



Tax-exempt Organization Issues, Directors & Officers Liability Insurance and Board Governance

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Measurable Results.

Agenda

- Tax-exempt organization issues
- Directors and officers liability insurance
- Board governance

Tax-exempt organization issues

501(c)(5) organizations

- Agricultural organizations exempt under IRC Section 501(c)(5) are those that have as their principal purpose:

The betterment of the conditions of those engaged in agriculture.

The improvement of their products.

The improvement of their occupational efficiency.

501(c)(6) organizations

- IRC Section 501(c)(6) of the Internal Revenue Code - provides for the exemption of business leagues, chambers of commerce, etc., which are not organized for profit.
- Business league:
 - association of persons having some common business interest
 - the purpose of the league is to promote that interest
 - The league does not engage in a business carried on for profit.

Creating a Tax-Exempt Organization

- The first stage in the life cycle of any tax-exempt organization is its creation.
- Can be created as a corporation, a trust, or an unincorporated association.
- Must apply for and received an Employer Identification Number (EIN).
- Organizations must file an application with the IRS for recognition of tax-exempt status (Form 1023 or Form 1024) .

Organizing Documents

- Each application for tax-exempt status must be accompanied by an exact copy of the organization's organizing document:
 - articles of incorporation for a corporation.
 - articles of organization for a limited liability company.
 - articles of association or constitution for an association.

Bylaws

- Bylaws are an organization's internal operating rules.
- Required under federal tax law but specific language is not required.
- Wisconsin state law requires that nonprofit organizations have bylaws.

Annual Tax-Exempt Organization Information Returns

- Tax-exempt organizations are required to file annual information returns.
- Penalties for no filing or late filing penalties may be assessed:
 - (\$10,000 first offense; \$50,000 second offense)
- If an organization does not file as required for three consecutive years -- automatically loses its tax-exempt status.

Annual Return Due Dates for Tax-Exempt Organizations

Form 990/990EZ/990-N is due 4 ½ months after the organization's year-end:

- December: due May 15
- June: due November 15
- If a due date falls on a Saturday, Sunday, or legal holiday, the due date is delayed until the next business day.

Form 990 Series - Which Form to File (filing phase-in)

2009 tax year (Filed in 2010 or 2011):

- Gross receipts normally \leq \$25,000:
Form 990-N or 990EZ.
- Gross receipts $<$ \$500,000 **and** total assets $<$ \$1,250,000:
Form 990EZ or 990.
- Gross receipts \geq \$500,000 **or** total assets \geq \$1,250,000:
Form 990.

Form 990 Series - Which Form to File (filing phase-in)

2010 tax year and later (Filed in 2011 and later):

- Gross receipts normally \leq \$50,000:
Form 990-N or 990EZ.
- Gross receipts $<$ \$200,000 and total assets $<$ \$500,000:
Form 990EZ or 990.
- Gross receipts \geq \$200,000 or total assets \geq \$500,000:
Form 990.

Jeopardizing Tax-Exempt Status

Tax-exempt status of a 501(c)(5) organization can be jeopardized when the organization ceases to:

- improve the conditions of persons engaged in agriculture or horticulture.
- improve the product it offers.
- become increasingly proficient at what it does.

Jeopardizing Tax-Exempt Status

Examples of Non-Qualifying Activities – Agricultural/Horticultural Organizations

- Horse racing not conducted as part of an agricultural fair.
- An organization formed by processors, packers and distributors of agricultural products to promote the sale and use of a processed agricultural product (such an organization may, however, qualify for exemption as a business league under Code section 501(c)(6)).
- Supplying laborers to farmers.

Political and Lobbying Activities

501(c)(5) or 501(c)(6) organizations can engage in some political activity.

May engage in lobbying that is germane to accomplishing the exempt purpose of the organization.

An organization (other than a labor organization) that engages in these activities may need to give members notice that dues were used for such activities, or be subject to a proxy tax on the amount of the expenditures.

Political and Lobbying Activities

Nondeductible lobbying and political expenditures are those that:

- Influence legislation.
- Help to participate or intervene in any political campaign on behalf of (or in opposition to) any candidate for public office.
- Attempt to influence the general public with respect to elections, legislative matters, or referendums.
- Any direct communication with a covered executive branch official in an attempt to influence the person's official actions or positions.

Tax Treatment of Donations to IRC Section 501(c)(5) organizations

- Contributions to labor, agricultural, and horticultural organizations generally are not deductible as charitable contributions for federal income tax purposes.
- Contributions may be deductible as trade or business expenses, if they are ordinary and necessary in the conduct of the taxpayer's trade or business.
- The organization may be required to disclose that contributions are not deductible when solicited.

Public Disclosure Requirements

- Federal tax law applies the following disclosure requirements to tax-exempt organizations:
 - Exemption applications and determination letters – must allow for public inspection.
 - Annual returns (e.g., Forms 990) - must allow for public inspection.
 - Member dues payments allocable to lobbying and political campaign activities may not be deducted as business expenses by the members.
 - May be required to provide solicitation notices indicating that contributions are not tax-deductible as charitable contributions.

Reporting Changes to the IRS

- A tax-exempt organization must report name, address and structural and operational changes to the IRS.
- If the organization files an annual return, it must report the changes on its return.
- If not required to file annually, report changes to the Exempt Organization Determinations Office.

Termination of a Tax-Exempt Organization

- Most tax-exempt organizations that end their operations, either through shutting down, transferring their assets or merging with another tax-exempt organization, must inform the IRS about the details of the action.
- Inform the IRS by filing Form 990-N, Form 990-EZ or Form 990.
- Schedule N of Form 990/990EZ is required - notifies the IRS that organization assets were disposed of/transferred.

State Sales Tax Exemption

The state of Wisconsin does not allow 501(c)(5) and 501(c)(6) organizations to apply for state sales tax exemption.

Directors & Officers Liability Insurance

What is Directors & Officers Liability Insurance?

- Provides financial protection for the directors and officers of the organization in the event they are sued in conjunction with the performance of their duties as they relate to the organization.
- Usually includes Employment Practices Liability and sometimes Fiduciary Liability. The former involves harassment and discrimination suits; the majority area of exposure.

What is Directors & Officers Liability Insurance?

- Directors & Officers (D&O) liability insurance is often confused with Errors & Omissions (E&O) liability insurance.
- E&O liability insurance is concerned with performance failures and negligence with respect to the organization's products and services; not the performance and duties of management and the board.
- Generally it is a good idea to carry both D&O liability insurance and E&O liability insurance.

When do I need Directors & Officers Liability Insurance?

- When you assemble a board of directors.
- When you have employees -- opens management up to employment practices lawsuits which usually can be covered under D&O liability insurance.

Why do I need Directors & Officers Liability Insurance?

- Claims from third parties can be made against the organization **AND** against the organization's board members.
- Members of your board of directors will not be willing to risk their personal assets to serve as a corporate director or officer, no matter how heartfelt their belief is in the organization.
- Lastly, employment practices suits constitute the single largest area of claim activity under D&O liability insurance policies. Over 50% of D&O claims are employment practices related.

Examples of Claims under Directors & Officers Liability Insurance

- Employment-related issues such as discrimination, harassment, and wrongful termination.
- Failure to provide services.
- Mismanagement of assets.
- D&O liability insurance does not pay for bodily injury or property damage.

Board Governance

Board Governance

Understanding a board member's responsibilities:

- Duties stem from the following:
 - the mission or purpose of the organization
 - the bylaws of the organization
 - the laws of the state in which the organization is located.

Board Governance

Understanding a board member's responsibilities:

- Determining the organization's mission and purpose
- Overseeing organizational planning
- Selecting the executive director, if applicable
- Enhancing the public image of the organization
- Documentation of board actions

Board Governance

Common-law duties:

Duty of care

- Show up for meetings

- Exercise independent judgment

- Read financial and other reports

- Adopt internal control procedures

- Document board actions in the minutes

Board Governance

Duty of loyalty

- Act in the best interest of the organization

- Avoid conflicts of interest

- Keep matters confidential

- Disclose illegal activities

Other duties

- Authorize major projects

- Manage the media

Board Governance

Your rights as a director:

- Protection under the business judgment rule:
 - act in good faith
 - act in the best interests of the corporation
 - act on an informed basis
 - to not be wasteful
 - not involve self-interest
- Access to corporate books and records
- Access to the minutes
- Right to communication with management
- Right to vote a dissenting opinion

Board Governance

- Conflict of interest policies

A conflict of interest policy should (a) require those with a conflict (or who think they may have a conflict) to disclose the conflict/potential conflict, and (b) prohibit interested board members from voting on any matter that gives rise to a conflict between their personal interests and the nonprofit's interests.

- Whistle-blower policies

Formal procedures for handling complaints about financial misdeeds within the organization. Prohibits retaliation.

- Document retention and destruction policies

Written, mandatory document-retention and periodic destruction policies including guidelines for voice and e-mail as well as paper documents.

Board Governance

Some documents and business records should be maintained permanently:

- Articles of Incorporation , Bylaws, Form 1024, etc.
- IRS Determination Letter
- Insurance policies
- Minutes of board and committee meetings
- Corporate resolutions

Board Governance

- Find financial experts to serve as board members
- Avoid conflicts of interest
- Adopt a code of ethics

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Questions??

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