

Legal Responsibilities of Your Nonprofit Corporation

*An Informational Brochure and Checklist
for Managing Your Nonprofit Corporation*

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Inside You Will Find Answers to These Questions:

- How do we maintain our nonprofit's corporate identity?
- What reports must management provide to the board of directors, to our members, make available to the public, and file with government agencies?
- What employee-related laws must we comply with?
- What licenses must we obtain?
- How do we maintain our nonprofit's tax-exempt status?



CENTER FOR
NONPROFIT
MANAGEMENT

Legal Responsibilities of Your Nonprofit Corporation: An Informational Brochure and Checklist for Managing Your Nonprofit Corporation

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Introduction

Now that your nonprofit public benefit corporation has been formed, it will face a number of ongoing legal responsibilities. It is very important that these legal requirements be satisfied in order to maintain your corporate tax-exempt status and to protect the corporation's directors and officers from legal liability. The purpose of this brochure is to provide guidelines for carrying out these responsibilities. (Note that it does not discuss the responsibilities of private foundations.)

These guidelines come from the California Corporations Code, the California Revenue and Taxation Code, other California laws, and the Internal Revenue Code. This brochure is not intended to be all-inclusive. However, it should make you aware of some of the major legal responsibilities of corporate life, and should highlight areas that will require further attention.

1 Overview of corporate governance

Control

Control of a nonprofit organization is vested in a governing board of directors or trustees. The board's responsibility is to see that the organization fulfills its purpose. To this end, the board makes final decisions regarding the direction and staffing of the organization. Board members do not act as individuals, but must act as a group. No one should be guaranteed permanent tenure on a board, and the board may decide it is necessary to fire an executive or to remove board members. This means that no single person, not even the founder, can control a nonprofit organization. Board members should be supporters of the organization who donate their time and money to its purpose. Under California law, fewer than half of the members of the board of directors of a public benefit nonprofit can be paid employees or officers, or related to other persons who are paid employees or officers.

Accountability

The California Attorney General has power to oversee the operations of public benefit corporations and can even take a corporation to court to make sure it complies with the law. Nonprofit organizations are accountable to the public and must file annual information returns with federal and state governments. These returns report the financial operations of nonprofit organizations, including the salaries of the five highest paid non-officer employees. In addition, various organizational documents must be made available for public review.

2 What procedures must our board of directors follow to maintain our corporate identity?

One of the greatest advantages of corporate status is limited liability. Limited liability means that directors, trustees, officers, employees, and members in most cases are not personally liable for corporation's actions, omissions, or obligations (such as debts). (Be aware, however, that there are exceptions to this rule.)

Maintaining this corporate status and its privileges, such as limited liability, requires that the corporation act like a corporation, and not like a mere collection of associated individuals. This demands thorough record-keeping, careful financial accounting, and most importantly, a corporate decision-making process.

Regular Board Meetings

Major decisions that affect the corporation as an entity (as opposed to decisions that affect the corporation's day-to-day operations) should be made by the entire board of directors. Regular board meetings provide the appropriate forum for making such decisions. While there is no statutory requirement as to how often the board should meet, four meetings a year is fairly typical. If issues that require board action should arise between meetings, the proper procedure for calling a special meeting can be found in your corporate bylaws. Follow this procedure if such an issue arises.

Remember: It is necessary to operate in a formal corporate manner to keep your tax exemption and limited liability.

Thorough minutes of each meeting should be taken and stored with the official corporate documents. Thorough record keeping is very important, especially if your corporation should ever face a challenge to its tax-exempt status or any other legal challenge.

Matters appropriate for action by the board of directors include:

- election of officers;
- approval of important decisions, including approval of budgets and fundraising plans, review of cash flow needs, approval of major grant proposals, review and approval of financial statements, approval of investments, opening and closing of corporate accounts, designation and change of corporate officers authorized as signatories on bank accounts, and so forth;
- approval of important contracts and leases;
- amendment of bylaws and articles of incorporation. (Note: If the corporation has voting members, they may have the right to vote on accepting such changes.)
- appointment of board committees;
- electing directors and filling vacancies (Note: If the corporation has voting members, they elect directors);
- oversight and review of the activities of the executive director;
- compliance with governmental reporting requirements;
- retaining auditors;
- defending or bringing legal actions;
- approving indemnification of corporate directors, officers, and other agents; and
- other strategic policy or fiscal matters not already delegated to an officer or committee of the full board of the corporation.

Directors' Duty of Care

The board of directors is generally responsible for managing the corporation. Although the directors may delegate some of the management functions to others, such as an Executive Director, the acts of such delegates must always be under the board's oversight and control. In addition, the actions of the Board and management must never violate the Articles of Incorporation or Bylaws.

Each director has a duty to the corporation to act in a manner he or she believes to be in the best interests of the corporation. In the case of nonprofits, this means a fiduciary duty to be faithful to the public good over your personal interests. The director must exercise reasonable oversight and inquiry, which means that he or she must act as an ordinarily prudent person would act under similar circumstances. In performing his or her duties, the director may rely on information, opinions, reports, or other statements prepared by others, both inside and outside the organization, so long as the director has a reasonable basis for belief in the presenter's reliability, competence, expertise, and integrity. A director may not rely on information if he or she has knowledge of facts that makes it unreasonable for him or her to rely on the information.

Directors involved in decisions concerning complicated financial transactions and investment holdings should familiarize themselves with the California Corporations Code § 5240, which details the special responsibilities of such directors when approving investments of the nonprofit corporation's assets.

Financial Oversight

Accurate financial records are critical to maintaining your nonprofit's corporate identity and tax-exempt status. You must establish a corporate bank account and keep these funds separate from the personal funds of those who manage the corporation or serve on its board. Make sure you pay the organization's expenses directly from the corporate bank account. Try to maintain enough money in the corporate account to pay any foreseeable debts and liabilities that arise in the course of normal organization activities. Finally, be certain to save all of the financial records of your corporation.

In addition, at every meeting of the Board of Directors, management should provide an unaudited financial statement showing actual year-to-date income and expenses as compared to the budget, by budget line item.

Nonprofit organizations that report to the California Attorney General¹ and have annual gross revenues over \$2 million, must have an annual independent CPA audit done, which must be made available for public inspection within nine months after the close of the nonprofit's fiscal year. The Board of such an organization must have an audit committee, the majority of whose members are not finance committee members. It cannot include the CEO, CFO, the Treasurer, or staff members. If a nonprofit organization's annual gross revenues are less than \$2 million, but the organization nevertheless has an annual independent audit performed, it also must make that audit available for public inspection within nine months of the end of its fiscal year. (See page 7 for a general discussion of the public's right to inspect your records).

The governing board or authorized board committee of all nonprofits, regardless of gross revenues, must annually review the compensation of both the CEO and CFO "to assure that it is just and reasonable."

What periodic reports must management provide?

Various laws require management to make periodic private internal reports to your nonprofit's directors and members, to make periodic public reports to state agencies, to file various state and federal informational and tax returns, and to keep certain records available for public inspection. See Table 1 for details.

1 This excludes hospitals and health and service plans, educational institutions (schools and universities), and religious organizations.

Table 1: Required Corporate Reports after Incorporation (Other than Tax)

Description	Contents	To Whom	Deadline	Filing Fees
Annual Report/ Annual Financial Information	Report on financial condition and loans to insiders or other transactions ²	Board of Directors/ Members ³	Within 120 days of fiscal year end	Not applicable
Statement of Do- mestic Nonprofit Corporation	Secretary of State mails form each year. Contact office if not re- ceived. ⁴	California Secre- tary of State	90 days after incorporation; then every other year no later than end of month of incorporation	\$20; \$50 penalty for non-compli- ance (contact Secretary of State for extra grace period)
AGO Form RRF-1	Reporting on prac- tices, including self-dealing, use of paid fundraisers, etc. ⁵	California Attorney General-Regis- trar of Charitable Trusts	Annually by 15th day of 5th month after end of organi- zation's fiscal year (see note 4 below for penalties)	Varies according to gross annual revenue
Designation of agent for service of process	Name and address of new agent (form available from Secretary of State free of charge)	California Secretary of State	Immediately upon appointment (you must have a reg- istered agent at all times)	None
Certificate of amendment of articles of incorporation	Wording of amend- ments to articles (e.g., changes in name or purposes)	California Secre- tary of State (and to IRS if major change in your purpose)	Immediately upon adoption (they are not effective until filed).	\$30

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- 2 Your nonprofit corporation must either issue an annual report or furnish the board of directors with the following information: Certified balance sheet and income/expense statement; a brief description of the amount and circumstances of any loans, financial guarantees, advances, or indemnifications totaling more than \$10,000 that were made the previous year to any officer or director of the corporation (NOTE: Avoid loans and guarantees to officers and directors if at all possible. They are almost always an improper use of charitable funds); a brief description of the amount and circumstances of any transaction in which the corporation was a party, and in which a member of the board or an officer of the corporation had a direct or indirect financial interest totaling more than \$50,000.
- 3 The following membership public benefit corporations are exempt from having to provide an annual report to their members (see Cal. Corp. Code section 6321): (i) any corporation which receives less than \$25,000 in gross revenues or receipts during the fiscal year; (ii) a corporation whose membership meets less than once a year must provide the report as often as meetings are held, except when a provision in the articles or bylaws require a yearly report; and (iii) a corporation which in writing solicits contributions from 500 or more persons (*there are several other requirements under this exemption; consult an attorney if you believe this applies to your organization*). The report should contain information on assets, liabilities, revenues, and expenses of your nonprofit.
- 4 Each public benefit corporation must periodically file a statement with the California Secretary of State containing: (i) the names and addresses of its chief executive officer, secretary, and chief financial officer or treasurer; (ii) the street (not P.O. Box) address of its principal California office; and (iii) a designation of an agent for service of process.
- 5 Nonprofits must also attach a copy of their IRS Form 990, 990-EZ, or 990-PF. The Registrar of Charitable Trusts should mail form RRF-1 to your corporation's principal place of business. Otherwise a copy can always be obtained by contacting the Registrar's office. Failure to file Form RRF-1 in a timely fashion could result in substantial penalties of at least \$1000.

What federal and state tax/informational returns must we file?

The following discussion of taxes and tax reporting requirements is intended only to outline your organization’s reporting responsibilities. You should consult with your organization’s accountant to set up procedures to ensure that you trace all the information you need to meet the requirements, and to set up a system for withholding and paying taxes and filing reports.

Table 2: Required Tax Returns

To Whom	By Whom	Contents	Form	Deadline	Penalty for late/non filing
IRS	Nonprofits, other than churches, with gross receipts over \$100,000	Report of incomes and expense	IRS 990	Within 4 ½ months of close of fiscal year	\$20/day, not to exceed smaller of \$10,000 or 5% of gross receipts (larger penalties apply to organizations with gross receipts over \$1 million) ⁶
	Nonprofits with gross receipts between \$25,000 and \$100,000, and total assets under \$250,000	Same	IRS 990 EZ		
	501(c)(3)s who file 990 or 990 EZ	Additional information	IRS Schedule A		
California Franchise Tax Board ⁷	Nonprofits other than churches, with gross receipts over \$25,000	Report of income and expenses	Cal 199	Within 4 ½ months of close of fiscal year	\$5/month, not to exceed \$40
	Nonprofits other than churches, with gross receipts under \$25,000	Same	Cal 199 B		

⁶ In addition to the IRS penalties shown in the table, a penalty will be imposed on a “responsible person” who fails to respond to an IRS demand that a Form 990/990 EZ be filed. This penalty is \$10 per day, up to a maximum of \$5000. There are also penalties for failing to pay any tax due in a timely manner, for willfully failing to file a return, and for filing fraudulent returns or making fraudulent statements to the IRS. Remember: a corporation’s limited liability protection does not apply to liability for unpaid taxes and tax penalties. The IRS and the State Franchise Tax Board can seek payment from persons associated with your nonprofit corporation who are responsible for reporting and paying its taxes.

⁷ As to California Form 199, there is an initial filing fee of \$10, and an additional \$15 filing fee if a return is filed late without reasonable cause. These fees are waived for certain organizations.

To Whom	By Whom	Contents	Form	Deadline	Penalty for late/non filing
IRS	Nonprofits earning more than \$1000 gross income annually from trade or business unrelated to tax-exempt purpose	Report of unrelated business income	IRS 990 T	Within 4 ½ months of close of fiscal year	Same as for Form 990s
	Organizations filing 990-T which expect income tax due of \$500 or more	Quarterly estimated tax payment	IRS 990 W	15th day of fourth, sixth, ninth and twelfth months of fiscal year ⁸	
California Franchise Tax Board	Nonprofits earning more than \$1000 gross income annually from trade or business unrelated to tax-exempt purpose	Report of unrelated business income	Cal. 109	Within 4 ½ months of close of fiscal year	Same as for Form 199

Cities also levy taxes, and nonprofits may have to pay them or obtain an exemption. In Los Angeles, exemptions are obtained through the Office of Finance. For more information, go to www.lacity.org/finance; telephone 213-978-3050.

What records must we keep available, and for public inspection?

The corporation must keep copies of its Articles of Incorporation, Bylaws, and all amendments at its principal California office, and make them available for public inspection.

Nonprofit organizations required to complete IRS Form 990⁹ must make available for public inspection copies of their Form 990 for the previous three years. These copies must be available during regular business hours throughout the year. The names of contributors to the organization need not be disclosed. These organizations must also make available for public inspection, during regular business hours throughout the year, the following documents: (i) copies of the application for tax exemption (IRS Form 1023) filed by your nonprofit with the IRS; (ii) papers submitted in support of your exemption application; (iii) the determination letter from the IRS confirming recognition of the tax-exempt status; and (iv) any other document issued by the IRS with respect to your exemption application. Internal Revenue Service Notice 88-120, 1988-2 Cum Bull 454, provides guidelines for the disclosure requirements.

⁸ IRS Form 990-W: Even if not due, because the total annual income tax expected to be due is less than \$500, use this form to compute any annual tax actually due.

⁹ This excludes religious organizations and nonprofits with less than \$25,000 in gross receipts.

A failure to satisfy the requirements for public inspection without reasonable cause will subject the organization and the person responsible for the failure to a penalty of \$10 per day. The maximum penalty for failure to disclose a return is \$5,000, but there is no maximum penalty for failure to disclose an exemption application. If the failure to disclose is intentional, an additional penalty of \$1,000 for each return or application is imposed. Moreover, anyone who furnishes information to any person, under the public inspection requirements, known to be fraudulent or false, may be fined up to \$10,000 (\$50,000 in the case of a corporation), or imprisoned for up to one year, or both.

What employee-related laws must we comply with?

Legally, a nonprofit organization is treated like any other employer; it is generally subject to federal and state laws governing terms and conditions of employment, such as overtime and vacation rules, and to prohibitions on discrimination. (Religious organizations may be exempt from some of these rules.)

Even if your nonprofit does not intend to hire employees, you must still apply to the IRS for a federal Employer Identification Number (“EIN”) by filing an SS-4 with your federal tax exemption application. If you have paid employees, you must also register with the California Employment Development Department.

With respect to wages paid to employees, all non-religious section 501(c)(3) organizations are required to withhold and pay taxes imposed under the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax (FUTA), and California Unemployment and Disability Insurance Act. These organizations are also required to withhold and deposit federal and state income taxes on employees’ wages. Payments to independent contractors must be reported to the IRS on form 1099. Because of the extensive record keeping and reporting requirements arising from these obligations, we urge you to discuss them with your financial advisor or accountant.

Payment for services performed by an employee of a religious, charitable, educational or other organization described in section 501(c), that are generally subject to FICA taxes if the payments are \$100 or more for the year, are not subject to federal unemployment taxes (FUTA). Payments for services performed by a minister of a church or a member of a religious order are not subject to FICA or FUTA taxes.

What licenses must we obtain?

Business Licenses

Your nonprofit corporation may be required to obtain a business license, or an exemption from the license requirement, from the city in which it will be operating. In Los Angeles, the license requirement is taken care of through the process of applying for an exemption from city taxes. See the text immediately following Table 2 on page 7.

Solicitation of contributions

More than 100 California cities and counties require nonprofit corporations to register with them before soliciting funds from the public at large. (See www.ceb.com/info/NonprofitsAppendixC.asp). For example, the City of Los Angeles requires organizations soliciting contributions from the public within city limits to register with the Charitable Services Section, Commission Investigation Division, Los Angeles Police Commission (phone: 213-978-1144), whether or not they are using a “commercial fundraiser.” You must file with the city a “Notice of Intention to Solicit Charitable Contributions.” The city provides a document called “Procedures, Ordinances and Standards for Charitable Solicitations in the City of Los Angeles.”

The California “Nonprofit Integrity Act of 2004” imposes new statewide requirements on fundraising by nonprofits (see Cal. Gov. Code sections 12581 through 12599.7). Nonprofits are prohibited from contracting with any “commercial fundraiser” or “fundraising counsel,”¹⁰ or to raise funds for any other charity required to be registered with the state, unless the fundraiser, fundraising counsel or other charity is registered with the Attorney General prior to the commencement of the solicitation. In addition, you must have a written contract with any commercial fundraiser that you use, signed by an official of the nonprofit, and including a lengthy list of provisions detailed in the law. You must establish and exercise control over fundraising activities conducted for your benefit, including approval of all contracts and agreements, and assure that fundraising activities on your behalf are conducted truthfully and without coercion.

In addition, notice of a solicitation campaign by a “commercial fundraiser for charitable purposes” must be filed with the Charitable Services Section of the Registry of Charitable Trusts in the office of the Attorney General¹¹ at least 10 days before the commencement of the solicitation campaign, events, or other services. There is an exception to this advance notice period, for charitable fundraising for disaster and emergency relief. The Registry of Charitable Trusts has a pamphlet available detailing the requirements.

How do we maintain our organization’s tax-exempt status?

Unless your nonprofit is a school, hospital, church or private foundation, you are a “public charity” and must receive a substantial part of your income from contributions from broad solicitation of funds from the public.

To maintain tax-exempt status your nonprofit corporation must also follow certain statutory requirements that are designed to ensure the accountability of public benefit corporations. Failure to comply with such rules can result in loss of tax exemption, which will mortally wound the organization, and can result in significant personal liability for

¹⁰ *Commercial fundraiser*: A person or company who solicits contributions, or receives or controls those contributions, or employs or engages any compensated person to solicit or control those contributions. An employee of the charitable organization receiving those contributions is not included. *Fundraising counsel*: A person or company who, for compensation, manages, advises, or prepares material for, the solicitation of contributions. An attorney or employee of the charitable organization receiving those contributions is not included.

¹¹ Office of the Attorney General, Registry of Charitable Trusts, P.O. Box 903447, Sacramento, CA 94203-4470; Phone: 916-445-2021; Web: www.ag.ca.gov/charities/index.htm.

directors and officers. If you become concerned that you may be violating one of the requirements discussed below, you should promptly consult an attorney. It would also be a good idea to consult an attorney whenever you amend your Articles of Incorporation to change aspects of the articles other than the organization's name or agent for service of process (for example, when changing or amending the organization's statement of purpose), because changes can affect the corporation's tax-exempt status.

The Operational Test

To meet the IRS' operational test, your charitable organization must be operated exclusively for tax-exempt purposes. This does not require complete and total devotion to exempt activities, but only an insubstantial amount of the organization's activities can be for nonexempt purposes.

If a nonexempt activity is deemed to be substantial, your organization's tax-exempt status will be revoked. Additionally, if any part of an organization's earnings benefit interested persons or it is deemed an "action" organization (an organization that participates in political activity), then tax-exempt status will be revoked. The best course is to be cautious when expanding your group's activities, and to keep careful records of your nonexempt activities.

The "Public Support" Test

To avoid being classified as a "private foundation," your nonprofit must obtain its financial support from multiple and diverse sources. You should periodically review this requirement with your accountant. In addition, any time you are offered a large grant of support from a single source or related sources, you should consult your accountant or lawyer before accepting it.

Carrying on a Trade or Business

Your nonprofit organization may operate a trade or business as a substantial part of its activities and still maintain its tax-exempt status, so long as the trade or business is not the primary purpose of your organization *and is in furtherance of the organization's exempt purpose*. Some of the factors considered by the IRS in making this determination include the size and extent of the trade or business and the size and extent of the organization's activities that further one or more exempt purposes. Since this determination is made on the particular facts of each case, and thus the IRS' response to any corporation's particular situation is difficult to predict, careful consideration should be given to any business involvement.

Private Inurement

The directors, officers and employees of your tax-exempt organization may not receive any financial benefits from the organization or its activities beyond the fair market value of the services they furnish the organization. The receipt of such benefits is called private inurement. This requirement serves to ensure that your organization truly serves a public purpose, and is not simply a vehicle for the enrichment of the persons involved. Directors, officers and employees may, however, receive the benefits of services the organization offers to a charitable class of persons, if they belong to the class (e.g. referral of an affordable housing unit to a low income board member). Issues of private inurement frequently arise in the following situations:

Insider Transactions: Transactions between the organization and persons who control or contribute to it. Related individuals must be dealt with at arm's length (in an adversarial and businesslike manner) and the organization's interests must be protected.

Percentage Compensation: If an employee's compensation is based on a percentage of the organization's income, the compensation must be reasonable in light of the nature of the employee's work, and should be the result of arms-length negotiations. IRS rules make directors and certain others potentially liable for payments that violate this requirement.

Compensation of Directors: While all directors may be compensated for their services as directors, no more than 49% of the directors of an organization may be compensated for any other service (for example, as officers or employees of the organization).

Donor's Retention of an Interest: Private inurement may be found if a donor retains an interest in donated property. There are acceptable ways for donors to retain control over how a gift is used, or to keep some form of interest in a gift, but complex rules govern these situations. Your organization should encourage donors to seek advice of their own counsel in such situations.

Transactions between the Corporation and Directors: Self-dealing transactions are those in which (i) your corporation is a party, and (ii) one of more of its directors has an important financial interest. Transaction in which a director has an important financial interest are not prohibited completely, but are permitted only if the corporation is acting in its own best interest and for its own benefit. Additionally, the transaction must be approved by one of the following methods:

Board of Directors: Nonprofit corporations usually choose approval by the board of directors. Approval must be obtained *before* any part of the transaction is consummated. The board's authorization or approval must be in good faith, by a vote of a majority of the board, excluding any interested director, and with knowledge of the material facts concerning the transaction and the interested director's interest in the transaction. Before approving the transaction, the board must investigate and consider alternative arrangements and in good faith determine that the corporation could not obtain a more advantageous arrangement with reasonable effort under the circumstances.

Attorney General: The board can obtain approval from the California Attorney General. The approval of a loan to or a guarantee of an obligation of a director or officer can be approved only by the Attorney General or by a court in an action in which the Attorney General is a party. (Obviously, loans to a director or guarantees of a director's personal obligations may only be made in extraordinary situations. A good rule of thumb is never to make such loans or guarantees.)

Statute of Limitations: The statute of limitations for someone filing an action on behalf of the corporation or the public against a director based on alleged self-dealing will be reduced to two years if written notice of the transaction is given

to the California Attorney General. If no notice is filed, the limitations period is three years after the transaction occurred, or ten years if the suit is brought by the California Attorney General. Under appropriate circumstances, a court may allow a suit to be brought after expiration of the applicable period.

Material Change

A material change in your nonprofit organization's character, purpose, or method of operation may result in the loss of its tax-exempt status. Prior to conducting activities that are different from those set forth in your Federal and California tax-exempt applications, your organization should seriously consider whether or not the activities are consistent with its exempt purposes. You may want to request a determination letter from the IRS.

Lobbying and Advocacy

Nonprofits play a critical role in our society by advocating for the best interests of the public at large as well as for particular causes and groups of people. Nonprofit organizations often unnecessarily limit their involvement in debates about important public policy issues out of fear of losing their tax exempt status. The good news, though, is that:

1. Most policy advocacy is not lobbying. Since there is no limit or restriction on the amount of such non-lobbying advocacy, it does not pose a threat to the organization's tax exemption.
2. Nonprofits actually can do a good deal of lobbying under current IRS limits without endangering their tax exemption.

Under IRS regulations, "lobbying" is defined as:

- a communication
- to legislators (or urging the public to contact legislators)
- intended to influence specific legislation

Tax exempt 501(c)(3) nonprofit organizations are prohibited from lobbying "except to an insubstantial degree." The IRS evaluates an organization's lobbying activities under two rules.

- The general rule looks at the totality of an organization's lobbying activities, whether by paid staff or volunteers, and considers whether those activities are "insubstantial." This test gives the IRS fairly broad discretion; courts have in the past considered expenditures of more than 5% of the organization's budget, time, and effort to be "substantial."
- The other more defined test is the 501(h) expenditure test, named after the bright line rule set forth in Section 501(h) of the Internal Revenue Code. This test sets specific dollar limits on a nonprofit's lobbying activities. The 501(h) test not only sets clear limits, it also only includes lobbying expenditures (money and staff time) toward those limits; the work of volunteers is not counted against the limits, as it would be under the "insubstantial" test. In order to be governed by the 501(h) test, an organization must file a form electing to be evaluated under the rule (IRS Form 5768). The disclosures required under the 501(h) test are essentially the same as that required for the annual informational return (IRS Form 990).

In most cases, an organization will be able to engage in more lobbying activity, with greater confidence that it will not endanger its tax exempt status, if it elects to be governed by the 501(h) test. The 501(h) rule places an overall limit of \$1 million on lobbying expenditures, however, so organizations with very large budgets may be able to do more lobbying under the old “insubstantiality” rule.

Elections

Nonprofits definitely can get involved in election campaigns for or against ballot initiatives or referenda, so long as that is not the organization’s primary purpose. These campaigns are very important policy tools in California and many other states. In these circumstances, trying to influence how people vote on initiatives is simply treated like other forms of lobbying, since the voters act as legislators in approving or rejecting a ballot initiative.

On the other hand, supporting or opposing any candidate for elected office, even in nonpartisan races, is strictly prohibited and can result in loss of your tax exemption.

For a more detailed discussion, go to www.cnmsocal.org/For Nonprofits/FAQLobbying.html. Finally, it is wise to seek advice of a lawyer in planning lobbying or advocacy activities.

Checklist

Board Governance

- ___ Does your nonprofit hold regular board meetings?
- ___ Are all major decisions made by the entire board of directors or by a committee authorized by the full board?
- ___ Do you keep minutes of each board meeting?
- ___ Have you established a corporate bank account?
- ___ Do you keep corporate funds separate from personal funds?
- ___ Do you save all corporate financial records?
- ___ Do you furnish annual reports to the board of directors?
- ___ Has your organization significantly changed or expanded its purposes? If so, have you consulted an attorney to see if you should amend the organization's articles of incorporation to reflect the changes?
- ___ Are no more than 49% of the board of directors "interested persons"?
- ___ Does the board of directors approve all transactions between the organization and a director or officer before the transaction is consummated, or seek advance approval from the Attorney General?

Reports and Returns

- ___ Do you file the appropriate biennial statement with the Secretary of State?
- ___ Do you annually file Form RRF-1 with the Attorney General's Registrar of Charitable Trusts?
- ___ If required, do you annually file income and expense returns with the IRS (Form 990, 990-EZ, Schedule A, Form 990-T, or Form 990-W) and with the California Franchise Tax Board?
- ___ Have you applied for and received a federal EIN, and if applicable, have you registered with the California Employment Development Department?
- ___ If required, do you withhold social security and income tax for paid employees, and pay unemployment and workers' compensation taxes?

Exempt Purposes

- ___ Under the operational test, is a substantial amount of the nonprofit's activities not in support of its exempt purposes?
- ___ Under the operational test, are you certain that no directors or officers of the nonprofit corporation receive compensation or financial benefits from the organization beyond the fair market value or services furnished?

Solicitation

- ___ Have you obtained any business licenses required by the city in which you operate?
- ___ If required, have you registered with the county, city, and state under their statutes and ordinances regulating solicitation?
- ___ Do you have written contracts with all commercial fundraisers or fundraising counsel used by your organization, and are they properly registered with the Attorney General's Registry of Charitable Trusts?