



NIGP FORUM

Connecting Procurement Communities

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Chapter Legal and Tax Issues

National Institute of Governmental Purchasing

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Today's Discussion

1. Organization and Governance
2. Tax Exemption
3. Fundraising



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Organization and Governance



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What Is a Nonprofit Organization?

Legal Form of Organization

- Most common legal structures:
 - Corporation
 - Unincorporated Association
- Governed by state law (statutes and common law)
 - Nonprofit Corporation Laws
 - Unincorporated Association Laws
- Non-distribution constraint is fundamental characteristic
- Nonprofit status is not synonymous with tax-exempt status



What Is a Nonprofit Organization?

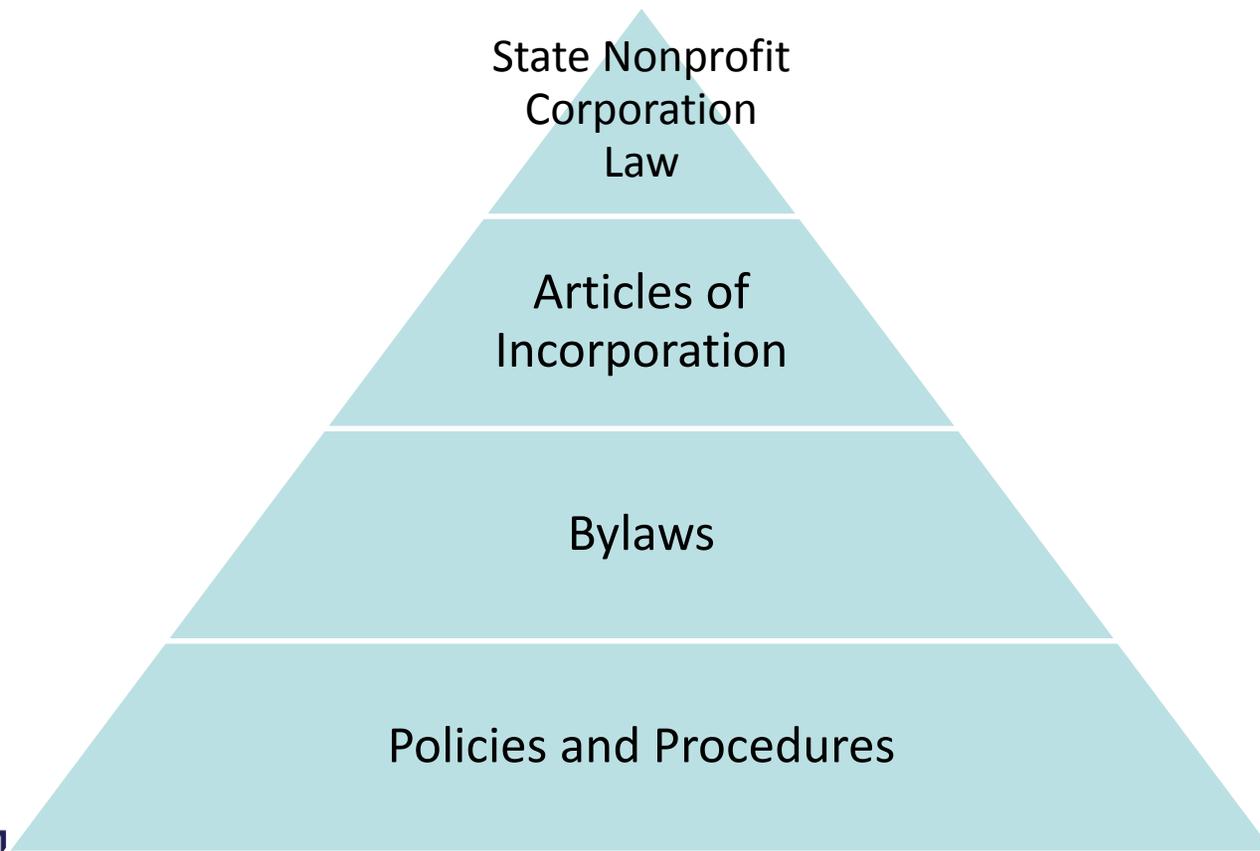
Legal Form of Organization – Corporations

- Limited Liability Protection
 - Incorporation grants organization “corporate shield” so long as operations are consistent with state corporate requirements
- Corporate Status Requirements:
 - File and maintain articles of incorporation with the state
 - Comply with state nonprofit corporation law governing organization and decision-making (i.e., elections, meetings, voting, etc.)
 - File annual report with the state to remain in good standing



Governance Legal Issues

Hierarchy of Governing Documents



Governance Legal Issues

Governing Documents in Context – Articles

- Filed with the state
- Include only the most basic provisions necessary to form a nonprofit corporation because cumbersome to change
 - Full legal name
 - Statement of purposes
 - Whether the entity will have members
 - Registered agent/office
 - Provision for disposition of assets on dissolution
 - Provisions limiting the activities of the organization to qualify for tax-exempt status



Governance Legal Issues

Governing Documents in Context – Bylaws

- Internal governance document
 - Not required to be filed with the state
 - But must be submitted to the IRS with the Form 990 when significant changes are made
- Subordinate only to the articles of incorporation and state law
- Usually more easily revised than articles of incorporation
- Include core rules governing:
 - Organizational structure
 - Rights and obligations of participants in the structure
 - Essential procedures by which participants' rights can be exercised



Governance Legal Issues

Governing Documents in Context – Bylaws

- Board-approved policies supplement the core governance rules of the articles and bylaws in greater detail; set parameters governing operational matters, programs
- Subordinate to the bylaws, articles of incorporation, and state law
- Most easily revised
- Common focus of policies:
 - Ethics and accountability (e.g., conflict of interest, whistleblower)
 - Finance and investments
 - Fundraising
 - Board operations
 - Committee responsibilities
 - Communications
 - Personnel



Governance Legal Issues

Role of the Board of Directors

- Board of directors is the **ultimate decision-making body**
- Boards generally are only allowed to act in a meeting or by unanimous written consent
- Authority to govern the corporation comes with duties—state statutory and common law require that corporate board members fulfill:
 - Fiduciary duty of **care**
 - Fiduciary duty of **loyalty**
 - Fiduciary duty of **obedience**



Governance Legal Issues

Fiduciary Duty of Care

- Standard is that of “ordinary and reasonable care,” or what would an **ordinarily prudent director** do in the **same or similar circumstances?**
- **Business judgment rule**—bad decisions are more easily defended than ignorance; it is the due diligence process that matters most
- Compliance with fiduciary duty of care:
 - Review all materials
 - Ask questions
 - Actively participate in meetings



Governance Legal Issues

Fiduciary Duty of Loyalty

- Duty of undivided allegiance
- Duty to avoid conflicts of interest (actual, potential, and apparent)
 - Examples
 - Business dealings with association
 - Business dealings with competitors
 - Corporate opportunities doctrine
 - Remedies
 - Disclosure; recusal or resignation
- Confidentiality



Governance Legal Issues

Fiduciary Duty of Obedience

- Articles of incorporation, bylaws, other governing documents must be followed
- Applicable laws and regulations must be followed



Governance Legal Issues

Board Role Summary

- Meet and deliberate
- Act in best interests of the organization
- Document compliance through minutes



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Governance Legal Issues

Apparent Authority

- As long as a board member, officer, or employee reasonably appears to be acting with the organization's approval, the organization may be **liable** for that individual's actions
- Often it is **no defense** to say that the board member, officer, or employee was not acting within the scope of his/her actual authority



Governance Legal Issues

Risk Management

- Insurance
 - General Liability
 - Directors and Officers
 - Meeting Cancellation
- Volunteer Protection Acts (state and federal)
- Indemnification of directors and officers
- Informed consent/waiver



Governance Legal Issues

Compensation and Expense Reimbursement

- Compensation
 - Directors of nonprofits generally not compensated for service as directors
 - Compensation may be paid for services rendered to the organization in another capacity
 - Conflict of interest policy should be followed
 - State laws often have rules governing approval of so-called related party or conflicted interest transactions
 - Consider IRS “rebuttable presumption” of reasonableness
- Expense Reimbursement
 - Expenses reasonably and necessarily incurred in connection with chapter leadership activities may be reimbursed if chapter chooses to do so
 - e.g., travel and lodging expenses incurred in attending a chapter board meeting
 - Consider expense reimbursement policy



Governance Legal Issues

Gifts

- Occasional non-cash gifts in appreciation of volunteer service are permissible
 - e.g., plaques, “thank-you” luncheon or dinner, etc.
 - Value should be reasonable and not excessive or lavish
- No gift cards or cash



Governance Legal Issues

Public Ethics Considerations

- NIGP chapter leaders who are government employees generally subject to public ethics laws
 - Restrictions on outside activities/employment
 - Loyalties owed to government employer
 - Restrictions on acceptance of gifts
 - Additional restrictions for procurement officials
- Potential for conflict of interest between duties owed to chapter and to government employer
 - Understand obligations of each role
 - Seek guidance where necessary



End of Topic #1

Questions?



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Tax Exemption Issues



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Tax Exemption Issues

Topic Overview

- 501(c)(3) and 501(c)(6) Requirements
- Lobbying and Political Activities
- Unrelated Business Income Tax and Key Exceptions
 - Convention and Trade Show Activities
 - Sponsorships
- Reporting



Tax Exemption Issues

Source of Tax Exemption

- Federal Tax Exemption
 - Internal Revenue Code provides exemption from federal income tax to qualified nonprofit organizations
 - Recognition by IRS obtained through application or group exemption
- State Tax Exemption
 - State statutes may provide exemption from state income or franchise tax, as well as state property, sales, and use taxes
 - May be conditioned upon recognition of federal tax-exempt status but *not* always tied together or automatically granted—application to state revenue agency may be required



Tax Exemption Issues

What Does It Cover?

- Revenue from activities **related** to tax-exempt purposes are not subject to federal income tax
- NIGP chapters' tax-exempt purposes:
 - 501(c)(3)
 - Educating members in order to enable them to perform their duties more effectively
 - “Lessening the burdens of government” by providing training and facilitating procurement
 - 501(c)(6)
 - “Professional society” or “trade association” promoting the procurement profession as a whole



Tax Exemption Issues

Ways NIGP Chapters Are Recognized

- NIGP group exemption
 - 501(c)(3) only
 - Must be subject to NIGP supervision/control
 - Evidence of exempt status is NIGP group determination letter with letter from NIGP confirming participation
- Separate recognition
 - 501(c)(3)—must apply to IRS
 - 501(c)(6)—may apply to IRS or may self-declare
 - Evidence of exempt status is IRS-issued determination letter (only provided upon application to IRS)



Tax Exemption Issues

Section 501(c)(3) Tax-Exempt Status

- Tax-exempt purpose—educational, scientific, or charitable
- Contributions tax-deductible by donors as charitable contributions (minus value of benefits received in return)
- No “private inurement” or impermissible “private benefit”
- No “substantial” lobbying
- No political campaign activities
- Taxation of unrelated business income (“UBIT”)



Tax Exemption Issues

Section 501(c)(6) Tax-Exempt Status

- Tax-exempt purpose—improvement of business conditions of industry or profession
- No “private inurement”
- No “particular services” for members
- Unlimited lobbying
 - Lobbying portion of dues not tax-deductible by members as a business expense
- Taxation of unrelated business income (“UBIT”)



Tax Exemption Issues

Restrictions on Lobbying and Political Activities

- 501(c)(3)
 - Lobbying permitted, provided it is not a “substantial part” of the organization’s total activities
 - Substantial part test v. 501(h) expenditure test
 - NO political campaign activities permitted
- 501(c)(6)
 - Unlimited lobbying permitted
 - Lobbying portion of dues not tax-deductible by members as a business expense
 - Political campaign activities permitted, provided they are not the organization’s primary activity
 - Be aware of federal and state campaign finance laws, particularly with regard to restrictions on political activities of corporations



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Tax Exemption Issues

When Do Tax Obligations Arise?

- Unrelated Business Income Tax (UBIT)—income is taxable if derived from:
 - a trade or business,
 - that is regularly carried on, and
 - that is not substantially related to furthering the exempt purpose of the organization



Tax Exemption Issues

Understanding UBIT

- Unrelated business activities permitted, but must be less than substantial portion of overall activities (otherwise tax-exempt status jeopardized)
- Revenue-generating activity itself must be related to exempt purposes; using the proceeds for good works is not enough to avoid UBIT



Tax Exemption Issues

Understanding UBIT

- Examples of “related” activities
 - Event registration fees
 - Exhibit booth rentals
- Examples of activities that can generate UBI:
 - Sale of **advertising**
 - Sale of consumer products where selling product does not further mission
 - Performance of services unrelated to mission
 - Job referral activities (except might link to 501(c)(3) “lessening”)
 - Certification activities by 501(c)(3) organizations (can do to limited extent but note UBIT consequences)



Tax Exemption Issues

Understanding UBIT – Key Exceptions

- Qualified Convention and Trade Show Activities
- Qualified Sponsorship Payments



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Tax Exemption Issues

Qualified Convention and Trade Show Activities

- Income from activities **traditionally** carried on at convention and trade shows is not subject to UBIT
- Traditional activities include (but are not limited to):
 - Activities designed to attract people to the show to view industry products or services
 - Activities designed to educate persons in the industry about new products or services or new rules and regulations
 - Incidental activities such as furnishing refreshments



Tax Exemption Issues

Qualified Convention and Trade Show Activities

- To be a “qualified” convention or show:
 - At least one purpose must be
 - education of members, or
 - promotion and stimulation of interest in and demand for the products or services of the industry of the members
 - Event must be designed to achieve the purpose through
 - character of a significant portion of the exhibits or
 - character of conferences and seminars held
- IRS considers a supplier-only show without educational component NOT qualified



Tax Exemption Issues

Qualified Convention and Trade Show Activities

- TIPS:
 - Incorporate educational programming for members with all shows
 - Demonstrate “qualified” purpose of show through marketing and promotional materials



Tax Exemption Issues

Qualified Sponsorship Payments

- Qualified sponsorship payments are excepted from the definition of UBI
- Sponsor neither gets nor expects any return benefit other than:
 - Goods, services, or other benefits, the total value of which does not exceed **2%** of the sponsorship payment during the tax year; or
 - **Recognition**, i.e., use or acknowledgement of the sponsor's name, logo, or product lines in connection with the nonprofit's activities
 - Advertising does NOT qualify as permissible recognition



Tax Exemption Issues

Qualified Sponsorship Payments

- QSP exclusion applicable to broad range of activities, NOT including:
 - Tradeshow and convention activities
 - Advertisement or acknowledgment in regular periodicals (journals, e-newsletters, etc.)
 - Contingent payments
- If substantial return benefit provided (i.e., benefits other than recognition valued at more than 2% of the payment):
 - Only the portion of the payment that exceeds the fair market value of the substantial return benefit is a QSP
 - Use regular UBIT analysis to determine whether any other portion of the payment is subject to tax



Tax Exemption Issues

Qualified Sponsorship Payments

- Permissible forms of recognition:
 - Use or acknowledgment of the **name or logo** (or product lines) of the sponsor’s business, as long as the use is not qualitative or comparative
 - List of **sponsor’s location, telephone number, and/or** Internet address, including a **hyperlink** from the exempt organization’s website to the sponsor’s website
 - Designating a sponsor as an “exclusive sponsor”
 - **Product samples okay**



Tax Exemption Issues

Qualified Sponsorship Payments

- Recognition v. advertising:
 - Advertising is defined as any message that **promotes or markets** any trade or business, or any services, facility, or product
 - Messages that include any of the following are advertising:
 - Qualitative or comparative language,
 - Price information or other indications of savings or value,
 - An endorsement, or
 - An inducement to purchase, sell, or use the products or services



Tax Exemption Issues

Qualified Sponsorship Payments

- Illustration
- ABC Corporation commits to \$5000 sponsorship of Chapter program (2% = \$100)
 - Ex. 1: \$ 75 Return Benefit – Safe Harbor
 - \$50 complimentary program registrations
 - \$25 advertising opportunity in program marketing materials
 - Ex. 2: \$125 Return Benefit – No Safe Harbor
 - \$100 complimentary program registrations (not taxed, related)
 - \$25 advertising opportunity in program marketing materials (taxed)



Tax Exemption Issues

Qualified Sponsorship Payments

- Analyzing benefits:
 - Recognition or advertising?
 - Eligible for safe harbor?
 - Determine value of benefits
- Essentials for sponsorship contracts:
 - Specify exact form of acknowledgment
 - Specify all return benefits
 - Specify value of taxable benefits, if any
 - Have right to approve any copy relating to sponsorship, or using tax-exempt's name/logo
 - Specify site to which hyperlinks will link



Tax Exemption Issues

Reporting

- Form 990 Annual Filing Requirements:
 - All tax-exempt entities must file the 990, 990EZ, or 990N (e-postcard)
- NIGP does *not* file a return on behalf of group exemption participants
- **Failure to file for three years in a row results in automatic loss of tax-exempt status**

Gross receipts \leq \$50,000	Form 990N (e-postcard) or Form 990
Gross receipts $<$ \$200,000 and assets $<$ \$500,000	Form 990EZ or Form 990
Gross receipts \geq \$200,000 and assets \geq \$500,000	Form 990



End of Topic #2

Questions?



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Fundraising



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Fundraising Issues

Raffles

- Federal law and all states prohibit lotteries (except state-run lotteries). A lottery has the following elements:
 1. The awarding of a prize,
 2. By chance,
 3. Where the participants have been required to submit consideration to enter.
- In many states, certain charitable or nonprofit fundraising raffles or games of chance are exempt from lottery prohibitions (but still regulated)



Fundraising Issues

Raffles

- What is consideration?
 - The giving up or undertaking something of value
- Often defined in **monetary terms**
- Some states take a broader view—consideration may be anything that involves a significant expenditure of one’s time and effort ... “**shoe leather consideration**”
 - Rule of thumb: **the less that is required of the participant, the less likely it is to be consideration—limit amount of personal information required**
- Consideration issue may generally be avoided if the required action (e.g., attending an event) is **not mandatory**—provide a free alternative method of entry (**FAME**)



Fundraising Issues

Raffles

- In states where nonprofit raffles allowed, permit or registration may be required
 - Some states have residency requirements
 - Restriction on ticket price
 - Limits on where raffle conducted and by whom
 - Distribution of proceeds of raffle
- If permit required, allow plenty of time (weeks or months)
- Know the raffle laws in your state, and review raffle laws before conducting a raffle in any other state



Fundraising Issues

Scholarship Fund Solicitations

- State charitable solicitation regulation
 - Registration and reporting of charitable fundraising required in about 40 states
 - Some states have exceptions if you are only soliciting members (seek counsel)
- IRS rules for substantiating charitable contributions for donor tax-deductibility (501(c)(3)s only)
 - Disclosure to donors of a *quid pro quo* contribution in excess of \$75
 - Contemporaneous written acknowledgment for donors claiming deductions of \$250 or more
- Consider adopting policies governing fundraising and scholarship programs



Questions?

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