Types of Nonprofit Organizations

- Non-Profit Corps: Corps and Trusts are the 2 forms of business orgs that work for non-profits
- Acceptable purposes under Mo Stat 355: charitable, benevolent, eleemosynary, educational, civic, patriotic, political, religious, cultural, social welfare, health, cemetery, social, literary, athletic, scientific, research, agricultural, trade associations.
- Issues for nonprofit organization forms
  - Cannot be charitable to one person b/c it takes away ability to provide public benefit
  - Cannot include vague terms that will allow the org to specifically benefit people of its choice
  - Must have rational foundation, but who makes decision about whether it is rational foundation
- Types of 501(c)(3) organizations: religious charitable, scientific, testing for public safety, literary, or educational purposes, to foster amateur sports competition, or prevent cruelty to animals or kids

Creation of a Nonprofit Organization

- Name: Sec. of State Website says if the name is taken already
- Public Benefit v. Mutual Benefit:
  - Public benefit: 501(c)(3) tax exempt organizations, organizations formed primarily or exclusively for religious purposes, organizations formed for public or charitable purpose that don’t fall into above categories, but must distribute assets to a 501(c)(3) corp or a state (charitable but political)
    - Public, through the AG, can intervene in the affairs, initial proceedings to compel meetings of the board, initiate proceedings to remove the director or compel dissolution
  - Mutual benefit: All nonprofit orgs that do not fall into one of the categories listed above
    - Member may transfer rights to another person or back to corp (unlike public benefit), greater voting rights w/ respect to amending articles, can receive cash, property or securities on merger w/ another corp, may distribute assets to members on dissolution
- Members or no members
  - Members have the right to vote for the election of directors, rights to sue, notice of meetings, inspection of records and financial statements
  - Reasons for members: community org needs participation and commitment, democratic concept
  - Reasons for no members: governing board self-perpetuating, easier to gain members than lose
- Articles of Incorporation - Filing of Articles begins the corporate existence
  - Articles include: name, whether it is private or mutual benefit, whether it will have members, period of existence (perpetual), name and address of individual who can receive official documents or service of process, lists of purposes to get it under 501(c)(3) [charitable and any other that fit], provision for distribution on dissolution (to 501(c)(3)), renounce private enurement
- Bylaws: Provisions for regulating and managing the affairs of the corp; must be consistent with articles
  - Number of board members:
    - Huge boards can be bad, advisory board is an option instead
    - Ruger recommends 9 to have odd number, 3 year rotation (9-mid teens)
  - Provision for selecting Board, quorum
    - Needs to be outside of director to avoid appointing family (alter ego), while founder wants to control organization, this will be accomplished with board, family not needed
  - Term Limits: Need graceful way for individuals to leave board positions
  - Compensation of directors is usually a bad idea scares away funders and blows immunity
  - Conflict of Interest Provision
  - Provision for dissolution
  - Provision for amending government instruments
- Payment of employees OK if arm’s length transaction and in line with compensation of other nonprofits

Tax Exempt Status of Nonprofits – to qualify for tax exempt status under 501(c)(3) an organization must meet the both the organizational and operational tests

- Organizational Test
  - Must be a not for profit corporation or trust
  - Corporate documents must
    - Show exempt and charitable purpose
      - General Charitable purpose: relief of poverty, lessen burden of govt., community beautification and maintenance, economic development, public interest law firms
      - Literary and Arts Activity
Health Promotion and Care – very broad
  - Public benefit demonstrated if ER open to all persons
  - Must provide public benefit that would not be provided if not for subsidy – noble articulation, but like ed. very hard to apply

Education – no formal curriculum required, must have connection to learning
  - Big Mama Rag – denied tax exempt status b/c not fully and fairly educating, but reversed b/c full and fair standard UC
  - Rev. Proc. 86-43: criteria used to determine whether advocacy is educ’l are the methods used to develop and present views
    - Not educational if it fails to provide factual foundation for views or fails to provide development from facts to aid learner
    - Factors show it is not educational
      - Presentation of views not supported by facts
      - Facts distorted
      - Use of inflammatory or disparaging terms and conclusions based on strong emotions
      - Doesn’t consider background or training of the readership in the matter
  - Cannot grant status to hate groups

Science and Research

Religion – difficulty separating religion from racist at times

Others: public safety testing, prevention of cruelty, amateur sports orgs, etc.
  - Show public benefit and disposition of assets to another exempt organization
  - Renounce private inurement and partisan political or substantial legislative activity
  - No racial discrimination – Bob Jones University can’t have racial discriminatory standard
  - Need line and IRS restrained from judging what actions qualify under 501(c)(3)

Operational Test
  - Must operate in accordance with organizational structure and in compliance with IRC
  - Issues threatening tax exempt status
    - Private inurement: Precludes Excess Compensation and Diversion of Assets
    - Excessive commercial activity:
      - Main cases religious publishers: consider whether $ losing publications are dropped, how books priced, and activities that are like for profits
        - Employ volunteers, publish non commercial books, modest prices
        - Can make $ so long as money is w/in mission or goes toward fulfilling mission
        - Can break off money making part of the corporation
    - Partisan Political Activity- absolute prohibition on endorsement of political candidates
      - Cannot intervene in political campaign no matter what level the election
      - Cannot get involved if political campaign, with respect to individual who is candidate, for public office
    - Substantial Legislative Activity
      - Legislative activity includes influencing action by state or fed legislature
        - Doesn’t include making research results available, discussion of broad social or economic problems, providing tech advice to a govt. body or committee in response to written request, self-defense lobbying, and communications w/ members about legislation not encouraging lobbying (can say please be aware of bill, can’t say call rep)
      - The organization’s activities must be balanced in relation to its objectives and circumstances in the context of the totality of the organization.
        - 5% of time an efforts is not substantial
        - Factors in Haswell such as hiring lobbyist, making trips to Congress, arranging to testify before Congress, holding cocktail parties for Congress and staff, materials did not let public reach independent conclusions, and presenting position in most forceful way - substantial
    - 501(h) election – creates safe harbor of lobbying activities w/o penalty
      - Generous amounts: 20% of first 500K, 15% of next 500K
      - Grants a clearer more definite rule for what is allowed
Problems with links to political organizations on websites
- Rules set with nonbiased standards, but historically applied with political taint
  - Revocation/Intermediate Sanctions – over concern that only way to deal with abuse is to take away tax-exempt status, Congress adopted intermediate sanctions
    - 25% penalty on the excess benefit on the recipient of benefit if beneficiary has control
    - 200% penalty if not corrected

Responsibilities of Directors and Officers – responsible for directing and managing the affairs of the corp

- **Six Principal Functions of the Board of Directors**
  - To select, encourage, advise, evaluate, and if need be replace CEO
    - CEO compensation should be determined by the whole board
  - To review and adopt long-term strategic directions and to approve specific objectives, financial and other, such as reviewing the basic mission of the org in light of changed circumstances
    - Full review of policies and strategies of board and corp at least every 5 years
  - To assure to the extent possible that the necessary resources, including human resources, will be available to pursue the strategies and achieve the organization’s objectives
  - To monitor performance and management
  - To ensure that the organization operates responsibly and efficiently
  - To nominate suitable candidates for election to the board, and to establish and carry out an effective system of governance at the board level, including evaluation of board performance
    - Evaluation of the board is rarely done, but important
    - Selecting new board members should be a more formal process

- Legal Standards – **responsibility to act in good faith, as a prudent person, and in best interest of entity**
  - Movement from a trustee model to a business model in *Stern v. Sibley Hospital*
    - Business Judgment Rule Applied, but more stringently due to the recent corporate events
    - Movement followed the *Lynch* (not invested $) case which intimated such standard
  - Duty of Care – must be well informed, independent, and reasonable in board decision making
    - Regular Attendance at Board Meetings
    - Exercising Independent Judgment (can’t be excessively deferential)
    - Relevant info must be timely, adequate, and clear
    - Reasonable reliance on credible individuals is OK
    - Must carefully look at financial statements
    - Adopt appropriate monitoring and control provisions
    - Avoid rubber stamping recommendations of management
    - Insure adequate discussion of significant matters
    - Avoid engaging in non-profits day to day operations
  - Duty of Loyalty – A board member shall act in the interest of the corporation, and not in their own interest or that of another person or entity
    - Avoid conflicts of interest, self dealing, and private inurement
    - *Nixon* – family took over trust, director put phone in every room, breach of loyalty
    - Avoid using the position for personal or financial gain
    - Have an effective conflict of interest policy that requires advance disclosure of interests and recusal from deliberations on the transaction by the interested director
    - Maintain confidentiality of the non-profit’s info until appropriate for public disclosure
  - Conflict of Interest – must be aware of substance of conflict and its appearance on the community
    - Many organizations prohibit transactions between board members and org even though disclosure and approval by other members is fair and legally sufficient
      - At least interested party should recuse herself from the meeting – possibly resign
    - Additional scrutiny signaled by addition of questions about conflict of interest when applying for 501(c)(3) status
    - Potential problems w/ lack of conflict of interest statement
      - Erosion of public confidence, Focus of scrutiny for IRS and outside orgs
      - Policy is to protect the everyone’s integrity
    - Fundamental Question: How does transaction further goals of the organization
      - All options considered? Aware of all risks? Conflicts completely disclosed?
  - Important to have disclosure, independence, appropriate monitoring, full discussion
    - Make sure that minutes reflect disagreement w/ conflicted transaction

- Characteristics of An Effective Board
- Collective and individual understanding and willingness to fulfill board duties and responsibilities
- Diversity in membership and opinions (lawyer, accountant, etc. - but don’t mix job for the firm and job as board member b/c independence is necessary and two different roles of thinking)
- Communication strategic and focused, substantive issues get fully discussed
- Board reflects on how it does its work - regular introspection
- Willingness to change (very difficult b/c we are tied to our ways)

- Potential problems with boards
  - Senate Finance Committee Investigating American U, Red Cross, U of Med and Dent of NJ
    - Ask for minutes, communications, board structure, board compensation
  - Even number of members, lack of term limits, incestuous selection of new board

Tort and Employment Issues in NonProfit Organizations
- Considerations of Risk for an employer
  - Settlement of liability may not be acceptable especially if issues go against core values
  - Common torts: Intentional of emotional distress and defamation – generally unsuccessful
- Protection from risk
  - D&O liability insurance v. general liability insurance
    - Statutory protections for uncompensated directors under Volunteer Protection Act
      - MO immunizes from civil liability for negligent activity in official capacity
    - Indemnification insurance not a huge issue for non-profits, D&O insurance not needed b/c suits rare against nonprofits and immunity provisions protect directors if negligent
  - Good background checks are necessary especially when dealing with vulnerable populations
    - Commercial firms and google search
  - Clear articulation of standards and rules required
  - Evaluate the workplace, etc. to develop the kind of protections necessary for org
  - Prompt investigation, channels for complaint, and monitoring of action
- Employment discrimination
  - Most common categories: Racial/ethnic minorities, sex discrimination, disability, against >40yrs
  - Need policy which allows employees to bring discrimination concerns to the attention of board
  - Internal policies to discourage even small misconduct is good policy, high standard of liability
  - Nonprofit problem of calling individuals independent contractors, but treating them as employees
    - Independent contractors should have own equipment, no office, set own hours and methods; Employer pays no SS or employee taxes; hire incorporated ind. Contractors
    - Control is major concern: behavioral and financial; consider type of relationship

Religious Organizations
- Basic Legal Concepts: Constitution and courts require govt. to assume a position of neutrality to religion
  - Lemon v. Kurtzman test for establishment clause compliance. Govt. law or action must
    - Serve a clearly secular govt. purpose
    - Have a primary effect which neither advances or inhibits religion
    - Avoids excessive government entanglement with religion
  - 1st Amendment requirements
    - Does not insulate religious organizations from wrongdoing
      - Moses v. Diocese of CO – parishioner w/ emotional issues affair w/ priest who takes advantage of her
    - Does not protect against revocation of 501(c)(3) status when IRC standards violated
    - Limits govt’l scrutiny of employment decisions made by religious organizations
      - Ministerial exception
        - Amos – janitor not under ministerial exception
        - Tomic – church musician under ministerial exception
    - Requires courts to resolve intra-chuch conflicts by applying neutral principles of law
      - Court invalidates law against animal sacrifice when Lukumi Babalu Aye church was coming to FL b/c not neutral in application