



## 2. GOVERNANCE –FEDERAL LAW

### KNOW

There are five key areas of **Federal Tax Law** for 501(c)(3) organizations to be aware of. If the nonprofit does not have tax-exemption as a 501(c)(3) organization, they will not have to comply with the following federal tax rules.



1. **Charitable Purpose and Assets:** Federal tax law provides tax benefits to 501(c)(3) organizations because they provide a benefit society in some way. In return, these organizations must further one or more “charitable purposes” and provide assurance that its assets will remain charitable.



2. **Private benefit:** Individuals or organizations may not benefit personally from the activities of a tax -exempt organization.



3. **Lobbying:** 501(c)(3) organizations are limited in their advocacy activities. Lobbying conducted by 501(c)(3) organizations cannot be a “substantial part” of their activities. There is an important difference between education and lobbying.



4. **Political campaigns:** 501(c)(3) organizations may not participate in or intervene in the campaign of a candidate for public office.



5. **Public documentation:** Tax-exempt organizations may not operate in the dark. They must make some documents available for public inspection. They must file annual informational tax returns and provide donors with appropriate donation receipts.

### KNOW MORE

#### 1. Charitable Purpose and Assets

- A. **Purpose:** A 501(c)(3) organization must be organized and operated



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exclusively for one or more charitable purposes. These purposes must meet the definition of charitable purposes under federal tax law.

B. **Dissolution:** The Articles must provide that, upon dissolution of the 501(c)(3) organization, all assets must go to another 501(c)(3) organization or a government entity for a public purpose.

C. **Income unrelated to purpose:** 501(c)(3) organizations may have a limited amount of unrelated business income (income unrelated to its charitable purpose), but it must report it and pay taxes on it. If there is too much unrelated business income, or it is not reported, it can jeopardize the nonprofit's tax-exempt status. There are legal tests to determine if income is unrelated business income and if there is too much unrelated business income. If this is an issue, the organization should consult an attorney.

## Definition of "Charitable"

The term "charitable" is used in the Internal Revenue Code section 501(c)(3) in its generally accepted legal sense. That includes relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of government; promotion of social welfare.

-irs.gov

## 2. Private benefit

Tax-exempt organizations are created to serve a public good, not the people creating or governing the organization. No officer, director or other insider can therefore receive any benefit for which they have not appropriately paid. Loans to board members are not permitted. In general, a board needs to pay close attention to compensation, purchases and sales, or other financial transactions with insiders. Transactions with insiders cannot exceed fair market value.



The IRS can impose financial penalties on insiders that violate rules around private benefit, as well as on directors who approve such dealings. The organization may have its tax-exempt status revoked.

## 3. Lobbying

Lobbying is any attempt to influence legislation by (1) expressing a position on specific legislation to a legislator or their staff, or (2) encouraging members of the general public to contact their legislators with a position on a specific legislation (like a "call to action"). Contrary to what many people think, tax-exempt organizations may engage in lobbying if it is not a substantial part of their activities. All tax-exempt organizations may engage in education.



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## A. Lobbying limits

- ❑ **The “substantial part” test:** Organizations that choose not to elect into Section 501(h) of the tax code are still subject to section 501(c)(3) and the rules developed in common law. Known as the “substantial part test,” these rules require that “no substantial part of a charity’s activities consist of carrying on propaganda or otherwise attempting to influence legislation.” “Substantial” has never been clearly defined. However, it is clear that the definition of lobbying under the “substantial part test” is not related to an expenditure of money alone. For example, activities conducted by volunteers to influence legislation may be considered lobbying.
- ❑ **501(h) expenditure test:** Those 501(c)(3) organizations that choose the Section 501(h) election must apply an “expenditure test.” Under this standard, lobbying only occurs when there is an expenditure of money. It sets forth specific dollar limits, calculated as a percentage of the organization’s total exempt purpose expenditures. Section 501(h) and its related regulations also provide helpful definitions of lobbying and several exemptions.

## B. Education

To be clear, 501(c)(3) organizations may engage in education without limitation. They may educate anyone anytime about the people they serve, the impact of policies on these people, and what ideas they have to help their community. They may tell the stories of clients or speak up when a better solution is possible. They may invite a policymaker into their facility to see their work in action. Nonprofits play an important role in the education of their community, including policymakers, about their work and the issues related to their success.

## 4. Political campaigns

A 501(c)(3) organization is not allowed to favor or oppose a candidate for public office. A candidate includes a declared candidate, an incumbent until they state that they will not seek re-election, and a person subject to speculation. A 501(c)(3) organization may not make endorsements. It may not use its resources for a campaign for public office. It is important to prevent any campaign activity by an employee, volunteer or Board member from being attributed to the organization.



## 5. Public documentation

### A. Annual filing

A tax-exempt organization must file a form 990 or one of its variations each year four and one-half months after the end of its fiscal year. There are financial penalties for filing the form 990 late. If an organization fails to file a form 990 for three consecutive years, its tax-exempt status will be automatically revoked.



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## B. Public Disclosure

It is considered to be in the public's best interest that tax-exempt organizations make public key information about their activities. Specifically, a tax-exempt organization must make available for public inspection its:

- Application for tax exemption, which is either Form 1023 or Form 1024 depending on the organization.
- Annual return, which includes Form 990 and its variations for the prior three years.

It is **not** required to disclose the name and address of any contributor.

## KEY DOCUMENTS

In addition to the State Law documents, these are key Federal Law documents:

- Form 1023
- Form 990N
- Form 990EZ
- Form 990

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## ACTION

If Yes, Date sent or reviewed	No	<b>Federal Law Legal Checklist</b>
<b>KEEPING CURRENT WITH IRS -MAINTAINING TAX-EXEMPT STATUS</b>		
		Our organization files a version of the IRS Form 990 every year. <input type="checkbox"/> Our Organization does not normally receive more than \$50,000 in annual gross receipts and files a 990N (e-Postcard). <input type="checkbox"/> Our Organization normally receives more than \$50,000 in gross receipts each year and files annual Form 990 or 990 EZ with the IRS.
		Our Organization understands its 501(c)(3) determination letter from the IRS, and its status as either a “public charity” or a “private foundation.
		Our Organization’s Board of Directors regularly reviews the Organization’s financial statements, and reviews and approves the annual IRS Form 990.
		If our Organization receives funds from regularly-conducted business activities that are unrelated to its exempt purpose, it correctly accounts for those funds and understands how to report and pay taxes on this unrelated business income.
<b>KEEPING CURRENT WITH IRS</b>		
		Our Organization has notified the IRS of any material changes to our exempt purposes or activities, or amendments to our Articles of Incorporation or Bylaws since we applied for 501(c)(3) status.
<b>CONFLICT OF INTEREST</b>		
		Our Organization has a written conflict of interest policy and follows that policy.
		Any transactions our organization undertakes with its insiders, known as “disqualified persons,” is approved by the board or an independent committee, no members of which have a personal or financial interest in the transaction.
		The setting of our executive director’s salary is based on appropriate comparability data.
		Transactions are concurrently documented by the board or committee which states the basis for its approval in writing.
<b>OTHER POLICIES</b>		
		Our Organization has considered adopting a written whistleblower policy and if adopted, follows that policy.
		Our Organization has considered adopting a written document retention policy and if adopted, follows that policy.
<b>ADVOCACY</b>		
		Our Organization does not endorse candidates for political office and does not participate in any political campaign for or against a candidate for any public office.
		Our lobbying activities, if any, are an insubstantial part of our Organization’s overall activities. If we are participating in any lobbying activities, we have considered the two ways that nonprofits can document their lobbying activities.