

# Nonprofit and CSBG Eligible Entity Governance

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## Agenda

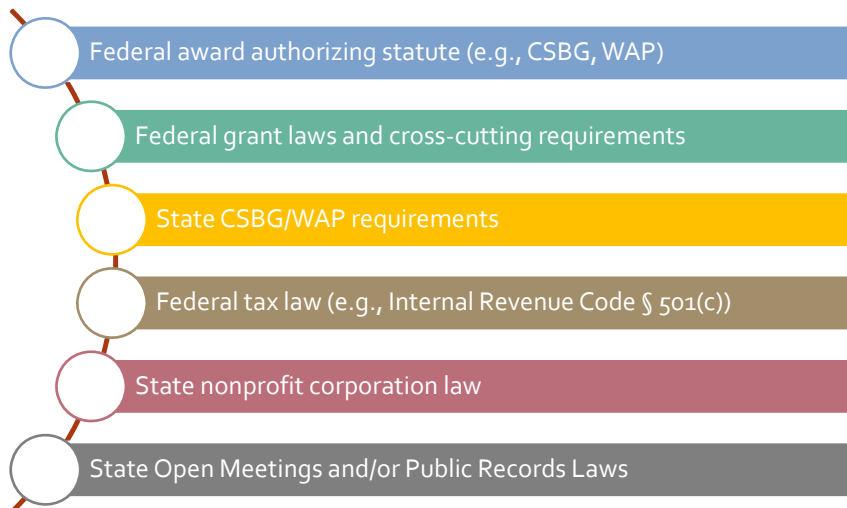
- **Board governance and bylaws**
  - State nonprofit corporation law
  - State sunshine laws
- **Tax law issues**
  - Unrelated business income tax (UBIT)
  - Compensation + board oversight of Executive Director
  - Charitable contributions
  - Form 990
  - Public inspection and copying requirements

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## Legal Framework for Nonprofit CAAs



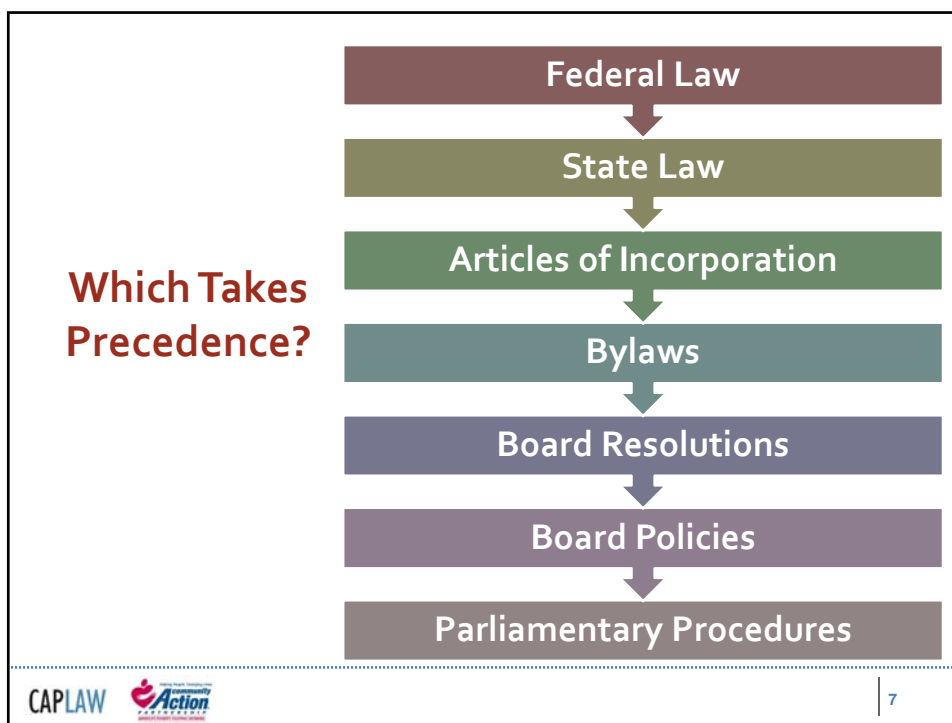
## Board Governance and Bylaws

## Role of the Board

- **Private, nonprofit CAAs**
  - Must **administer** the CSBG program through a tripartite board that “fully participates in the development, planning, implementation, and evaluation of the program to serve low-income communities” (42 U.S.C. § 9910(a)(1))
- **Public CAAs**
  - Must **administer** the CSBG program through either (1) a tripartite board whose members are selected by the organization; or (2) another mechanism chosen by the state (42 U.S.C. § 9910(b))

## Role of Bylaws

- Basic governance structure and rules of procedure for board
- Set ground rules for procedural disputes
- IRS and funding sources review them
- CSBG Organizational Standards address them
- Failure to follow bylaws can cause problems



## Articles of Incorporation

- Filing with secretary of state creates nonprofit corporation
- Statement of purpose(s):
  - Unless otherwise required, be fairly general as to charitable purpose
- However, 501(c)(3)s need to include specific purposes language
  - Charitable purposes and fact that purposes limited to those described in section 501(c)(3)

## Articles of Incorporation

- **Other required 501(c)(3) language:**
  - No substantial part of activities is influencing legislation
  - No part of earnings inures to benefit of private shareholders or individuals
  - No participation in political campaign activity
  - Upon dissolution, distribution of assets only to 501(c)(3) or to federal, state or local gov't, for public purpose
    - Leave dissolution language out of bylaws

## Board Powers and Duties

- **Nonprofit bylaws usually just include a general statement of board's authority, such as:**
  - For example: "The governing body of the corporation shall be the board of directors, which shall have supervision, control and direction over the affairs of the corporation."
  - State CSBG laws may require the board to "administer" the CSBG program and assure compliance with the board's responsibilities
- **Some bylaws also include language aligning with board's responsibilities under the CSBG and/or Head Start Acts**

## Board Size

### Federal Law

- Does not address

### State Law

- Some state laws set minimum and/or maximum board size

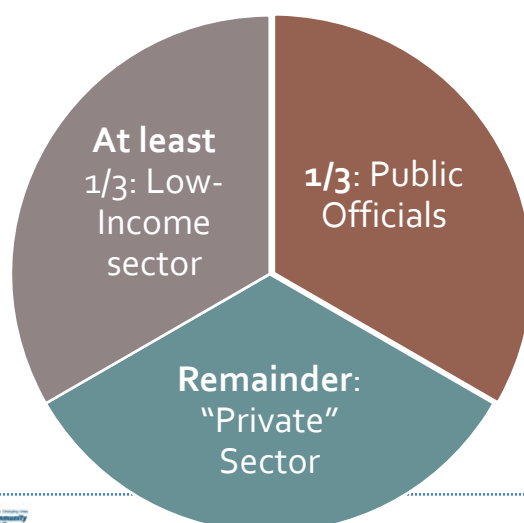
### Strategy

- Maintain flexibility
- Keep it manageable
- Must be divisible by 3

## Tripartite Boards – Governing Law

- **Federal CSBG Act (42 U.S.C. § 9910) and some state CSBG statutes outline tripartite board requirements**
  - If state CSBG law or policy is inconsistent with federal CSBG Act, federal CSBG Act governs
- **OCS Information Memorandum (IM) 82**
  - Guidance only, not binding
- **CSBG Organizational Standards (IM 138)**
- **State nonprofit corporation law**

## Tripartite Boards – Composition and Selection



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## Tripartite Boards – Composition and Selection

- Board members are to be chosen by the board (for nonprofit CAAs) or governing officials (for public CAAs)
  - Once selected through appropriate selection process
- Residency Requirements
  - Required for low-income representatives of public CAAs
  - Required for low-income representatives of nonprofit CAAs selected to represent a specific geographic area

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## Board Structure and Composition

- **Other federal funding sources impose board composition requirements, for example:**
  - **Head Start funding requires (42 U.S.C. § 9837(c)(1)(b)):**
    - Licensed attorney familiar with board issues
    - Early childhood education expert
    - Fiscal management or accounting expert
    - Reflect community served and include current/former HS parents
  - **HUD Community Housing Development Organizations (CHDO), funding requires (24 C.F.R. § 92.2):**
    - At least 1/3 low-income community representatives
    - No more than 1/3 public officials (broad definition)
    - Remainder unrestricted

## Alternates

- **Unless Articles of Incorporation specifically state otherwise, no director may vote by proxy (i.e., a director who is absent cannot designate another director or person to cast the vote of the absent director)**

### Recommendation

- Do not allow board votes by “proxy” or “alternates”



## Petitions for Board Representation

- **Federal CSBG Act: CAAs must have procedures for certain individuals and groups to petition for representation**

### Recommendation

- Adopt written procedures and include them in your bylaws

## Board Members' Terms

- **Federal CSBG Act is silent**
- **State CSBG laws may impose requirements**
  - For example:
    - **Public sector directors:** Term must coincide with the term of the public official's elected office
    - **Different terms for different sectors**
- **State nonprofit laws usually set default if bylaws are silent (e.g., 1 year)**

### Recommendations

- Specify board terms in bylaws
- Consider staggered terms

## Term Limits

- **Federal CSBG Act is silent on term limits**
- **State CSBG laws may impose requirements:**
  - For example:
    - No more than 2 consecutive terms without 1 inactive year
    - Must coincide with elected public official's term of office (regardless of whether terms are consecutive)
- **State nonprofit laws typically do not address**

### Recommendations

- Different limits for board sectors
- Permit to re-join after break

## Removal of Board Members

### Recommendation

- Include removal provisions in bylaws and use them if necessary

- **Include in provision:**
  - Removal with or without cause
  - Vote needed to remove
  - Removal procedures (e.g., notice, opportunity to be heard)
- **Check state law for additional removal requirements**

## Board Vacancies

- Federal CSBG law is silent
- State CSBG laws may address
- State nonprofit laws typically defer to bylaws

### Organizational Standard 5.5 (Private):

- The organization's governing board...fills board vacancies as set out in bylaws.

### Organizational Standard 5.5 (Public):

- The department's tripartite board/advisory body...fills board vacancies as set out in its governing documents.

## Board Vacancies

### Recommendations:

#### Fill vacancies ASAP

- Have a plan in place before vacancies arise

#### Specify in bylaws:

- How vacancies in each sector will be filled
- Term length of replacement director
- How partial term counts towards term limits, if any

#### Have full board:

- Elect replacement board members once chosen through appropriate process

## Board Meetings

- **Bylaws may specify minimum frequency**
  - Procedures for annual, regular, special meetings
- **Bylaws may describe notice to board members**
  - Form of notice and time periods
  - Permit board members to waive notice (including by attending the meeting)
- **Meeting minutes**
  - Generally, no required form under state nonprofit corporate law
  - Note date, time, location, members present/absent, issues discussed, and actions taken

## Remote Participation

- **Many nonprofit corporate laws allow organizations to conduct meetings via teleconference or similar means, provided that all persons participating in the meeting can hear and communicate with each other.**
  - Statute often says “participation in a meeting [via this mechanism] shall constitute presence in person at such meeting...”
- **However, must check:**
  - Whether state Open Meetings Law applies?
  - If so, whether the state Open Meetings Law permits remote participation in board meetings

## State Sunshine Laws

- **Sunshine/open meetings laws (OMLs) apply to public CAAs as divisions/departments of a local government**
- **However, the application of OMLs to nonprofit CAAs varies by state and may apply for reasons such as:**
  - OML applies to entities that receive a certain % of public funds;
  - OML specifically applies to CAAs;
  - Attorney general or state office charged with enforcing OML interprets it as applicable to CAAs via published opinions; or
  - State CSBG laws require all CAAs to comply with OML

## Quorum Requirements

- **Generally defined in state nonprofit corporate law**
  - **For example:** A majority of the board of directors is necessary to constitute a quorum for the transaction of business
- **What if directors leave and come back during meetings?**
  - Some state nonprofit law may dictate that quorum is fixed at the beginning of the meeting until adjournment
  - Otherwise, must have quorum throughout meeting

## Committees

- **Bylaws typically address:**
  - What authority DO committees have?
  - What authority do committees NOT have
  - Who has authority to create committees and appoint members?
    - How are committees created?
  - Who can be on committees?
  - What are the standing committees?
    - Executive, governance, audit, personnel, etc.

## Officers

- **Bylaws should specify officers and their duties**
  - State nonprofit corporate laws often have required officers (e.g., president, secretary/clerk, and treasurer)
  - Bylaws should state whether one person can hold more than one office

## Officers

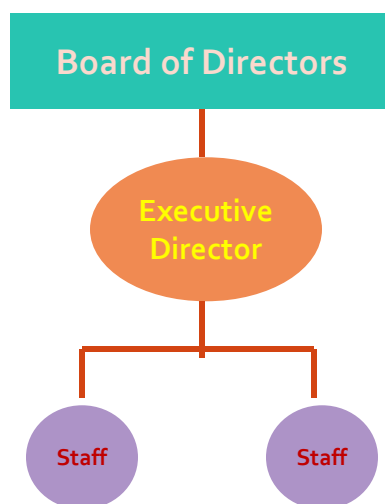
- No requirement re: how often to be elected
- Include removal and resignation procedures
- Specify how vacancies filled
- Permit officers to delegate duties to employees or agents in certain cases
- Specify whether officers required to be bonded
- Board can also appoint other agents, employees and define their duties

## Board-Executive Director Roles

Responsibility	Board of Directors	Executive Director
Policy	Establishes policy	Executes policy
Agency Mission	Sets agency mission	Accomplishes agency mission
Performance Targets	Sets performance targets	Guides work to achieve performance targets
Agency Performance	Evaluates and is accountable for org. performance	Executes, evaluates and is accountable for org. performance
Supervision of Employees	Supervises Executive Director only	Supervises org. staff generally

## Executive Director Oversight

- Sole employee of the board is the executive director



## CSBG Organization Standards Executive Director Oversight



A Guide to Enhancing the Board  
& Executive Director Partnership



### CSBG Org. Standard 7.4

- The governing board conducts a performance appraisal of the CEO/executive director within each calendar year



## Conflict of Interest Policy

- Bylaws should require board to adopt and implement separate conflict of interest policy
- Review and update periodically
- Head Start conflict of interest rules
  - No compensation for board membership
  - No immediate family member employed by grantee or delegate agency
  - Board members may not have financial conflict of interest with grantee or delegate agency
  - Board members must operate independently of grantee staff

## Conflict of Interest Policy

### Organizational Standard 5.6 (Private)

- Each governing board member has signed a conflict of interest policy within the past 2 years.

### Organizational Standard 5.6 (Public)

- Each tripartite board/advisory body member has signed a conflict of interest policy, or comparable local government document, within the past 2 years.

## Signing Checks and Contracts

- **Bylaws may include language on who can sign contracts and checks etc.**
  - Bylaws can authorize certain officers to sign and let board authorize, by resolution, other officers, employees and agents to sign, or
  - Can leave it general and let board authorize on a case-by-case basis

## Indemnification

- **Definition – one party agrees to compensate another party for losses or damages under certain circumstances**
  - Specify in articles or bylaws who, when and how organization will indemnify
  - Encourages individuals to serve on board
  - Clarifies when CAA will and will not indemnify
- **Keep indemnification provision up-to-date with current state law**
- **Cover indemnification with insurance**

## Bylaws Amendments

- **Bylaws more easily amended than Articles of Incorporation**
  - Don't need to file bylaws amendments with state, but need to notify IRS on Form 990
- **Requirements**
  - State nonprofit corporate laws may require (and bylaws should state):
    - Notice period
    - Minimum vote (majority vs. supermajority)

## Federal + State Tax Law Issues

## Federal Tax-Exempt Organizations

- **Not all nonprofits are tax-exempt under federal tax law**
- **Section 501(c) of the Internal Revenue Code**
  - 501(c)(2): Title-Holding Corp. for Single Exempt Parent Organization
  - 501(c)(3): Religious, Educational, Charitable Organizations
  - 501(c)(4): Civic Leagues, Social Welfare Organizations
  - 501(c)(5): Labor, Agricultural, or Horticultural Organizations
  - 501(c)(6): Business Leagues, Chambers of Commerce
  - 501(c)(7): Social and Recreational Clubs
  - 501(c)(8): Fraternal Beneficiary Societies and Associations
  - 501(c)(10): Domestic Fraternal Societies and Associations
  - 501(c)(19): Veterans' Organizations
  - 501(c)(25): Title-Holding Corp. for Multiple Exempt Parent Organizations
- **Generally, must file Form 1023 with the IRS to be recognized as tax-exempt under section 501(c)(3)**

## Benefits of 501(c)(3) Tax Exemption

### Carrots

- **Income related to exempt purpose is exempt from federal income tax**
  - May be eligible for exemptions from other taxes, including employment, state income, sales, and/or property taxes
- **Contributions made to organization are deductible on the donor's federal income tax return**



## Restrictions on 501(c)(3) Orgs Sticks

- **Must be organized and operated exclusively for exempt purposes**
  - “Exclusively” = primarily
- **May not conduct lobbying activities as a substantial part of overall activities**
- **Restricted from participating in political campaigns**
- **May not allow earnings to inure to the benefit of private individuals**
- **Must disclose certain information on Form 990**

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## Unrelated Business Income Tax (UBIT)

- **IRC §511**
  - Tax imposed on income generated from any “unrelated trade or business” conducted by a 501(c)(3) tax-exempt organization
    - Unrelated Business Taxable Income (UBTI)
    - UBTI = gross income derived from UTB, less any business deductions directly connected with carrying on UTB
    - Income taxed at corporate income rates or trust rates, depending on form (15% - 35%)
- **Why UBIT?**
  - To prevent unfair competition with for-profit entities

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## Three Elements of UBTI

### Income from:

(must meet ALL three requirements)

1. A trade or business

2. Regularly carried on

3. Not substantially related to the organization's exempt purpose

(IRC §511(a)(1))

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## Key Exceptions to "Unrelated Trade or Business"

### Volunteer Exception (IRC §513(a)(1))

- Substantially all of the work is performed by volunteers without pay

### Convenience Exception (IRC §513(a)(2))

- Activities conducted for convenience of members, students, employees

### Donated Goods Exception (IRC §513(a)(3))

- Substantially all merchandise sold has been donated (e.g., thrift shop)

*\*Activities not considered an "unrelated trade or business"*

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## Key Exclusions to UBTI

### Convention and Trade Show Activity (IRC §513(d))

- If one of org.'s purposes is to promote/stimulate interest in the industry and the exhibits are designed to achieve this purpose

### "Passive" Investment Income (IRC §512(b)(1))

- Dividends, interest, royalties, rents, annuities
- E.g., partnership investments with "pass-through" tax treatment

### Qualified Sponsorship Payments (IRC §513(i)(1))

- No arrangement or expectation of "substantial return benefit" other than the use or acknowledgment of name/logo/product

*\*Activities considered "unrelated trade or business" but income not taxable as UBTI*

## Reporting UBTI

### ■ Federal filing requirement: Form 990-T

- Must file Form 990-T if organization generates more than \$1,000 in gross income from unrelated trade or business
- Must file by 15th day of 5th month after organization's tax year
- Form 990-T must be made available for public inspection

### ■ State UBTI and reporting requirements

## Compensation

- **Bylaws may state that board members will not be compensated for services as board members**
  - IRS: Charities generally should not compensate board members for service on the board, other than expenses
- **Bylaws may state that board members may be reimbursed for reasonable and documented travel and meal expenses incurred in course of performing services as board members**

## Compensation

- **IRS prohibits “private inurement”**
  - Transactions where an “insider” receives a disproportionate benefit share of the benefits of an exchange (i.e., a sweetheart deal)
  - “Insiders” are directors, officers, key employees
  - Examples: executive compensation, employee benefits, loans, rental arrangements
  - Penalties for violation
    - Excise taxes on insiders/managers who approved; and/or
    - Revocation of tax-exempt status



## Executive Director Compensation

- Establish a “rebuttable presumption” that compensation is reasonable:
  - Use board committee
  - Assure board independence
  - Link pay to performance
  - Rely on meaningful comparables
  - Document the process
- Recognize funding source requirements

## CSBG Organizational Standard Executive Director Compensation

### CSBG Org. Standard 7.5:

- The governing board reviews and approves CEO/executive director compensation within each calendar year.



### DYNAMIC DUO

A Guide to Enhancing the Board  
& Executive Director Partnership

A Publication by:



In Partnership with:  
**CAPLAW**

## Charitable Contributions

### ■ Deductible contributions

- May deduct contributions of money or property to or for the use of a qualified organization
  - Only to the extent it exceeds fair market value of any goods/services received in return
  - Special rules for certain types of property, such as clothing and household items, vehicles, inventory

## Charitable Contributions

### ■ Deductible contributions (continued)

- Cannot deduct the value of a person's time or services
  - But may be able to count these towards matching requirements for certain federal funds
  - May deduct unreimbursed expenses directly connected with providing services
- Cannot deduct less than donor's entire interest in property (e.g., rent-free space, vacation home)

## Charitable Contributions

### ■ Acknowledging charitable contributions

- Should provide written acknowledgment to donors
  - Donor's responsibility to obtain
  - Include contributions in the form of unreimbursed business expenses
  - Typically sent no later than January 31 of following year
  - No prescribed format - may have one for each contribution or for all contributions in the year

## Goods and Services Provided

- Contemporaneous written acknowledgment must describe any goods or services provided by the organization to the donor
  - Includes cash, property, services, benefits, or privileges
- Token exception for “insubstantial” goods or services, which do not need to be described
  - Fair market value  $\leq$  2% of donation (or \$111\*), or
  - Donation is at least \$55.50\* and the only items provided bear the organization's logo and do not exceed \$11.10\* (for all items received during the year)

*\*2019 amounts; adjusted annually for inflation*

## Charitable Contributions

### ■ Organization responsibilities

- Quid pro quo contribution: Charitable organizations must provide a written disclosure to a donor who receives goods or services in exchange for a single payment > \$75
  - Must inform donor that the amount that is deductible for federal income tax purposes is limited to the excess over fair market value of goods/services
  - Must provide a good-faith estimate of the fair market value of goods/services given to donor in connection with either the solicitation or the receipt of the quid pro quo contribution
  - Not required for token exception goods
- Penalty: \$10/contribution; \$5,000/event

## Contemporaneous Written Acknowledgment

### ■ Include in the statement:

- the name of organization;
- the amount of cash contribution;
- a description (but not the value) of non-cash contribution;
- a statement that no goods or services were provided by the organization in return for the contribution, if that was the case; and
- a description and good faith estimate of the value of goods or services, if any, that an organization provided in return for the contribution.

## Public Disclosure and Copying Requirements

- **501(c)(3) organizations must provide copies of and make the following available for public inspection:**
  - Annual Return (Form 990)
  - UBIT Tax Returns (Form 990-T)
  - Tax-Exemption Application (Form 1023)
    - Including IRS determination letter
- **Can satisfy obligation to provide copies by making documents widely available**
  - Posting on own website or in a public database in a format meeting IRS guidelines
  - But still must make available for public inspection

## Property and Sales Taxes

- **State laws govern property and state sales tax exemptions available for 501(c)(3) charitable organizations**
  - Not automatically applied
  - May need to apply for certificates of exemption

**Questions?**

**Community Action Partnership Annual Convention  
August 26-28, 2020  
CSBG and WAP Specific Sessions**

Join us for the CSBG State Office Lunch on Thursday, August 27<sup>th</sup>



