TAKING CARE OF BUSINESS: 501C3 COMPLIANCE

Non Profit Handling of Funds

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I. SHOW ME THE MONEY !

- **Allowable income streams**
- **Record-keeping**
- **Fundraising Pitfalls**
- **Suggested Strategies**

1(a)Allowable income streams

- **Carefully monitored to protect 501C3 tax-exempt status**
- **Traditional income streams**
  - **Individual support and donations**
    - Typically result from outreach (newsletter, social media)
    - Includes cash, pledges, stock in a company, property (real estate and personal), life insurance, etc.
    - Donations are tax deductible by donor
  - **Gifts from major donors**
    - Typically result from formal meeting with prospective donor and members providing "donation pitch"
    - Relationship based; focus on donor's recognition for gift
    - Special fund raising events; house tours, luxury auctions, gala events
  - **Capital Campaigns**
    - Coordinated efforts to raise a large sum of money for a particular goal
      - i.e. Construction of new building
      - Creation of an endowment fund
  - **Legacy Gifts**
    - Wills, trusts, or beneficiary designation

Resources: Fundraising

- **Fundraising and Hosting Special Events:**
- http://www.nolo.com/legal-encyclopedia/nonprofit-fundraising-methods-overview-29619.html
- Tip #1:
  - Create a special "Fundraising Strategy Committee"
  - Have them review the above article and its links – ALL OF THEM.
  - Have them report to the Board on the recommendations, what suggested strategies are feasible for YOUR organization in the next 3 to 5 years
  - Designate a sub-committee to begin planning those events
  - After the events, hold a Board Review to determine:
    - Was it successful and why / why not?
    - Can changes be made to improve it next year?
    - Is there a computerized follow-up system created to stay in touch with interested players?
    - Should the event be tabled and new means explored instead?

Donor Fundraising Tips

- Collect names and create a special database
- Create ways to interact with donors /potential donors
- Get names from Board members, staff, volunteers and add to the Dbase
- Identify high end donors/ look for a “hook” to pique interest
- Is your web page designed to attract donors?
- Use Social Media

Donor Fundraising Tips

- Plan special donor-only trips or events
  - Auctions
  - Farm / wine tours
  - Equi-Tours for Donors Only
- Promote "legacy gifts" or planned giving
- BE SURE THEY ARE RECOGNIZED!

1(b) Recordkeeping

- **Don't Dink Around – Read the Holy Grail**
- **IRS "Compliance Guide for 501C3 Public Charities"**
  - Activities jeopardizing tax-exempt status
  - Required federal information returns, tax returns or notices
  - Required recordkeeping
  - Changes to be reported and when, and
  - Resources for 501C3 organizations
  - https://www.irs.gov/pub/irs-pdf/p4221pc.pdf

1(b) Basic Elements of Recordkeeping

- **Various Annual Federal Income Tax Reports**
- **Responsible Board Members**
  - **Executive Director / President / Treasurer / Secretary / Accountant**
- **Business Reports Should Include:**
  - Charitable program evaluations
  - Budgetary results
  - Financial Statements (P&L, Balance Sheet)
  - Annual Information and Tax Returns
  - Income Source and Receipt Information
  - Substantiated Expenses
  - Deductions for Unrelated Business Income Tax (UBIT) Purposes
  - Grant Making Procedures
  - Compliance with Federal Non-Discrimination Policies
  - Accounting Period Means and Methods Reports
  - Supporting Documents

1(c) Fundraising Pitfalls

- **UBIT – You Bet!**
- **Unrelated Business Income Tax**
- **General Rules:**

1. 501C3's CAN engage in income-generating activities
2. BUT – carefully and transparently and with limits
3. For profit, "Earned Income Activities" trigger certain rules in IRC
4. Improper treatment results in severe IRS penalties and/or revocation of tax-exempt status.

1(c) Fund Sources

- **2013 NCCS Report:**
  - In 2013, public charities reported over **$1.74 trillion in total revenues** and **$1.63 trillion in total expenses**.
  - 21% came from contributions, gifts and government grants.
  - 72% came from program service revenues, which include government fees and contracts.
  - 7% came from "other" sources including dues, rental income, special event income, and gains or losses from goods sold.
  - Exhibit 1 Natl Center Charitable Stat 2013

1(c) UBIT Guidelines

- **What is "Unrelated Business Income**?"
- The general rule is that income is treated as unrelated if it is:
  - **A trade or business;**
  - **Regularly carried on; and**
  - **<u>Not substantially related to the organization's exempt purpose.</u>**
    - Based on IRS "facts & circumstance review"
    - Does it "contribute importantly to accomplishing the organization's exempt purpose" <u>other than</u> through the production of funds
    - "**Nature" vs "Source of Revenue" review**
    - *Treas. Reg. 1.513-1(d)(2).*

1(c) UBIT Exclusions

- **Unrelated Business Income specifically excludes (i.e. this remains non-taxable):**
  - Activities run by a volunteer workforce;
  - Activities carried on for the convenience of its members, students, patients, officers, or employees; or
  - The selling of donated merchandise.

  Treas. Reg. 1.513-1(e)(1), (2), (3).

Don’t Go Too Crazy Though:

- **IRS “Fragmentation Rule”**
- If an activity is “conducted on a larger scale than is reasonably necessary to perform an exempt purpose,” the part that is more than needed is treated as unrelated and subject to UBIT.
- Example: Museum
  - Restaurant: Serves employees (Not UBI)
  - Serves public (UBI)
  - Gift Shop: Sells materials relevant to display and thus
  - “educational” & “relevant to core” (Not UBI)
  - Sells other items (UBI)
- *Treas. Reg. 1.513-1(d)(3).*

Example

- Example: Museum
  - Restaurant:
    - Serves employees (Not UBI) (Not taxable)
    - Serves public (UBI) (Taxable)
  - Gift Shop:
    - Sells materials relevant to museum display and thus "educational" & "relevant to core" (Not UBI) (Not taxable)
    - Sells other items and merchandise (UBI) (Taxable)

1(c) UBIT Rule of Thumb

- **Its ok to generate Unrelated Business Income**
- **But must be clearly segregated**
- **UBI can't be the tail wagging the dog**
- **No stated pro-rata percents**
  - **UBI should definitely be under 50%, but regulations don't clearly state how much**
  - **Organizations typically run between 20% to 40% UBI**
  - **Seek accounting or legal review to determine acceptable levels**

Consider the "Good Will" "Related Activities" Example

- Goodwill Industries of San Francisco and San Mateo reported on its 2009 Form 990 that approximately $27M of its $34M revenue (roughly 80%) was from program services, and of its program service revenue, about 99.8% came from merchandise sales at its stores.
- Aside from selling donated merchandise (an exception to UBIT), the operation of the Goodwill stores also serves as training centers for the program participants. Thus, Goodwill Industries is able to rely heavily on earned income because there is a substantial causal relationship between the store operation and the mission of Goodwill Industries, as described on the Goodwill Industries International's website, to enhance "the dignity and quality of life of individuals, families and communities by eliminating barriers to opportunity and helping people in need reach their fullest potential through the power of work."
- **NOTE: The importance of clearly defining your organization's mission and purpose.**

1(d) Suggested Strategies

- **Identify Unrelated Business Income lines and how to appropriately report**
  - Although taxable, you still are generating income to the benefit of the organization
  - Review with your Board, Lawyer and Accountant
- **Work with the business associations to:**
  - Identify revenue producing educational programs and services,
  - Causally related to education and increased growth of the equine industry
  - To support:
    - Job creation
    - New Industries
    - Research and Development
    - Tax Generation (i.e. $12 billion / annually from sales of $112 billion annually)

II. Save Me Some Money!

- Director and Officer Liability
- D & O Insurance
- Commercial General Liability Insurance
- Special Coverages
- Volunteer Protection Acts & Insurance Impact

2(a) Elements of D & O Liability

- Director and Officer Liability Arises From:
  - Sloppy corporate governance
  - Sloppy adherence to corporation or business law
  - Lack of knowledge of fiduciary obligations owned to shareholders, board or organization members, or other beneficiaries

2(d) D & O Liability

- **Stay Tuned for Afternoon presentation**
  - How to avoid Sloppy Governance
  - How to avoid Non-compliance with applicable laws and regulations

2(b) D & O Insurance

- **What is D & O Insurance Coverage?**
- It is "liability insurance"
- Payable to the directors and officers of an organization, or to the organization itself
- To indemnify (or reimburse)
- For losses or cost of defense related to
- A legal action brought for the alleged wrongful acts in their capacity as Directors and Officers
- Typically a rider available in private insurance contracts
- **Should be considered a mandatory coverage provided automatically by ALL 501C3 and C6 boards**
- **Should be kept current and details of policy, and available list of Riders and Exclusions, reviewed annually with carrier**

2(c) CGL Coverage

- **Commercial General Liability Coverage**
  - Covers negligence and professional negligence exposures related to activities of organization and/or its special events
  - Should be in an amount sufficient to cover double the maximum potential damage exposure anticipated per year or per event
  - Policy covers cost of defense PLUS damages to the extent of the policy limits
  - Again, review policy terms, riders and exclusions ANNUALLY with your carrier to keep it current.

2(d) Special Coverages

- Special Event Coverage
  - Similar to Umbrella CGL, but "activity specific"
- Equine Specific Coverages
  - Fire & casualty (damage to buildings)
  - Care, Custody and Control (Damage to Livestock)
  - Transportation (applicable to any hauling for legal consideration, INCLUDING splitting gas)
  - Vehicle
  - Personal articles
  - Review annually with carrier to discuss policy terms, riders and exclusions to keep current

2(e) VAP Statutes & Impact

- Volunteer Protection Act Statutes
  - Exist both at Federal and State Levels
  - Enacted to encourage volunteers to participate without fear of litigation
  - Your organization should provide a handout to volunteers explaining this liability protection

Elements of VAP Protection

- Protects volunteers
- Of 501C3 and Governmental Agencies
- From being sued in tort (ie personal injury, negligence actions)
- For actions arising out of their volunteer activities
  - (i.e. A "volunteer" cannot receive compensation/items of value exceeding $500)
- Immunity does not extend to:
  - Improperly licensed volunteers if license required
  - Volunteer's willfull, wanton misconduct
  - Operating a motor vehicle, vessel, aircraft or other vehicle requiring a license.

III. Make Me Some Money

- Events
- Grants
- Endowments
- Life Insurance Beneficiary Policies
- Donor Solicitations
- Purpose related educational merchandising
- **See Part I**
- **Get that special committee formed**

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