



Your Ultimate Guide for Nonprofits, An Update: Nonprofit Law, Leadership, and Financial Management

Prepared and Presented by:

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Intro to Nonprofit Law

Warren Law Group

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Meet The Discussion Speaker



Todd Kulkin is a Partner at the Warren Law Group: a boutique law firm in New York City.

In 10+ years of practice, Todd has represented over 200 not-for-profit organizations in the United States & Non-Governmental Organizations across the globe.

Named by *Reuters Superlawyers* as a Business Law “Rising Star” for the New York Metro Area from 2014 to the Present.

Proud Father of Jonah R. Kulkin (9 months)



Terms of Engagement

- We’re here for 4 hours: we might as well enjoy it.
- Please ask questions in the chat!
- Participation is key - Audience Discussion Questions
- 5 Modules
 - Module 1 – Introduction to Nonprofit Law (30 Minutes)
 - Module 2 – The Nonprofit Board (1 Hour)
 - Module 3 – The Nonprofit Deal Making (1 Hour)
 - Module 4 – Nonprofits & Handling Money (30 Minutes)
 - Module 5 - Fraud Protection & Security for Nonprofits (1 hour)
- ***Presented by Tompkins VIST Bank***
- Continue the Conversation afterwards





Introduction to Non-Profit Law & Management

Module 1



Basics: What is a Nonprofit Organization?

- Definition of Nonprofit: A corporate entity, which is organized for a purpose other than the generation of profits to be distributed to equity holders.
- Nonprofit Organizations, or NPOs, are “non-stock” entities: they have no equity and no ownership. One can only control the entity.
 - This does not preclude an NPO from owning equity in another entity.
- Most NPOs are not automatically tax exempt on the federal or state level - they must apply for that status.
- Some NPOs can be “Accredited Investors” or “Qualified Institutional Buyers.”





Philosophy of Nonprofit Law & Management

- NPOs are corporate entities too, they just don't have equity units. Therefore, they should be treated by attorneys exactly like they treat their for-profit clients (with some additional considerations).
- Tax exemption and donation deductions take money from Uncle Sam's pocket in furtherance of a nonprofit purpose for the public good.
- NPO attorneys don't have to personally agree with the Nonprofit's purpose, but they still need to use their best judgment!
- Some additional considerations:
 - Tax-exempt status must be managed concurrently on the Federal and State levels.
 - Nonprofit clients need to be disabused of the idea that nonprofit activities don't come with risk.
 - The "exempt purpose" of an NPO is a fiduciary duty, to which officers and directors are held.



Types of NPOs

- IRC § 501(c) names twenty-nine (29) distinct types of tax-exempt organizations.
- Here are the most common in our practice:
 - 501c3 – Charitable Orgs
 - 501c4 – Social Welfare Orgs
 - 501c5 – Labor Orgs
 - 501c6 – Business Leagues/Chambers of Commerce
 - 501c7 – Recreational Clubs
 - 501c10 – Fraternal societies using the Lodge System





Form a U.S. Nonprofit in 5 Steps

- Step 1: File Articles of Incorporation with the applicable state's secretary of state's office and apply for a Federal Employer Identification Number (FEIN) and a state tax ID number (if applicable).
- Step 2: Have the Initial Board Meeting for the NPO – Elect initial Board of Directors, adopt By-laws, and adopt a Conflict-of-Interest policy (if applicable).
- Step 3: Apply for Federal Tax-Exempt Status.
 - Form 1023
 - Form 1023-EZ
 - Form 1024
- Step 4: Once you receive Federal Tax-Exempt Status, apply for State/Municipal tax-exempt status.
- Step 5: Register the nonprofit with the State Attorney General's Office (if applicable).



501c3 At a Glance

- 501(c)3 organizations are public charities and private foundations and are prohibited from doing substantial political work outside basic issue advocacy and encouragement of the political process generally.
- Most political organizations do not go the 501c3 route despite deductibility of donations.
- 501(c)3 Organizations must be created for a “charitable, religious educational, and scientific purposes.”
- The organization must not be organized or operated for the benefit of private interests,
- No part of a section 501(c)3 organization's net earnings may inure to the benefit of any private shareholder or individual (*i.e.*, Private Inurement).
- Section 501(c)3 organizations are restricted in how much political and legislative (*lobbying*) activities they may conduct.





501c3 Political Prohibitions

- Influencing Elections or Legislation is banned
- “Substantial activities” test
- “Expenditure” test - Only available to Religious Organizations
- What are “Political Activities”
 - endorsements of a candidate; publication or distribution of statements in favor of or in opposition to a candidate; direct financial contributions or other support to a candidate, political party, or PAC (other than a ballot measure committee); in-kind contributions to a candidate, political party, or PAC (other than a ballot measure PAC) including, but not limited to: mailing, membership, or donor lists or other resources for fundraising; provision of facilities or office space; staff time; polling results; organizing volunteers for the campaign; opposition research; comparative ratings of candidates; publicizing names of political candidates who support or oppose the organization’s position on public issues; membership communications expressly advocating the election or defeat of a candidate; payment of the administrative and fundraising costs of a political organization.



Non-Profit Governance

Module 2





Intro to the NPO Board

- An NPOs Board of Directors is the governing body.
 - Individuals who sit on the board are responsible for overseeing the organization's activities.
 - Some states refer to them as "Trustees."
 - Corporate entities can sometimes be board members (but be careful).
 - Board members meet periodically to discuss and vote on the affairs of the organization.
 - Board members are not set up to be permanent positions; most organizations have terms set up for board members.
 - Board members must be 18+ and "legally competent."



Nonprofit Board Concepts

- Fiduciary Duties
 - Loyalty
 - Care
 - Tax Exempt Purpose [Cert of Inc.]
- Directors/Officers
- Member vs. Non-Member NPOs
- Conflict of Interest Policy
- Bylaws
- Volunteer Liability





Further Nonprofit Board Concepts

- Advisory Board
- Attorney General Registration
- Uniform Registration Statement (URS)
- Member vs. Non-Member NPOs



Liability Insurance for NPOs

- General Liability
- Auto Liability (commercial)
- Errors & Omissions
- Employment Practices Liability
- Cyber Liability
- Event Liability
- I.P. Liability
- Products liability





Compliance Essentials

- Keep immaculate financial records.
- Cap expenditures that actively encourage one political candidate over another based on your corporate structure.
- File your 990 each and every year
- Remember to do your state and federal lobbying disclosures (Lobbying Disclosure Act).
- Follow the Conflict-of-Interest Policy.
- Make sure that your exempt purpose is in line with your political activities.
- Do due diligence when providing funds to someone else that may involve political activities.
- Don't forget State Compliance!



Tax Exempt Dealmaking

Module 3





NPO Deal Making

- Anything (almost) a for-profit entity can do, an NPO can do.
- Certain transactions are only available to NPOs (*e.g.*, bargain sales).
- Some NPOs can be “Accredited Investors” or “Qualified Institutional Buyers.”
- NPOs can do Securities Offerings (yes, really).
- NPOs can own other corporate entities and accumulate assets.
- NPOs can own, license, and profit from Intellectual Property.



Tools of the Trade: Friends of Organizations

- NGOs cannot simply “waive in” to tax exempt status in the United States.
- Friends-of Organizations (“FoOs”) are separately incorporated NPOs that exist as a fundraising conduit for a specific NGO (or group thereof) outside the United States.
- FoOs must have a separation of management between themselves and the NGO to which their funds are distributed.
- In its 501(c)(3) application, a FoO must provide details as to the NGO which will receive their funds, that NGO’s management, and the forms of control they will have on the use of tax-exempt funds.
- A FoO is ultimately responsible for how its NGO handles the donated funds. Thus, a strong grant agreement with financial oversight and claw back provisions is essential.
- If a FoO is handling large amounts of money, they may want to have signatory access to the NGO’s operations account, as additional security.
- Friends-of African organizations generally undergo heightened scrutiny with the IRS.





Tools of the Trade: Professional Fundraisers

- Professional Fundraisers (“PFs”) can be a useful tool for larger Non-Profits to obtain sponsors for events, and to obtain other forms of donations.
- Professional Fundraisers and Professional Grant Writers may overlap in skill-sets, but they are NOT the same thing.
- PFs must be registered with the Charities Bureau of the states in which they work.
- Each Charities’ Bureau has different standards for PF services contracts in their state.
- If your client is using a PF’s services, their contract must be registered with the local CB.
- PFs generally work on contingency, taking a percentage of the gross revenue attributable to their services.
- BEWARE THE EXPENSES TRAP



Tools of the Trade: Fiscal Sponsorships

- A fiscal sponsorship is a contractual arrangement, in which a 501(c)(3) organization effectively extends their tax-exempt status to an organization which also has a non-profit purpose but *doesn't* have tax exempt status.
- Fiscal sponsors take in the donations directly, provide 501(c)(3) compliant receipts to donors, and distribute funds to the sponsored org.
- The sponsored organization does not need to be incorporated separately, but that is helpful for liability protection purposes.
- Fiscal sponsors have a fiduciary duty to ensure that the funds they take in and distribute are used for non-profit purposes.
- Fiscal sponsors generally take a percentage of the funds received as a service fee. The percentage taken varies wildly, and there are NPOs that do only this professionally.
- If you are representing a fiscal sponsor, make sure you have a strong claw back provision and auditing capabilities.





IRS Notice 2012-52

- Single member LLCs wholly owned by a 501(c)(3) organization are disregarded for tax purposes – but NOT for liability purposes.
- This rule allows nonprofit organizations to open special purpose entities for exempt purposes, without cumbersome regulatory issues.
- Funds placed into a single member LLC owned by a 501(c)(3) organization are deductible as if the funds were donated to the 501(c)(3) organization directly.
- The rules on unrelated trade or business income are applied to such a single member LLC.
- This rule is a useful tool in hybrid partnerships in creating SPEs.
- <https://www.irs.gov/pub/irs-drop/n-12-52.pdf>



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Module 4





Intro to the Unrelated Business Income Tax (UBIT)

- The Unrelated Business Income Tax (“UBIT”) is a tax levied on 501(c)(3) Organizations for money they collect from ventures which are unrelated to their charitable exempt purpose.
- UBIT is taxed at the Corporate Rate.
- Deductions such as expenses, depreciation, etc. count in UBIT calculation.
- Guided by “Majority of Activities” threshold.
- Common UBIT Scenarios:
 - Sale of Advertising (except for QSPs)
 - Gaming (*e.g.*, Bingo games and raffles)
 - Sale of Merchandise and Publications
 - Rental Income
 - Parking Lots
 - Pro Tip: Remember the Substantial Relationship Test!



Private Inurement & Consequences

- Excess Benefit Transactions (*far and above* Fair Market Value)
- Excessive Compensation to Employees
 - “Reasonable compensation” standard
 - Rebuttable presumption of reasonability (26 CFR 53.4958.3)
- Flow of exempt funds to privately owned businesses
- Excise tax levied upon the disqualified person or entity
- If pervasive, there may be a potential loss of exempt status





Mitigating Risk: Grant Issues

- When you're representing the Granting Organization:
 - The grant application must filter out undesirable applicants, using a balance of "business considerations" and "tax considerations".
 - For international grants, having a 3rd party administrator or trustee may be prudent.
 - Auditing and Claw-Back provisions are key to grant agreements. Warranties of the grantee as to use of funds should be taken directly from IRC § 501.
 - Make sure to obtain enough information about the grantees for Donor Reports.
- When you're representing a Grant Recipient:
 - Ensure that your client is using the funds within the scope of their grant.
 - Operational grants and project grants MUST be treated differently.
 - Ensure your client keeps meticulous financial records.
 - Grant money should NEVER go towards UBIT transactions



What is Money Laundering?

- Money laundering is the process by which criminals attempt to place the proceeds of criminal activity into general circulation.
- Money Laundering has three (3) Steps:
 - Placement – Placing illicit funds into the financial system.
 - Layering – Obscuring the origin of funds through complex (or not so complex) transactions
 - Integration - Moving the previously laundered money into the economy through the banking system in order to look like legitimately earned funds.





Why Care about AML?

- Attorneys, especially those who use escrow accounts, can be prone to money laundering schemes.
- Usually these involve using an attorney as escrow agent to handle the placement of the funds via purchase of high valued assets such as real estate.
- Securities attorneys need to be especially vigilant when representing their clients in the purchase or sale of equity or debt securities such as private placement of capital and the issuance and purchase of corporate bonds.
- If you keep anti money laundering considerations in mind in your practice, it's easier to avoid problematic transactions.
- Law practices can be held liable by law enforcement or sued for malpractice by not taking the proper precautions to ensure that AML principles are met in a transaction.



AML Risk Mitigation



- There are several tools in your arsenal that you can use to confidently transact with your clients without worrying about AML issues:
 - AML-minded representations & warranties in your contracts
 - Signed and sworn affidavits as to the origin of funds and intended use of funds
 - Client Information Sheet ("CIS")
 - Only accepting funds in trackable ways such as wire transfer, certified check, and ACH.
 - Only accepting funds directly from top banks in the United States and non-OFAC sanctioned nations (be wary of "corresponding banks")
 - Only sending funds to U.S. Federal Reserve member banks or top banks in non-OFAC sanctioned nations.
 - ***The strongest tools you have are due diligence and good record keeping!***



What Are Your Key Takeaways from Today?

What did you find most surprising or interesting?
Name one thing that you learned that you'll take back to your practice.



THANK YOU FOR YOUR TIME!



Let's Continue the Conversation

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