

Not-for-Profit Organizations Alert

Sallmann, Yang & Alameda is committed to serving our community and its not-for-profit organizations. We'd like to bring your attention to several items that should be considered by all parties affiliated with not-for-profit organizations. Please contact us if you would like to discuss any of these or other not-for-profit issues.

Board members responsibilities and liabilities

Directors are ultimately responsible - The corporate board of directors is responsible for setting policy, conducting the corporation's affairs and for exercising the powers of the corporation. Directors may delegate many powers to others, such as officers and employees, but the directors are ultimately responsible for all corporate decisions. In general, directors of not-for-profit corporations, like directors of business corporations, are usually not personally liable for the debts, liabilities or obligations of the corporation. California law on directors' liability is complicated and has been changed frequently by Legislature.

Directors and officers insurance - Although California statutes purport to protect volunteer officers and directors of charitable corporations against personal liability for monetary damages to third parties under certain circumstances, these statutes cannot prevent the filing of lawsuits. For this reason, it is important for directors to review the matter of "directors and officers" insurance.

Directors may be held personally liable - Directors may be held personally liable to repay damages to the corporation itself where he has breached his duty of care or loyalty to the corporation. This can occur through "self-dealing" transactions, prohibited loans of corporate funds or prohibited distribution of charitable assets. California law requires that charitable assets must be used exclusively to further the charitable purpose of the organization.

Fines and penalties - Incurring fines or penalties does not constitute furthering the charitable purpose, and is often the result of negligence or a breach of fiduciary duty, which is why charitable funds may not be used to pay for fines or penalties. Therefore, fines and penalties incurred by the charitable organization must be paid personally by the board of directors.

Don't lose your tax-exempt status

The not-for-profit organization may lose its tax-exempt status under several circumstances of which these are but a few: not filing required annual tax returns, not completing an annual financial audit when required, or by supporting political candidates.

Tax returns - Federal tax returns are required to be filed by all not-for-profit organizations regardless of the level of gross receipts. Those with gross receipts, which include special activity gross income and gross proceeds from investment sales, of \$50,000 or less, may file form 990-N (termed the e-postcard) rather than a 990-EZ or a full 990. For 2013 returns, the threshold for the full form 990 filing requirement and all its complexities is \$200,000 in gross receipts or \$500,000 in total assets.

California tax returns are not required for organizations with average gross receipts less than \$50,000. New organizations with less than three tax years have higher reporting thresholds: more than one year but less than three years is \$60,000, and less than one year is \$75,000.

All registered charities are required to file form RRF-1 with the Attorney General annually; this has been required since 2003, regardless of level of gross receipts or total assets.

Annual information forms 1099 are also required to be filed. The filing requirements are the same as any other business entity. Payments for services or rents of \$600 or more are required to be reported to the IRS on form 1099 by January 31st of the following year.

Financial statement audits - Independent audits of annual financial statements are now required for charities with gross revenues of \$2 million or more. The audit requirement applies to charitable corporations, unincorporated associations and trustees required to register and file reports with the Attorney General. If audited financial statements are required, they must be made available to the Attorney General within nine months of the close of the fiscal year for which the audits were prepared.

Commercial fundraisers - California's Not-for-profit Integrity Act requires that not-for-profit organizations only use commercial fundraisers who are registered with the Registry of Charitable Trusts, the organization must have a written signed contract with specific language included, they must control and approve solicitations and the solicitations must include certain disclosures. Fundraisers include grant writers, event planners, and other businesses that help the not-for-profit organization with fundraising.

Political campaign activity - All political campaign activity is prohibited. Organizations may take sides on political issues, but not political candidates. The following activities are unallowable for charitable organizations when performed in relation to a political candidate: engaging in fundraising, donating money, endorsing a candidate, distributing information, performing any service or action that is detrimental or beneficial to a candidate.

Corporate address - If you do not have a physical office for the organization, you need to make sure the Internal Revenue Service and other governmental agency correspondence reaches the current board, so that if a problem does arise you have the opportunity to cure the issue before losing your tax-exempt status. You are required to notify the Internal Revenue Service, Franchise Tax Board and Attorney General of any change in address. To simplify the process when there is no physical office, especially when board members change every year or two, the organization should consider opening a P.O. Box at a local post office or mail service location.

Unrelated business income may cause tax due

Unrelated business income generally means the net income derived from any unrelated trade or business regularly carried on by the exempt organization. An unrelated trade or business can include advertising sales in a periodical of the organization, or sales of food or products even if for fundraising purposes. The following activities are specifically excluded from the definition of unrelated trade or business: when substantially all work performed is by volunteers; business carried on primarily for the convenience of its members, officers or employees (such as a company or school cafeteria); sale of merchandise, substantially all of which the organization received as gifts or contributions (many thrift shop operations meet this exception); and certain bingo games are also not treated as an unrelated trade or business. Also, combined unrelated business income below \$1,000 per year is not required to be reported and does not result in any tax liability.

Registration with the State Board of Equalization

Sales tax - Not-for-profit organizations must obtain a seller's permit if it intends to sell or lease (even on a temporary basis) tangible personal property that would ordinarily be subject to sales tax if sold at retail. This could include auctions, snack bar at an event, Christmas tree lot, garage sale, community events, and other fundraising activities. If applicable, sales tax must be collected, reported and remitted to the California State Board of Equalization. An exemption applies for concession stands of qualified youth organizations; they are considered consumers and not retailers of the snack foods sold on an intermittent/irregular basis, provided the profits from such sales are used solely and exclusively for the furtherance of the purposes of the organization. Sales tax also does not apply to the price of raffle tickets only when prizes are not guaranteed to every ticket holder. If the organization holds no more than three fundraising events with taxable sales in a year, it may obtain a temporary seller's permit for each event. Organizations should keep separate records for each event that clearly distinguish between taxable and nontaxable sales. These records should be kept for four years.

Use tax - All businesses with receipts of \$100,000 or more, who do not hold a seller's permit, are required to register with the California State Board of Equalization as a Use Taxpayer. Returns must be electronically filed by April 15th for each calendar year. The use tax rate is the same as the sales tax rate for your county. What is and is not subject to sales and use tax can be complicated.

Raffles

Registration - Not-for-profit organizations must register with the Attorney General's Registry of Charitable Trusts by September 1st of each year prior to conducting a raffle during the annual registration period September 1st through August 31st. They must also file financial disclosure reports on each raffle event for the prior year, on or before September 1st.

Tax withholding and reporting - Not-for-profit organizations that sponsor raffles are required to secure information about the winners with form 5754 and file reports on the prizes with the Internal Revenue Service if the amount paid, reduced by the cost of the raffle ticket, is \$600 or more, and the payout is at least 300 times the amount of the wager. The organization is also required to withhold and remit 25% federal income taxes on prizes of more than \$5,000. For noncash prizes, the winner must pay the organization 25% of the fair market value of the prize less the amount of the wager. Failure to withhold correctly may result in directors being personally liable.

Donation acknowledgements

Written acknowledgment - Donors are responsible for obtaining written acknowledgment from a charity for any single contribution of \$250 or more before the donor can claim a charitable contribution on their federal income tax return. However, generally the organization assists by providing a timely, written statement automatically for such donors. Statements should include the name of the organization; amount of the cash contribution; description (but not the value) of non-cash contributions; a statement that no goods or services were provided by the organization in return for the contribution, if that was the case; description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution.

Written disclosure statement - A charitable organization must provide a written disclosure statement to a donor who makes a payment exceeding \$75 partly as a contribution and partly for goods and services provided by the organization. The disclosure must inform the donor that the amount of the contribution that is deductible for federal income tax purposes is limited to the excess of money (and the fair market value of property other than money) contributed by the donor over the value of goods or services provided by the organization; and provide a donor with a good-faith estimate of the fair market value of the goods or services. A penalty is imposed on charities that do not meet the written disclosure requirement, not to exceed \$5,000 per fundraising event or mailing.

Valuing non-cash donations for an auction

Donor's charitable deduction is limited to the donor's tax basis in the contributed property (i.e., generally the cost paid by the donor to originally buy the item). Donors who purchase items at a charity auction may claim a charitable contribution deduction for the excess of the purchase price paid for an item over its fair market value.

Restricted donations

If an organization accepts a donation subject to restrictions, these restrictions must be fulfilled. These donations may not be used for any other purpose than that stipulated by the donor. There are basically two types of restrictions, permanent restrictions (endowments) and temporary restrictions.

Permanently restricted donations - Endowments include donor-imposed stipulations which require that their donation be maintained by the not-for-profit organization, in perpetuity. Generally, the donors of these assets permit the organization to use all or part of the income earned on related investments for general or specific purposes.

Temporarily restricted donations - Donations where the donor imposes stipulations that may or will be met either by actions of the not-for-profit organization and/or by the passage of time.

These issues are general in nature and only include limited areas of not-for-profit tax law. Contact us if you have any questions or need further information and analysis to apply these areas to your specific circumstances.