of the United States Code (Internal Revenue Code of 1986, as amended). 501(c)(3) organizations are the most common of the 29 types of 501(c) nonprofit organizations in the U.S.

Articles of Incorporation

The document filed with the Secretary of State (in Washington State) to create a corporation.

Board of Directors

The governing body of a nonprofit corporation; sometimes called the Board of Trustees.

Business and Occupation Tax

A tax imposed on the state and city level on the gross receipts of every person engaged in business activities. While nonprofit organizations are not exempt from such tax obligations, some specific exemptions and deductions may be

applicable depending on the nature of the business conducted and the amount of revenue of the business activity subject to the tax.

Bylaws

The code of rules adopted by an organization or business after incorporation for its governance and regulation.

Charitable Organization

Any organization recognized as tax exempt under Section 501(c)(3) of Title 26 of the United States Code (Internal Revenue Code of 1986, as amended.)

Charitable Solicitations

Any request to the general public for funds for a charitable purpose is considered charitable solicitation.

Charitable Solicitations Act (CSA)

A statute that regulates the activities of persons and entities that raise money for charitable purposes. Under the CSA, charitable organizations must register and report annually to the Secretary of State, and also make certain disclosures when soliciting for charitable contributions.

Charitable Trust Act (CTA)

Nonprofit corporations that meet the definition of a "trustee" are subject to the requirements of the CTA, which empowers the Attorney General to enforce the terms of the trust as the statutory representative of its public beneficiaries. Furthermore, trustees are required to report notice of all judicial proceedings affecting the trust, and to register with and report annually to the Secretary of State.

Commercial Fundraiser

A commercial fundraiser is a person or entity that conducts charitable solicitations on behalf of others in exchange for compensation or other consideration.

Consolidation

When two or more nonprofit corporations consolidate their operations such that each of the original corporations ceases operations and the resulting entity is new and distinct. This process differs from a merger in which one of the merging corporations emerges as the surviving entity.

Consumer Protection Act (CPA)

The CPA, protects consumers from deceptive and/or dishonest practices. The CPA applies to all fundraising activities that fall within the scope of trade or commerce.

Copyright

Copyrights are a form of intellectual property protection afforded to "original works of authorship" that allow the creator of such works to prevent a third party from copying, distributing, or adapting their original product. While these rights are afforded to the owner of the work upon its creation, additional rights (such as the right to sue third parties for infringement) can be obtained by registering the copyright with the U.S. Copyright Office.

Cumulative Voting

A manner of electing directors that may be permitted by an organization's articles of incorporation or bylaws of an organization. Cumulative voting permits each voting member to distribute the votes to which they are entitled to a number of, or just one, candidate.

Direct Lobbying Communication

Attempts made to influence legislation through direct communication with members of legislative bodies or their staff or with government officials involved with the formulation of legislation. Also, communication with the general public that expresses a view in reference to a specific ballot measure.

Disqualified Person

Any person who is in a position to exercise substantial influence over an organization with respect to a transaction. Influential positions include, but are not limited to, those who are substantial contributors, directors, officers, trustees, or family members of disqualified persons.

Dissolution

The act or process of dissolving or terminating a corporation in accordance with the provisions established in the Washington Nonprofit Corporation Act and the organization's articles of incorporation.

Employee

A person who performs work for an organization with the expectation of being paid for that work.

Excess Benefit Transaction

A transaction in which an economic benefit is provided by a 501(c)(3) or 501(c)(4) organization, either directly or indirectly, to a disqualified person and that value is determined to be in excess of the value of the services or property received in exchange.

Excise Tax

A tax that applies to a specific type of income, activity, good, or service. These taxes may also be imposed in response to the engagement in prohibited activities.

Exempt and Nonexempt Employees

The Fair Labor Standards Act and Washington Minimum Wage Act regulate the hours and wages of workers in Washington State. Work beyond 40 hours per week must be compensated at a minimum of one and one-half times the employee's regular rate of pay for each hour worked. To avoid confusion, employees should generally be assumed to be non-exempt from such requirements unless they meet the qualifications for exemption set forth by the U.S. Department of Labor.

Fair Use

The right to use the intellectual property protected by trademarks or copyrights for certain qualifying entities or professionals. Nonprofit status does not entitle an organization to assert fair use claims.

Feasibility Study

A study used to determine whether an idea has the support, commitment, and resources to succeed as a nonprofit organization. Also used to describe a blueprint for an organization's capital campaign.

Fiscal Sponsorship

A cooperative relationship between a tax-exempt entity (the sponsor) and a project which has not secured tax-exempt status (the sponsored organization). In a fiscal sponsorship, the tax-exempt organization agrees to receive and disperse funds for the project, often in exchange for fees or other benefits.

Form 990

The federal informational return which most 501(c)(3) organizations must file annually with the IRS. The type of form required varies depending on the size and type of the organization.

Fraud

Wrongful or criminal deception intended to result in financial or other personal gain.

Friends-of-Organizations

U.S. organizations formed to solicit and receive contributions from United States donors and to spend the funds on behalf of a charitable organization organized outside the United States.

Fundraising Activity

Activities are those activities conducted to further the goals of a nonprofit by either the direct solicitation of money or property, or the anticipated exchange of goods or services for money between the soliciting organization and the organization or person solicited.

Grassroots Lobbying Communication

Communications designed to influence specific legislation by affecting the opinion of the general public and encouraging the public to take action.

Incorporation

The act or process of forming or creating a corporation by filing articles of incorporation with the state.

Incorporator

Any individual or entity participating in the formal organization of a nonprofit corporation; including the signing and filing of the articles of incorporation with the State.

Indemnification

A promise to protect a director or officer from expenses, liabilities and losses incurred by the individual when acting in official capacity, and in good faith, for the benefit of the corporation. Indemnification provisions may be included in the articles or bylaws of a corporation.

Independent Contractor

An individual or entity that provides goods or services under specified terms with duties, pay, the amount spelled out and is distinguished from an employee, who works regularly for an employer.

Internal Controls

Practices and adopted systems which monitor, measure, and direct against risk and fraud and are the responsibility of board members to establish.

Internal Revenue Code

The codified laws of the federal government related to federal taxation.

Involuntary Dissolution

When a nonprofit corporation is dissolved involuntarily by administrative action of the Secretary of State. This happens when the nonprofit fails to adhere to its operating requirements, or by judicial action, if the nonprofit engages in fraud or abuses its authority.

Joint Ventures

When two organizations partner with one another as a strategy to fulfill shared goals. Joint ventures can be project-specific or comprehensive in their scope; both require careful attention to guard against private inurement, especially when a nonprofit organization partners with a for-profit entity.

Listed Persons

Terrorists and terrorist organizations identified under Executive Order 13224.

Mutual Benefit Organization

Organizations are formed and operated for the benefit of some identifiable group, such as condominium associations and social clubs.

Nonprofit Corporation

A corporation that is established for the benefit of the community, a specific group or cause. It does not distribute income or shares to its members, directors, or officers.

Patent

A form of protection within intellectual property law, falling within three main categories: utility, design, and plant.

Private Foundation

A 501(c)(3) organization that is funded by one source or a very few sources (usually one individual, family, or corporation) and operates under more restrictive rules than public charities.

Private Inurement

When a person who is an "insider" with respect to the organization, such as an officer or director, derives a benefit from the organization without giving something of at least equal value in return. The Internal Revenue Code establishes prohibitions against private inurement.

Public Benefit Organization

A Public Benefit Corporation is defined in the Washington Nonprofit Statute (RCW 24.03.500), as a nonprofit, in compliance with the Washington Nonprofit Statute RCW 24.03 and is tax-exempt under section 501(c)(3) of the Code.

Public Charity

A 501(c)(3) organization with income generated from a broad base of support from the public.

Qualifying Distributions

Any amount paid to accomplish religious, charitable, scientific, literary, or other public purposes, usually in the form of a grant. Distributions by the private foundation to a disqualified person with respect to the private foundation, or to a non-operating private foundation are not considered a qualified distribution.

Quid Pro Quo Contribution

Payment to a charity that is partly a contribution and partly a payment for goods or services. If the contribution is in excess of $75, the charity must provide the donor with a written statement that specifies the amount of the payment, above the value of the goods and services provided, that can be considered deductible as a contribution.

Quorum

The minimum number of voting members who must be present in a meeting in order to conduct business. For the board of directors of a Washington nonprofit corporation, this number may not be less than one-third of the total number of directors.

RCW

The Revised Code of Washington, which codifies Washington State statutes.

Reasonable Accommodation

The Americans with Disabilities Act (ADA) requires all employers to provide "reasonable accommodation" to enable employees with disabilities to have

access to equal employment opportunities. Such accommodations are changes in the standard application process, changes that enable the employee to perform the essential functions of their position, and changes that provide equal access to the same benefits and privileges of employment available to employees without disabilities.

Registered Agent

A person or entity designated to receive legal and tax documents relevant to the operation of business. The registered agent must have a registered office, with a mailing address to receive notices. The registered agent may be an individual resident of Washington State, or a corporation or limited liability company authorized to do business in the state.

Resolution

A formal expression of a decision or motion of the governing body of an organization, adopted by a vote.

Sarbanes-Oxley (The Public Company Accounting Reform and Investor Protection Act of 2002)

Commonly known as the Sarbanes-Oxley Act, it was enacted to rebuild public trust in corporate America. In response to several scandals, this act establishes stricter expectations for corporate accountability, especially on the financial affairs of publicly traded corporations. Some provisions, such as those relating to the preservation of records (Title VII) and new protections for whistleblowers (Title XI), extend to the operations of nonprofit organizations.

Section 501(h) Election

An election provides the opportunity for public charities, other than churches, to avoid the ambiguity of the "substantiality" test and to become subject to a more objective standard for lobbying activities. The standards set by the § 501(h) election allow organizations a greater ability to plan lobbying activities.

Segregation of Duties

The concept of having more than one person involved in completing a task in order to prevent fraud and error.

Social Welfare Organization

A public benefit organization that focuses on achieving its goals through advocacy and efforts to influence public policy. Social Welfare Organizations often forego the ability to receive certain grants and tax-deductible donations

in exchange for greater freedom to engage in lobbying efforts and are often exempt under 501(c)(4) of the Code.

Solicitation

Any oral or written request for a contribution, or any attempt to make a sale in connection with a charitable purpose

Tax-Exempt

An organization exempt from federal income taxation and organized for specific charitable, educational, scientific, religious or other specific purposes described in the Internal Revenue Code.

Trademark

A logo, business or product name, tag line, or other item that identifies the source of origin for a good.

Trade Secret

Any information that derives economic value from not being known.

Trustee

A nonprofit corporation fits the definition of a trustee if it is either (1) formed for the administration of a charitable trust or (2) holds assets that can only be used for charitable, religious, eleemosynary, benevolent, educational or similar purposes. The Charitable Trust Act empowers the attorney general to enforce the terms of these trusts as the statutory representative of its public beneficiaries.

Unrelated Business Income

An exempt organization should consider income generated from a trade or business activity unrelated business income (UBI) if the activity is regularly carried on and if it is also not substantially related to the charitable purposes of the organization. Such income is subject to the federal UBI tax.

Voluntary Dissolution

A process called voluntary dissolution is available to nonprofits when the directors and members, if any, believe that it is in the best interest of the organization to discontinue its existence as a legal entity.

Volunteer

A person who performs services for an organization without any expectation of, or receipt of, compensation for his or her services.

Whistleblower

An individual within an organization who reports suspected illegal activities within the organization. The Sarbanes-Oxley Act establishes protections for such individuals and criminal penalties for acts of retaliation against them. Nonprofits must develop policies and procedures that encourage the reporting of misconduct and that specifies the protections available for those who do report.

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