



Nonprofit Governance & Financial Stewardship Workshop



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Agenda

- Nonprofit/Tax-Exempt Formation Basics
- Erie County DEP Cultural Funding Basics
- Fiduciary Duties of Directors: Care, Loyalty and Obedience
- Conflict of Interest
- Related Party
- Stay out of the Weeds! Governance vs. Administration
- Perfect Committee Structure
- Unrelated Business Income Tax (UBIT)
- Excess Benefit Transactions/Private Inurement
- Common Pitfalls
- Attorney General Update



Exempt Organization Formation Basics

- Corporate Formation (state level)
 - Not-for-profit corporation – file Certificate of Incorporation with New York Department of State.
 - Upon formation, initial Board will need to adopt Bylaws, appoint directors/officers, adopt policies, etc.
- IRS Form 1023 tax-exemption application
 - Requires description of charitable purposes and activities, disclosure of various other information, and financial projections
 - Approval timeline: 6+ months, expedited review is available if donor conditions significant gift on exemption status
 - Generally, tax-exemption is retroactive to date of organization formation (if application is filed within 27 months of formation)
- NYS tax-exemption registrations
 - Franchise tax (Form CT-247)
 - Sales tax (Form ST 119.2)
 - Charities Bureau registration (CHAR410; must be e-filed)
 - NYS Charities Bureau website publishes guidance for these filings and others



Exempt Organization Formation Basics (cont'd.)

- Certain annual filing requirements for exempt organizations
- IRS Form 990
 - Due May 15 for calendar year organizations
 - Simplified version for smaller organizations (e.g., 990-EZ, 990-N)
 - Generally, no late filing penalties, but failure to file for 3 consecutive years = automatic revocation of tax-exempt status
 - Should be filed even if tax-exemption application is still pending IRS review
- NYS CHAR500
 - Due May 15 for calendar year organizations
 - Required to include copy of IRS Form 990
- Other state charitable solicitation registrations (each state is different!)



Overview of Erie County DEP Cultural Funding

- Grant funding for general operating support
 - Applications released in February and due in the spring for funding the following year
- Eligibility requirements
 - Arts and/or cultural 501(c)(3) organization
 - Must have adopted a Conflict of Interest and a Whistleblower policy
 - Locate and provide services in Erie County
 - Primary charitable purposes/mission includes at least one of the examples provided by the DEP
 - Must agree to maintain requisite insurance coverage
- New applicants can create an account at erie.gov/cultural/AccountRequest to determine eligibility
 - DEP may request additional information, e.g., copies of tax filings, IRS determination letter, bylaws, articles of incorporation, etc.



Overview of Erie County DEP Cultural Funding (cont'd.)

- Grant applicants must provide the following documentation/information to the County:
 - Same Acknowledgment of County funding (e.g., screenshot of acknowledgment on website, copies of posters or flyers with acknowledgment seal, etc.; see samples on County's website)
 - Copy of most recent financial statement (independently reviewed if annual gross revenue >\$250k or audited if >\$1m)
 - Completed EACAB financial worksheet (note different worksheets apply for different level applicants)
 - Copy of most recently filed IRS Form 990 (or 990-EZ or 990-N, if applicable)
 - Copy of bylaws and, if not included in bylaws, conflict of interest policy and whistleblower policy
 - Current “Strategic Plan” (see County website and application for more details)
 - Any additional information or documentation requested by the County

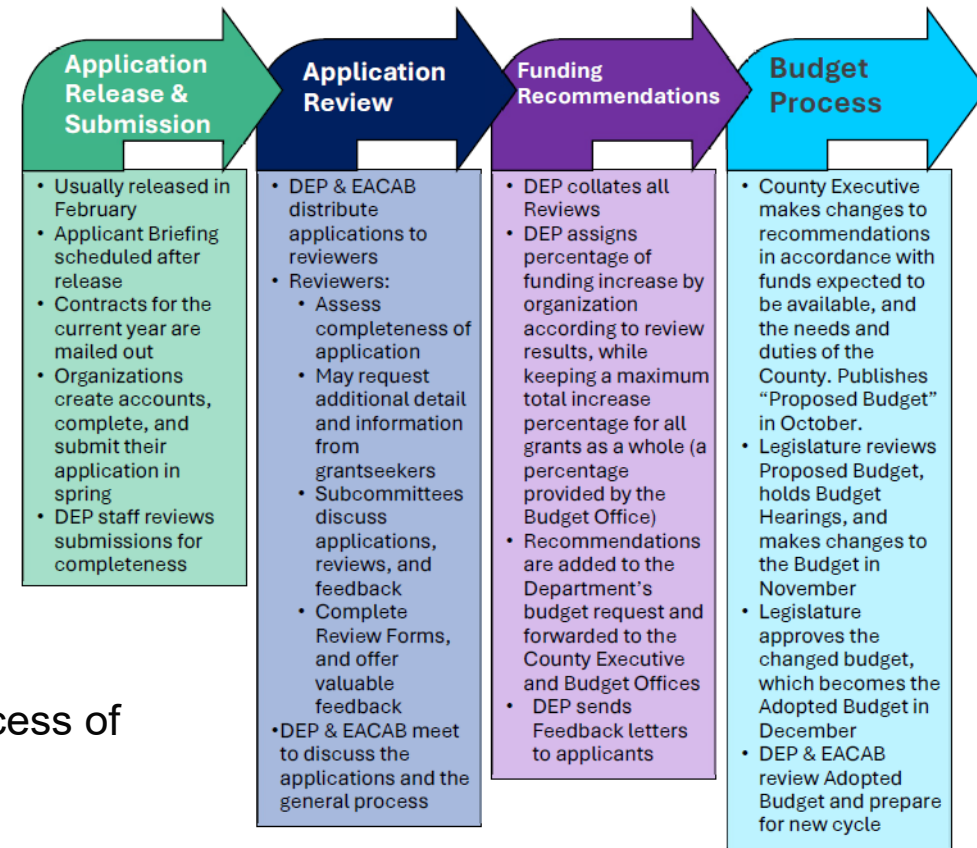


Overview of Erie County DEP Cultural Funding (cont'd.)

- Level 1 application:
 - Grants of up to \$50,000
 - Grant limited to 20% of PY expenses

- Level 2 application:
 - Grants of \$50,001 to \$200,000
 - Grant limited to 20% of PY expenses

- Level 3 application:
 - Grants in excess of \$200,000
 - Grant not limited to expenses, but requests in excess of 20% will adversely impact application





Overview of Erie County DEP Cultural Funding (cont'd.)

- Funding is for the organization as a whole, not a particular project
- Grant funds may not be used for or applied towards capital projects or improvements
- Note restrictions regarding use of grant funds to purchase alcohol
 - Organization must have a valid NYS liquor license/permit
 - Any serving, selling, or distribution of alcohol by the organization occurs during public programming or public events specifically related to furthering the organization's cultural mission/operation
 - Does not include internal meetings (staff, board, committee, etc. meetings)
- No reporting requirement currently, but the County may occasionally review the use of funds, pursuant to the contract with the organization



Fiduciary Duties of Directors

1

Duty of care –

act in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances;

2

Duty of loyalty –

act in good faith in a manner the director reasonably believes to be in the best interests of the organization; and

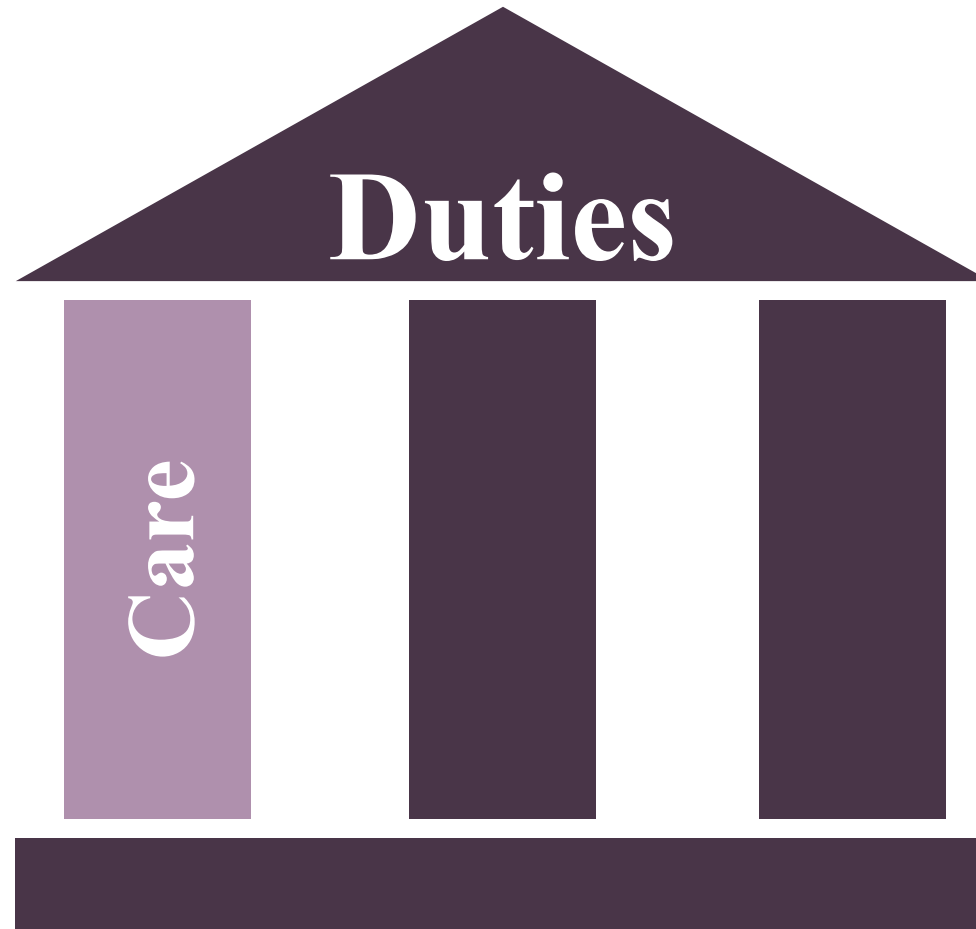
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Duty of obedience –

act within the organization's purposes and ensure that the mission is pursued.



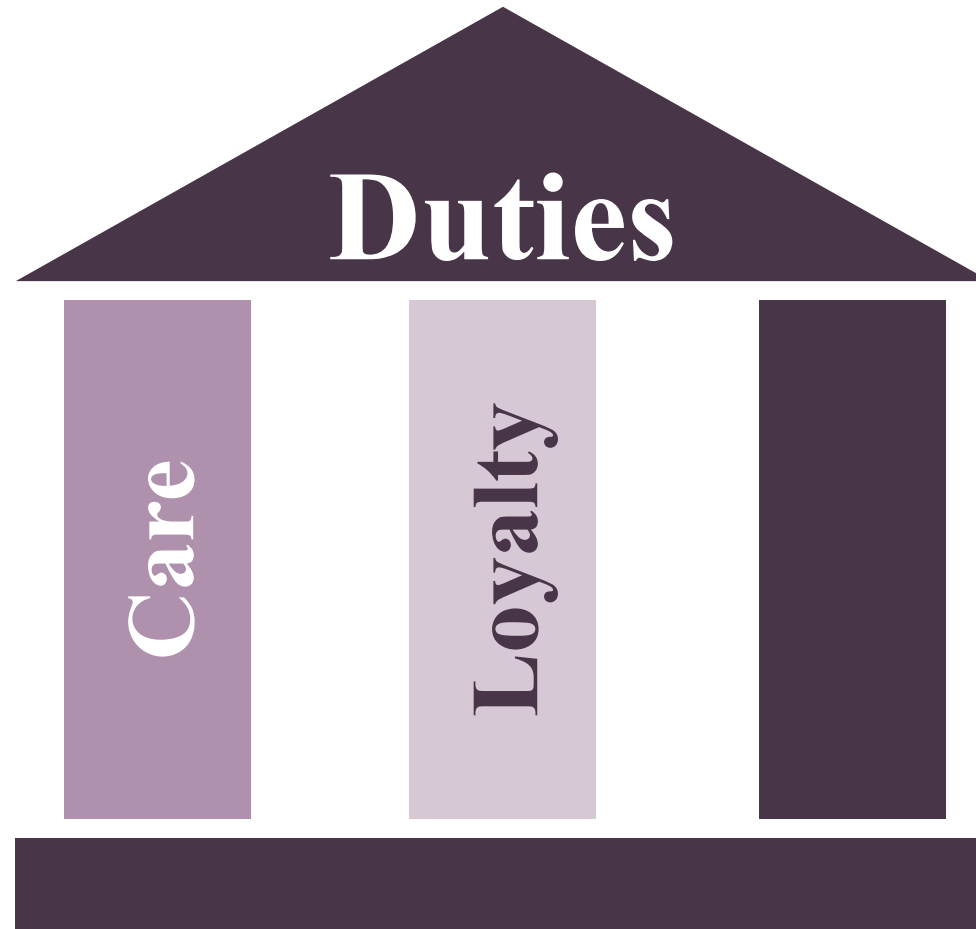
Fiduciary Duties of Directors





Duty of Care

- What it Means
 - Adopted from for-profit, corporate law
 - Corporate standard defers to directors' good faith judgments
 - Allows delegation to committees
 - Definitive judicial authority applying “business judgment rule” to decisions of directors
- Directors Must
 - Be familiar with important corporate documents
 - Monitor finances, directly or through committees
 - Review corporate books and records
 - Regularly attend Board and committee meetings
 - Review any written materials disseminated in advance of meetings
 - Delegate to qualified professionals tasks requiring specialized expertise





The Duty of Loyalty

- Director must act in good faith in a manner the director reasonably believes to be in the best interests of the organization
- Act in a manner that does not harm the organization.
- Avoid using their position to obtain improperly a benefit for themselves, or an advantage which properly belongs to the corporation.
- The fact that a transaction is one in which the director has a personal interest is usually less significant than whether it was fair to the corporation at the time the decision was made and whether the decision was reached in an impartial board environment.



Conflict of Interest

- Must have written conflict of interest policy
- No specific statutory definition of a conflict of interest
- Describe how organization will deal with Related Party Transactions
- Require annual disclosure by directors
- Individual with a conflict cannot be part of deliberations
- Adoption, oversight and implementation by Board or a committee of the Board



Related Party Transactions

- Transactions in which a Related Party has a financial interest
- Must be fair, reasonable and in the best interest of the organization when the transaction is approved
- Alternative transactions must be considered where Related Party has substantial financial interest
- Penalties when statutory requirements not followed
- Exceptions to related party transactions
 - De minimis transactions
 - Transaction not customarily reviewed by Board of Directors or boards of similar organizations in ordinary course of business AND available to others on same/similar terms
 - Benefit provided to Related Party solely as member of class of beneficiary that the organization serves as part of its charitable activities
 - Must be available to all similarly situated members of same class on same terms



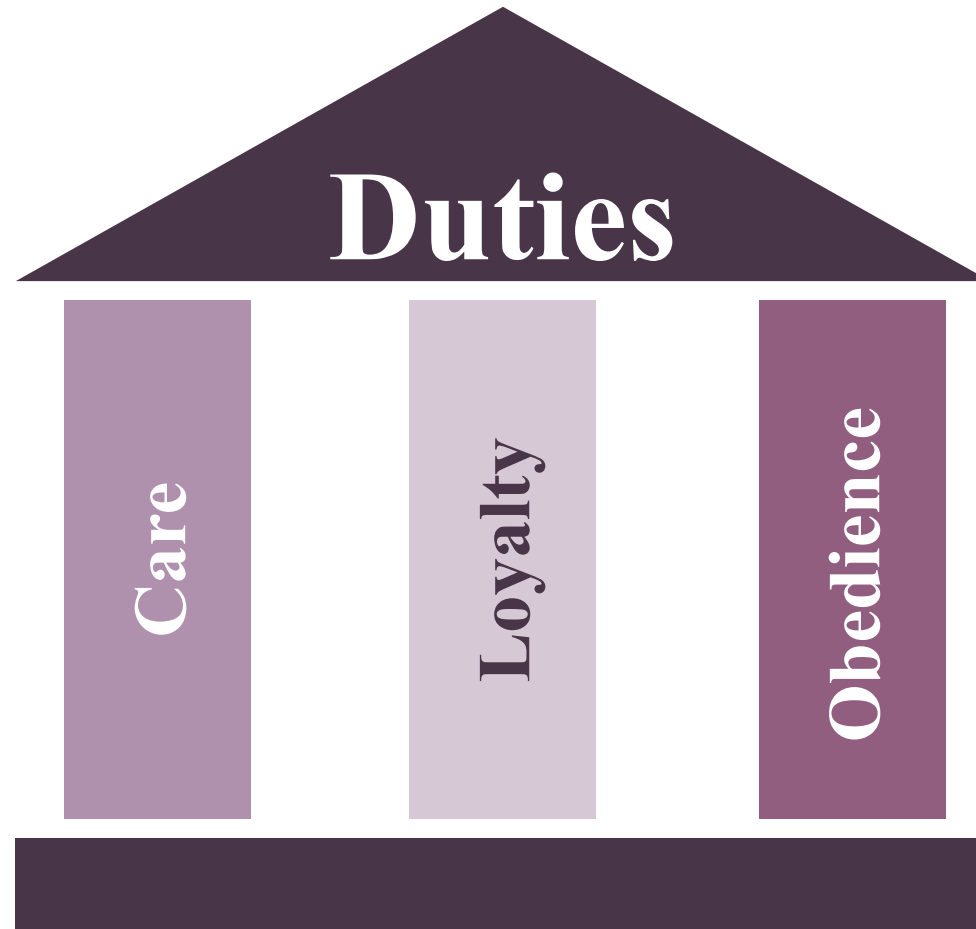
Related Party

- Voting Directors
- Officers
- Key Person
 - Responsibilities or exercises powers/influence over organization as a whole similar to the responsibilities, powers, or influence of directors/officers
 - Manages organization or segment of the organization that is substantial portion of activities, assets, income or expenses
 - Alone or with others controls or determines a substantial portion of the organization's capital expenditures or operating budget
- Other persons who exercise powers of directors, officers or Key Persons



Related Party

- Relative
 - Spouse, domestic partner
 - Ancestors
 - Siblings (whole or half-blood) – and their spouses/domestic partners
 - Children, grand-children and great-grandchildren – and their spouses/domestic partners
- Entities
 - Corporations – more than 35% combined voting power
 - Partnerships or personal service corporation – more than 5% of profits interest
 - Trusts or estates – more than 35% beneficial interest





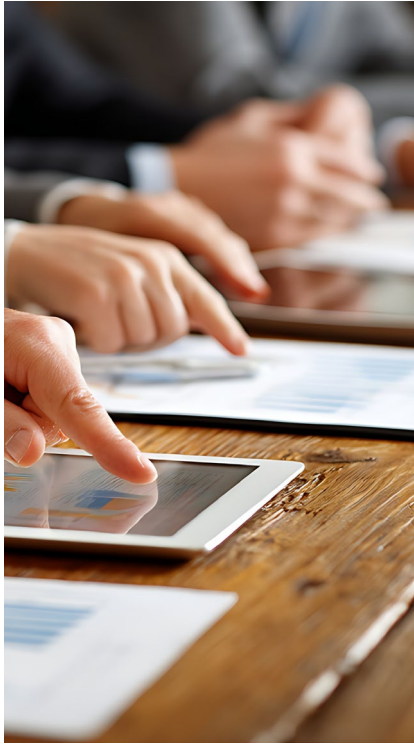
Duty of Obedience

- **Duty of Obedience is based on caselaw, NOT statutory!**
- Requires board members to:
 - “be faithful to the purposes and goals of the corporation as unlike business corporations, whose ultimate objective is to make money, nonprofit corporations are defined by their specific objectives: perpetuation of particular activities are central to the raison d’etre of the organization.”

- Directors Must
 - Mandates that a board not only seek to carry out the charitable purposes of the organization as stated in its certificate of incorporation, but also that it guard and seek to preserve that original mission as well.
 - Look at charitable purpose in your Certificate of Incorporation!



STAY OUT OF THE WEEDS!



CEO selection,
monitoring, compensation



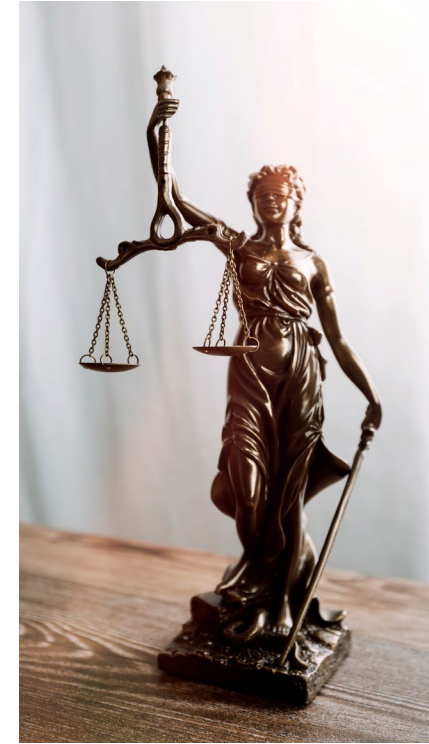
Long-term strategy



Balancing constituency
interests consistent with
mission



Budgets / financial plans



Compliance with
applicable laws,
regulations, policies and
ethical standards



STAY OUT OF THE WEEDS!

Board of Directors Orientation



Best Practices

Board
Process

Consent
Agenda

Conflicts

Committees



Perfect Committee Structure

Depends on needs and circumstances of organization as well as required statutory requirements.

Organization with significant financial resources or complex financial arrangements may benefit significantly by establishing an audit committee.

Small organization with simple financial structures may decide that oversight by the entire board is more efficient and effective.

Committee charters often help set responsibilities of a committee and clarify whether decisional authority is delegated to the committee or whether the committee is to undertake the background work and make recommendations to the board for board approval.



Unrelated Business Income Tax (UBIT)

- Tax imposed at corporate income tax rates on net income from an “unrelated trade or business”
 - Trade or business
 - Regularly conducted
 - Not substantially related to organization’s exempt purpose
- If unrelated business income is substantial, it may jeopardize tax-exempt status
 - “Substantial” varies greatly based upon facts and circumstances
 - Generally, unrelated business income >50% of total income invites IRS scrutiny
- Examples of potentially unrelated business activities
 - Regular food sales
 - For-profit merchandise sales
 - Selling advertising space



UBIT Exceptions and Exclusions

- Certain activities are excepted from the definition of “unrelated trade or business”:
 - Activities conducted primarily by volunteers
 - Convenience exception: a trade or business provided for the convenience of the organization’s members, employees, etc.
- Certain types of income are excluded from “unrelated business income”:
 - Interest and dividends
 - Royalty income
 - Rental income
 - Gains and losses from the sale of property
- NOTE: certain exceptions to these exclusions



Private Benefit/Inurement

- **No part** of an organization's net earnings may *inure* to the benefit of a private shareholder or individual
- Private inurement: "Insider" receives a benefit in excess of FMV of goods or services provided
- Inurement to insiders (e.g., board members, officers, key employees, etc.) is **absolutely prohibited**
- Private benefit applies to outsiders and must be **incidental**



Excess Benefit Transactions

- IRC Section 4958 penalizes “insiders” and organization managers involved in “excess benefit transactions”
- Excess Benefit Transaction:
 - Economic benefit provided (directly or indirectly) to an “insider”, the value of which exceeds the value of the consideration received
- Insiders means “disqualified persons”:
 - Directors, officers, trustees
 - Other persons with substantial influence
 - Substantial contributors
 - Family members of these individuals



Excess Benefit Transactions (cont'd.)

- 3-prong “rebuttable presumption of reasonableness”
- Presumed reasonable if, in approving a transaction with an insider:
 - Advance approval by board (any interested parties must be recused from voting on transaction)
 - Board relies on appropriate data of comparability (e.g., salary survey, appraisal, other comparables)
 - Adequate contemporaneous documentation by board



Excess Benefit Transactions (cont'd.)

- Penalty imposed on disqualified person involved in an excess benefit transaction:
 - Repayment of excess (plus interest)
 - 25% excise tax on excess (200% if uncorrected)
- Penalty may also be imposed on organization managers who knowingly participate in an excess benefit transaction:
 - 10% excise tax on excess
- Will **not** be considered “knowingly” if manager:
 - Relied on a professional's written advice; or
 - Relied on the rebuttable presumption requirements having been satisfied



Common Exempt Organization Pitfalls and Solutions

- Pitfall #1: Failure to file annually (IRS AND NYS Charities Bureau)
 - Solution? Establish a compliance calendar with key filing deadlines, including Form 990 deadlines and state registration renewal dates. Automatic calendar reminders for filing deadlines.
 - Do not forget – each state has its own charitable solicitation rules!
- Pitfall #2: Lack of organizational policies which leads to confusion, inconsistent governance and inadequate recordkeeping.
 - Solution? Adopt required and recommended policies (and distribute them to board members; then use them!)
 - Required Policies: Conflict of Interest; Whistleblower
 - Recommended policies: Signatory Authority and Contract Approval Policy; Reimbursement Policy; Financial Policy; Retention Policy; Procurement Policy; Nominations Policy; Membership Policy (if applicable)
 - Monthly financial reporting to the board
- Pitfall #3: Board Composition – Board burnout, Unclear Board Roles
 - Solution? Recruitment, retention, compliance with terms in Bylaws
 - Annual Board Orientation
 - Well-defined committees with specific responsibilities streamline operations and improve the board's ability to address diverse organizational needs. This strengthens oversight and enhances decision-making.



Common Exempt Organization Pitfalls and Solutions – cont'd

- Pitfall #4: Inadequate record keeping
 - Solution?
 - Accurate minutes provide a vital record of board decisions, discussions, and actions, contributing to transparency and accountability. This documentation is essential for demonstrating compliance and resolving potential disputes.
 - Gift record keeping– donor records; receipts; restricted funds
- Pitfall #5: Maintaining appropriate permits and licenses for your activities and events (e.g., liquor license)
 - Solution? Confirm with attorney, state authority and local municipality regarding requisite permits and licensure for events
- Pitfall #6: Failure to track UBIT
 - Solution? Be vigilant about tracking unrelated business income (UBI) to avoid unexpected tax liability. Implement procedures to clearly distinguish between income related to your exempt purpose and UBI.



Attorney General Update

Charities Bureau



Questions?



Contact for More



Jennifer L. Aronson

PARTNER / CO-LEADER NONPROFIT/TAX-EXEMPT ORGANIZATIONS

585.613.3954

jaronson@hodgsonruss.com



Brian S. Krastev

SENIOR ASSOCIATE

716.848.1252

bkrastev@hodgsonruss.com