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COMMUNITIES RISE

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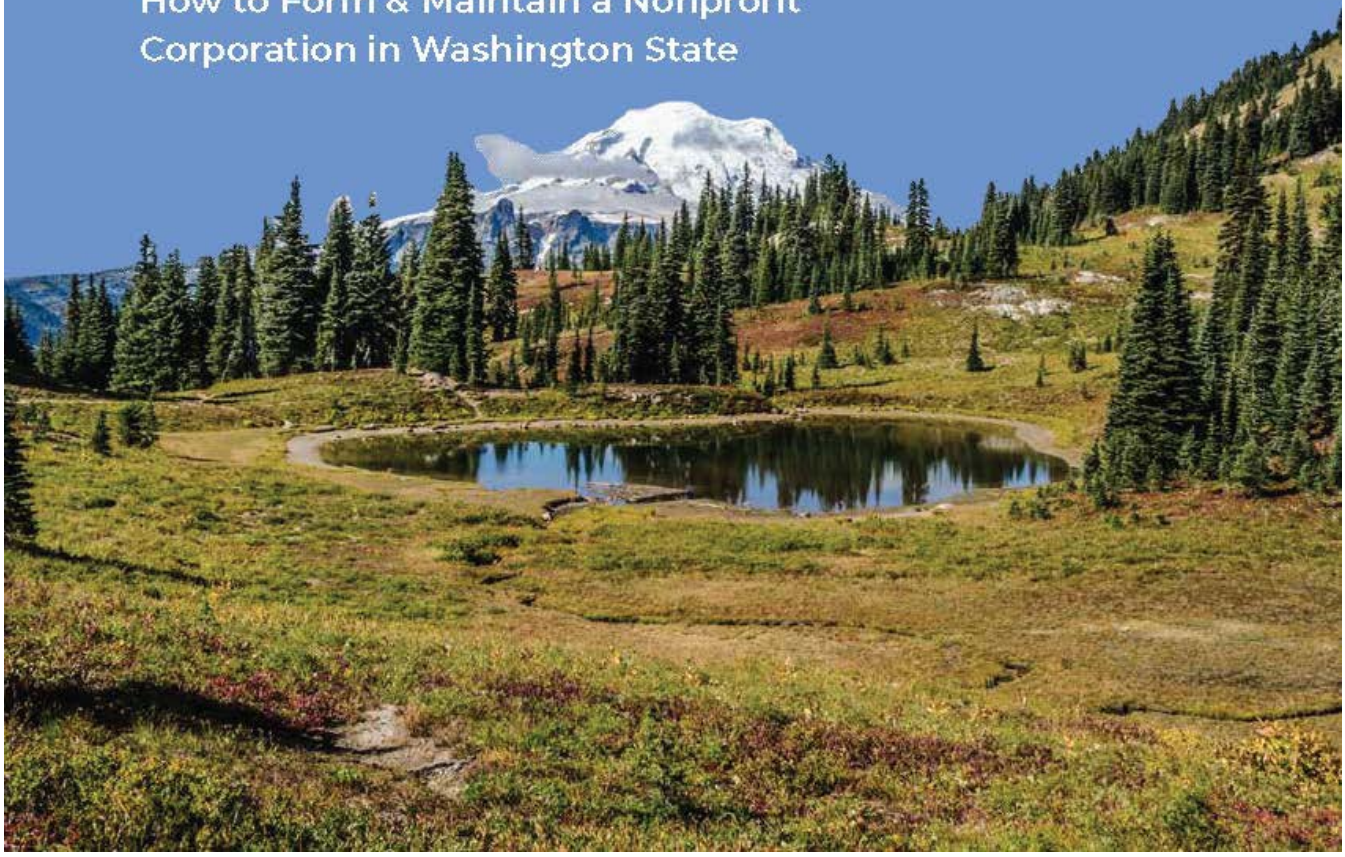
Washington Nonprofit Handbook

How to Form & Maintain a Nonprofit Corporation in Washington State



WASHINGTON NONPROFIT HANDBOOK:

How to Form and Maintain a Nonprofit Corporation in Washington State

July 2022 Edition

Published by Communities Rise

In Partnership
with
Nonprofit Association of Washington
and
Washington State Office of the Secretary of State

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We wish to express our gratitude to the Advisory Committee, authors and editors of the July 2022 Edition of the Washington Nonprofit Handbook. This book was a collaborative project that could not have been accomplished without the good work of all its contributors.

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We would also like to acknowledge Dagny Safon, Assistant Editor, for proofreading and helping us to present the material in a way that is relevant and helpful to lawyers and community members without a legal background.

Finally, thank you to the Nonprofit Association of Washington and the Washington Office of the Secretary of State for their financial support.

Judy Andrews
Jodi Nishioka
Lead Editors
Washington Nonprofit Handbook, July 2022 Edition

Publisher's Note

Communities Rise is proud to publish the Washington Nonprofit Handbook, 2022 Edition. We would like to give special thanks to Judy Andrews, Co-Lead Editor for her editorial guidance and expertise on the revision of the Washington Nonprofit Handbook (July 2022 Edition). Content integrity were ensured because of Judy's knowledge and dedication to this project. Under Judy Andrews' leadership the Washington Nonprofit Handbook was created and the first edition was published in 1992. Judy has been a Lead Editor since the first edition of the Washington Nonprofit Handbook published and has continued to be a Lead Editor with every revision, including this 2022 edition.

Communities Rise would also like to acknowledge the Nonprofit Association of Washington for their on-going partnership with Communities Rise to develop high quality learning tools, including the Washington Nonprofit Handbook. We are grateful for their ongoing support and commitment to the nonprofit sector.

Finally, Communities Rise would like to thank the Washington Office of the Secretary of State, Corporations and Charities Division, for its support in developing educational tools like the Handbook and for its commitment to creating a thriving environment for nonprofit organizations in our state. Resources like this one make a meaningful difference in the nonprofit sector and beyond.

Jodi Nishioka
Executive Director
Communities Rise

Cautionary Note

This handbook contains information about the laws impacting nonprofit organizations in Washington. Legal information is not the same as legal advice (which involves applying laws to particular individuals and organizations and their unique circumstances). It is always a good idea to consult with an attorney to obtain advice as to how the law should be interpreted in light of the particularities of you, your organization and your situation. You should be aware that the laws impacting nonprofit organizations change over time. The information contained in this handbook may become out of date.

This 2022 Edition includes information on the revised Washington Nonprofit Corporation Act (RCW 24.03A) which was materially revised and became effective on January 1, 2022. Please disregard previous editions of the Washington Nonprofit Handbook, which include information that is now obsolete.

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This handbook is available for personal use by downloading and printing from the websites of Communities Rise (www.communities-rise.org), Nonprofit Association of Washington (https://nonprofitwa.org/) and Washington State Office of the Secretary of State (https://www.sos.wa.gov/corps/nonprofitinformation.aspx).

WASHINGTON SECRETARY OF STATE

Washington state has a thriving nonprofit sector comprising more than 55,500 active domestic nonprofit corporations and 18,800 registered charities. These organizations touch every aspect of life in Washington, from veterans' advocacy to environmental stewardship, performing arts to education, elder care to economic development, and much more. These organizations leverage hundreds of thousands of volunteer hours and hundreds of millions of dollars in donations to improve the lives of Washingtonians, and drive a significant part of Washington's thriving economy.

For those seeking guidance in how to start and manage a Washington nonprofit, the Nonprofit Handbook published by Communities Rise provides valuable insight. This book is a practical resource for anyone considering forming an organization that will benefit their neighbors, or looking to wind down the affairs of a nonprofit corporation. It outlines management standards and offers tips for how nonprofit leaders can stay in compliance with the laws and develop their organizations.

The Office of the Secretary of State (OSOS) maintains state registrations for nonprofit corporations and charitable organizations. In addition to giving nonprofit corporations and charitable organizations the ability to file required documentation and reports by mail or in person, we offer an online service called the Corporations and Charities Filing System (CCFS). CCFS not only enables customers to file a wide range of corporate and charitable reports online, it also provides full public access to all corporate and charitable records filed with the OSOS. These records can be viewed online and downloaded at no charge, saving customers time and money when obtaining this information.

As overseer of this program, I commend the handbook's authors for the knowledge they have contributed to assist people who care about Washington nonprofits.

For more information about registering a nonprofit with my office, please contact the specialists in our Corporations Division at 360-725-0377 or our Charities Program at 1-800-332-GIVE (4483).

Thank you for your interest in these very important organizations.

Sincerely,

Steve Hobbs
Secretary of State

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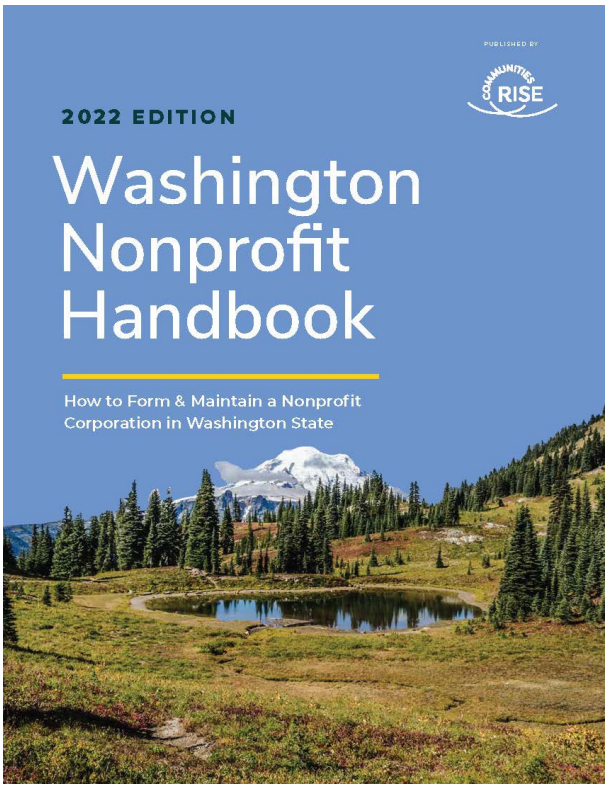


PART 1 THERE ARE MANY WAYS TO DO GOOD IN THE WORLD

Chapter 1 What is a Nonprofit?
Chapter 2 Are You Sure You Want to Do This?
Chapter 3 Alternatives to Incorporating
Chapter 4 Importance of Formality
Chapter 5 Early Decisions
Chapter 6 Alternative Leadership Models

PART 1. THERE ARE MANY WAYS TO DO GOOD IN THE WORLD

CHAPTER 1. What is a Nonprofit?

There are many ways to do good in the world. A community of people can team together for a cause, such as a group of neighbors who lend their time and expertise for community disaster-planning. A group can accomplish a mission in collaboration with an existing organization in their community, such as the chapter of a larger organization registering voters, or a program of a local group, such as a hiking club for seniors. A group can start a B-Corp — a certification of high social or environmental performance — and share profits and resources with the community. A community coffee shop can train youth for employment. A nonprofit is just one way that a group of people comes together around a mission to make a difference.

What is a nonprofit? A **nonprofit** is a type of **corporation** that is created at the state level to accomplish a public benefit. It does not have owners. It does not have shareholders. It cannot be set up to generate an income or profit for the organizers. In Washington State, nonprofit incorporation happens at the Office of the Secretary of State.

Many people confuse nonprofits with tax-exempt organizations. While nonprofit status is a state-level designation, tax-exempt status is determined at the federal level. In other words, a nonprofit is not tax-exempt by definition. In actuality, nonprofits must pay state taxes, as explained in CHAPTER 55 of this Handbook. A nonprofit can *choose* to apply for **tax-exempt status** from the Federal Internal Revenue Service (IRS). Tax-exempt status means (1) that donations to the nonprofit can be tax-deductible for the donor, (2) the organization is eligible for grants from private foundations and government agencies, that require tax-exemption, and (3) that it can avoid paying federal corporate income tax.

Nonprofits and tax-exempt organizations come in many different forms. Washington State law outlines different classifications of nonprofit organizations. The IRS similarly allows for tax-exemption for many types of organizations, and *one* of which is charitable organizations exempt under section 501(c)(3) of the Internal Revenue Code of 1986. Thus, not all tax-exempt organizations are **501(c)(3) organizations**.

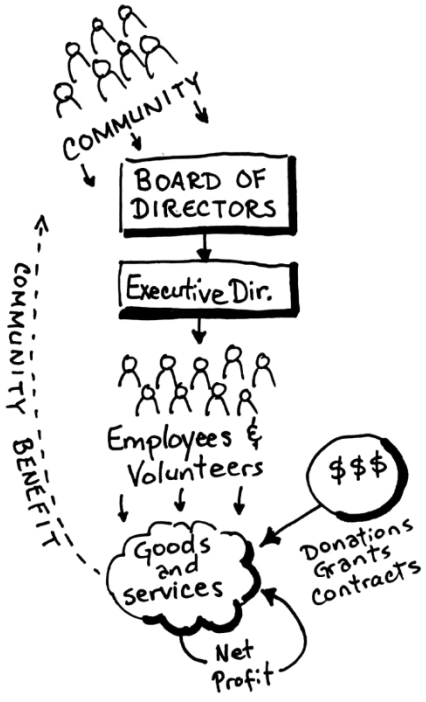
There are four main differences between a nonprofit and a for-profit organization. They are:

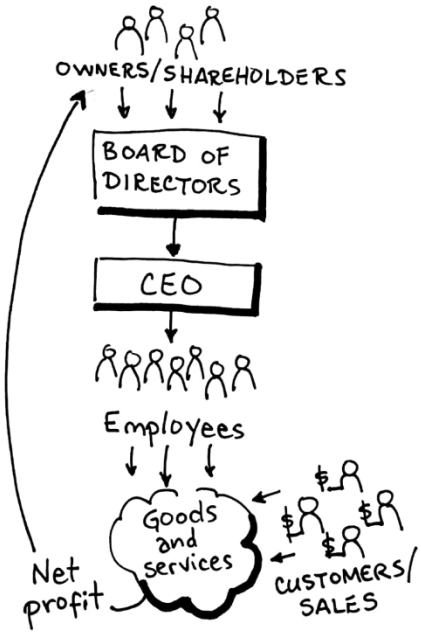
1. **Owners**: A nonprofit does not have any owners. It is owned by the community with board members serving as its stewards. Assets are held in trust for charitable purposes or purposes that otherwise benefit the community.

2. **Profits**: A nonprofit does not share profits with owners or shareholders. Any money left over at the end of the year goes back into furthering the organization's mission.

3. **Volunteers**: Most nonprofits have volunteers. A for-profit is not allowed to have volunteers in accordance with Washington State labor law.

4. **Control**: Control is disbursed across a board of directors and staff that ideally represents the diversity of the community. No one person owns or controls a nonprofit. In traditional nonprofit structure, the board of directors hires an executive director to implement strategy and run the operations of the organization, who may in turn manage employees and/or volunteers. Nonprofit organizations may choose an alternative leadership model that shares leadership, power, and decision-making among staff and board. *See* CHAPTER 6 for more on alternative leadership models. Meanwhile, a for-profit organization can be owned by one person or a group of people who makes all strategic decisions and has control of the company.





CHAPTER 2. Are You Sure You Want to Do This?

The rest of this handbook explains how to form and maintain a nonprofit organization. Before we continue, we want to pause for a moment and invite you to think critically before you start down the path of founding a new organization. Like many startup businesses, most new nonprofits exist only a short period of time. The specific reasons they close down vary widely, but the implications are clear: a nonprofit is not always the right structure, organizers are not always ready to create a nonprofit corporation, and starting a new organization is hard work that takes time and resources. Surviving beyond the start-up phase depends on good fortune, dedication, significant planning, community support, and the ability to execute the organization's business plan. There are many reasons for creating a nonprofit, but there are also simpler and less demanding ways to serve your community. We suggest you consider those possibilities first; you can read about them in the following chapter.

TIP:

The *Starting A Nonprofit* tool kit provides more information on how to determine if starting a nonprofit is right for you. *Starting A Nonprofit* is a collaboration between Nonprofit Association of Washington (fka Washington Nonprofits), the Office of the Secretary of State, 501 Commons, and Communities Rise.

We celebrate the role that nonprofits play within our communities. The community service and mutual support that characterize the role of nonprofits are an essential part of how we take care of each other, protect our rights, and enrich our quality of life. There are over a million recognized nonprofit organizations at work across the country today. Each of them had its start in the same way: a small dedicated group of people who were committed to bringing a new organization into existence. Some have remained small, meeting a specific need in a valued way. Others have grown to be such familiar features of our communities that it is hard to imagine a time when they were nothing more than a shared vision.

Whatever the future holds for the idea that brings you to this handbook, the authors wish you the best of luck and great success in your efforts to benefit the community.

CHAPTER 3. Alternatives to Incorporating

Many groups who want to do good in the community may not have the resources, time, or capacity to create and run a nonprofit corporation. There are

alternatives to creating a new nonprofit corporation, in which the organizers can focus on the work in the community and get help with back-office support, legal compliance, and other support services from other nonprofits or foundations. It is common for community groups to get support through fiscal sponsorship for the first year(s) of operation, and then incorporate and obtain their own tax-exempt status later, when they have enough community support and internal capacity to run the organization.

a. Fiscal Sponsorship

There are alternatives to creating a nonprofit corporation that are still exempt from federal income taxes. The two most common are both fiscal sponsorship options:

1) Partner with a nonprofit exempt under section 501(c)(3) and do you work as a project of that nonprofit, or

2) Incorporate as a nonprofit and enter into a fiscal sponsorship agreement, in which another tax-exempt organization becomes your organization's fiscal sponsor.

Both of these options allow a new project or entity to do the work in the community, but does not require as much governance, legal compliance, and back-office work. These options allow for the new organization to benefit from the fiscal sponsor's 501(c)(3) status, allowing the organization to receive tax-deductible donations and grants from private foundations and government agencies, and have its revenues be exempt from federal income tax through the fiscal sponsorship of a 501(c)(3) organization. For more on fiscal sponsorships, *see* CHAPTER 63.

b. Informal Community Project

It is also possible to just do the community work as volunteers without a formal structure. This option works if there is no money involved and volunteers are doing something simple, such as gathering school supplies and donating them to a school. Once there is money flowing through the entity, there needs to be greater formality.

c. Work With a Community Foundation

Another option may be to work with an established community foundation to put in place a program and procedures for achieving the charitable purposes that will be executed under the foundation's auspices. This option is worth considering,

for example, if the planned purposes are focused on passing funding through to recipients for a specific purpose that is aligned with the community foundation. One common example is a scholarship fund where the funds are specifically for a particular scholarship. Discussing your plans with one or several community foundations may offer practical solutions for achieving your charitable goals without incurring the costs and administrative burdens of establishing a new nonprofit organization.

CHAPTER 4. Importance of Formality

Having a legal corporate structure in the form of a nonprofit corporation, or under the fiscal sponsorship of another nonprofit corporation, is important for two main reasons: (1) accounting of money and (2) avoiding personal liability.

1) Accounting of money: Whether or not you create a new nonprofit, if there is any money flowing into and out of the entity, it is important to have some sort of structure and formality. If the entity is accepting money for a particular purpose, a donor relationship and an implied legal obligation to use the funds for that particular purpose is created. With that obligation comes the responsibility to account for the care and expenditure of the funds. It is necessary to open a separate bank account so that the money is not commingled with personal money. To open a checking account for the new organization, a bank will ask for a "banking resolution" adopted by a board of directors. A banking resolution is usually a form document provided by the bank or can be drafted by the board, that shows that the board of directors approves of opening of the bank account in the organization's name and for the purpose of serving the organization. Using a personal checking account for an organization's business, even if you are scrupulous in the way you account for the organization's money, invites suspicion from others involved and might complicate your own personal tax situation.

2) Avoiding personal liability: Having a formal corporate entity, such as a nonprofit corporation, provides protection to individuals from personal liability. This means that if something goes wrong and someone makes a claim that they suffered some injury in the course of the work of the project, the claim will be against the nonprofit corporation and not the individual volunteers or employees. If there is no corporate entity, and a group of individuals are doing the work informally, those individuals involved can be sued individually in the event of a work-related accident.

CHAPTER 5. Early Decisions

Once you have determined that a nonprofit is the best fit for your objectives, there are some fundamental decisions that you will need to make. These choices can have important and lasting consequences.

a. What is the organization's mission?

The mission of the organization is a brief statement of the organization's specific goals. The mission should be determined by the organizers or founding board of directors. If the organization is going to apply for tax-exemption as a 501(c)(3) organization, the mission must fall within certain categories of "charitable" purposes identified by the IRS. *See* Part 4 on Obtaining Recognition as a 501(c)(3) Organization.

b. How many board members will the organization have and who will be the founding board members?

The founding board members should be individuals who are committed to the mission of the organization, willing to provide financial support to the organization, and have time and capacity to govern the organization. Under the Washington State Nonprofit Corporations Act only one director is needed; however, if the organization is seeking tax-exempt status, the Act requires at least three directors. The founding board members will be drafting the mission and bylaws of the organization.

c. Will the organization have members?

Typically, a nonprofit organization has members if the organization provides certain benefits to a defined group of people. If a nonprofit has members, there are many rules regarding membership that need to be thought through. For example, the organizers will need to think through who qualifies to be a member, what benefits members have, what decision-making powers members have, if the members elect the board of directors, etc. *See* CHAPTER 10 for more on membership.

d. Will the organization seek to have tax-exemption as a 501(c)(3) organization?

Tax-exemption under section 501(c)(3) of the Internal Revenue Code of 1986, as amended, is a tax status for which charitable nonprofit organizations can qualify. To obtain such tax-exempt status, the nonprofit organization must apply to the IRS. There are many issues and requirements to meet when you are applying for this tax-

exemption, and it can be a relatively complicated process. *See* Part 4 on Obtaining Recognition as a 501(c)(3) Organization.

The 3 main reasons for obtaining tax-exemption as a 501(c)(3) organization are:

1) Donations can be tax-deductible to the donor,

2) The organization has the ability to qualify for grants from private foundations and governments, and

3) Not have to pay federal corporate income tax (the organization is "exempt" from federal corporate income tax).

CHAPTER 6. Alternative Leadership Models

Nonprofit organizations reflect what is happening in the communities they serve. We are living in turbulent times of political and social upheaval and our community organizations are no exception. We have seen a rise in community leaders questioning and exploring how our nonprofit and community organizations are structured and whether the current and traditional approaches to nonprofit leadership reflect the values of the organization and are ultimately serving the community.

a. Traditional Leadership model

Traditional leadership structures in nonprofit organizations tend to have a volunteer board of directors, one executive director, and staff that can include administrative roles (accountant, operations manager, development director) and program roles (client services staff and other program staff). With respect to decision-making and power, the Board is seen as the body that decides on mission, vision, and strategy and approves an annual budget. The original group that creates the organization usually become board members. Often someone from the original forming group may become the first executive director or the volunteer board will conduct a hiring process for the executive director role. Traditionally, the board then delegates the day-to-day implementation of the strategy to the executive director. Hiring and managing staff is also usually delegated to the executive director. In this traditional model, staff focus on their administrative or program roles, and do not spend much time on overall strategy or budget decision-making.

Every nonprofit organization is unique and nonprofit organizations can utilize traditional, top-down hierarchical models, consensus decision-making or some other

and democratic decision-making models. Often, the current leadership model evolves without much intentionality, depending on who the leaders are and what their skills and personality lead to.

In this chapter we explore alternative leadership models that fall somewhere on this spectrum with a movement away from the traditional hierarchical model.

b. Definition of Alternative Leadership

Alternative Leadership within organizations can be seen through practices that are emerging and derived from leadership traditions that can be traced to centuries ago within Indigenous cultures and communities of color.

Because there are so many different ways in which we have seen emerging leadership practices labeled (shared leadership, distributed leadership, flat organizations, etc.) we have chosen to use the term *alternative leadership* for this Handbook. For the purposes of this Handbook, we will define alternative leadership as:

An approach to leadership that distributes authority, promotes the sharing of power, and challenges the convention of top-down organizational hierarchy.

The defining difference between an alternative leadership model and traditional leadership is the commitment *in theory and practice* to actively share power vs. a tendency to consolidate, protect, or hoard it.

c. Challenges in Exploring Alternative Leadership

While momentum continues to pick up within organizations across the nonprofit sector to commit to alternative leadership practices, it's important to acknowledge that this shift isn't occurring without challenges.

(i) Uncertainty

One of the clearest challenges of exploring alternative leadership is lingering uncertainty about just how much the unlearning process will shock an organization as a system. A few questions we might ask ourselves in thinking through a transition to an alternative leadership model:

- How will we ensure this shift doesn't compromise the way services or advocacy is done within the communities we serve?

- What is our commitment to conflict-resolution and repairing ruptures that occur because of more broadly distributed decision-making?

(ii) Unlearning Old Habits

Depending on what type of alternative leadership practices our organizations choose to try on and implement, we can find ourselves needing to engage in individual and collective unlearning. As Mark Boncheck writes, *"Unlearning is not about forgetting. It's about the ability to choose an alternative mental model or paradigm. When we learn, we add new skills or knowledge to what we already know. When we unlearn, we step outside the mental model in order to choose a different one."*

In their 2014 Report, *Structuring Leadership: Alternative Models for Distributing Power and Decision-Making in Nonprofit*, The Building Movement Project highlights the following three points as the three key challenges in moving to an alternative leadership model.

(iii) Striking a delicate balance

It's important to get buy-in from staff while making sure people who are not on-board don't impede the process.

(iv) Accountability

Being as clear as possible about where final decisions will occur and who's responsible is key. It takes disciplined practice to be clear and to document who's responsible for what, and who is making the decisions.

(v) Hard to be nimble

Realizing that being well-informed about the decisions we make may require more time in responding to quickly emerging demands. The pressures of everyday nonprofit management creates a sense of urgency and there are always deadlines to meet. This type of process and planning takes time and can be difficult to manage when the sector is driven by funding opportunity deadlines, which create a real sense of urgency. But most organizations who are sacrificing urgency for this process report that it is well worth the effort.

d. Advantages to Changing to an Alternative Leadership Structure:

What makes the challenges listed above worth working through?

(i) Abundance of perspective

Alternative Leadership models provide the ability to get and give input from more people with diverse perspectives, and specifically from people who are closest to the issues the organization is trying to address.

(ii) Innovation

Alternative leadership models at their best allow for staff to collaborate and be creative as they step into increased responsibility and opportunities. When we value innovation it expands our possibilities. To many, it may seem that alternative leadership is a trend across the nonprofit sector that is in its "infancy" and that we are just beginning to scratch the surface of what may be possible in terms of formal structures and practices. But our imaginations are pulling from both entire histories of collectivism in movement-building and futures where interdependence is the remedy for many of the problems we seek to solve through our organization's missions.

(iii) Living into our values

A clear advantage to an alternative leadership model is the promise of it helping us to further live into our values. As members of an organization, we determine the values that guide us and serve as a north-star when setting strategic direction. Alternative leadership is a chance to practice what we preach about named organizational values. Whether it's equity, collaboration, transparency, or any other value, we can design our leadership model to actualize these values in practice, not just theory.

(iv) Trust

Trust at all levels of our organization (community, staff, and board) is core to our capacities to implement an alternative to traditional top-down hierarchical leadership. In fact, the absence of trust is likely the main inhibitor to most organizations committing to alternative leadership models. Ultimately, all of our trust-building efforts require a shift in the way we think about the relationships we form and the interactions we have in our organizations. If our primary mode of engagement remains transactional, we may notice that our ability to garner the trust needed to feel confident about deviating from the familiarity of top-down hierarchies, feels like a reach. However, if we are grounded in developing transformational relationships, we will strengthen our alternative leadership efforts.

The most vital value for navigating the uncertainty and unknown is trusting in ourselves, one another, and our shared vision.

(v) Iteration

One of the most perplexing and promising aspects of alternative-leadership is the iterative nature of continuing to understand if experiences are changing and desired outcomes are occurring. It won't happen overnight. While changes may be noticeable in a moment in time, the transitions people experience (psychological and process-based) occur over time. There is an opportunity for new nonprofits to start with the value of iteration, acknowledging at the beginning that they expect things to continue to evolve. When transforming from a more conventional leadership model, understanding the promise of being iterative in our approach affords us the ability to be both pragmatists and pioneers at the same time. **Iteration gives us permission to not know everything**. We build our capacity to trust a process, noting what works and what doesn't, and to continue to be in integrity by reminding ourselves of the purpose of our leadership evolution altogether.

e. Spectrum of Alternative Leadership Models

There is no one-size fits all model when it comes to alternative leadership models. The leaders of each organization must do the work to figure out the right time, the readiness of the organization's staff, board, and community to change, and the best components and structure to meet their needs given the unique skill sets of their staff, board and community members.

There are several examples of existing alternative leadership models that we can potentially emulate.

(i) Co-Executive Director Model

RVC has adopted a co-executive director model. RVC now has four Co-Executive Directors. Each of the Co-Executive Directors will devote a portion of their time to executive leadership responsibilities, while the rest of their time is devoted to working directly on programs and community relationships.

(ii) Autonomous Project Model

Urban Justice Center has provided a model that is trailblazing in many regards. The Urban Justice Center is composed of ten projects, each project has its own project director who is responsible to raise their own budget in exchange for an extraordinary level of autonomy. This autonomy leads to a sense of ownership over

the nonprofit's mission, purpose, values, and programs. It fosters visionary thinking and growth in unparalleled ways.

(iii) Semi-Autonomous Model

(a) Sustainable Economies Law Center

Sustainable Economies Law Center adopted policies that distribute ownership throughout the organization. Each program is run by a semi-autonomous circle of volunteers and staff in a larger circle of accountability.

(b) CompassPoint

CompassPoint has adopted a leadership structure that is grounded in principles of distributed power and practicing deep democracy. CompassPoint leans in the direction of self-management principles where everyone has increased ownership of their work. Their aspiration for collective leadership reflects a respect for individual autonomy (empowering everyone to have agency and make decisions from their roles) while also centering belonging (being united in purpose, vision, and a sense of community).

(iv) Nonprofit Unions

Nonprofit leaders can also encourage employees to join professional nonprofit unions. This also allows for an alternative leadership structure as it gives nonprofit personnel a collective bargaining power and encourages collaboration between management and employees. Such "disruptive" actions create more equitable and productive workplaces.

(v) Membership Organizations

The new Washington State Nonprofit Corporation Act overhauls and reforms the governance structures of nonprofit organizations. It offers more clarity on the standards for member-based nonprofit organizations. These standards will allow for nonprofit organizations to distribute or re-distribute power to individuals in the community in a membership structure. It offers a possibility that strategies may take a different direction from that intended by the initial board or founder, thereby increasing the possibility of organic growth and sustainability for the organization. *See* CHAPTER 10 on Membership Organizations.

f. Legal Perspective on Alternative Leadership

As nonprofit leaders are feeling burnt out, underpaid, and unsupported, more organizations and nonprofit leaders are challenging the status quo and envisioning a more sustainable way of doing business. Sharing power and responsibility means moving away from concentrated leadership, and toward a more balanced, equal division of leadership and a more interactive and collaborative decision-making process. This is possible under our current legal framework.

Although possible under the current legal framework, moving to a shared or distributed leadership model does not change the fact that nonprofit organizations need to maintain legal compliance with all federal, state, and local statutes. Failure to do so may result in the nonprofit organization jeopardizing its tax-exempt status and in some cases, risk legal action, including personal liability of board members. Despite stringent legal compliance requirements, nonprofits can explore alternative leadership models, as long as they explore such models within the parameters of the law.

The following are practices and compliance areas a nonprofit should consider and address to ensure that it remains in good standing under the law:

(i) Values

Consider the values shared in this Nonprofit Handbook as well as any additional values important to the nonprofit. Discuss the values on an individual and organizational level and use those values to guide the nonprofits decisions.

(ii) Governance Documents

Please review Part 2, CHAPTER 11 of this Handbook.

Articles of Incorporation. Review the articles of incorporation and ensure that the alternative leadership model does not conflict with the stated mission and purpose of the nonprofit organization.

A nonprofit's articles of incorporation create the corporation under state law. This document is filed with the Washington Secretary of State. Articles of incorporation require nonprofits to state their mission or purpose.

- Nonprofits often forget what was filed with the Secretary of State and in the course of business adapt and change to meet the needs of the community. It is good practice to review the filed copies of the articles of

incorporation annually. Furthermore, the articles of incorporation are submitted to the Internal Revenue Service ("IRS") when the nonprofit applies for tax exemption and then is reported on the Form 990 (annual filing with the IRS). If the nonprofit makes a fundamental change to its mission and does not inform the Secretary of State and the IRS, it could jeopardize the nonprofit's tax-exemption status. Finally, consider the impact of the new alternative leadership model on the mission and purpose of the organization. The mission of the organization must align with the new alternative leadership model.

- Bylaws. Bylaws are the rules and procedures adopted by the nonprofit for the regulation and management of the nonprofit. Bylaws are an internal-facing document and are not filed with any state or federal agency. Bylaws of the nonprofit will need to be reviewed for compliance with the new vision of the nonprofit. For example, the Board may decide to have employee representation on advising committees or serve as ex-officio non-voting members of the Board of Directors. If this type of change is made, it must be reflected in the Bylaws. Further, membership nonprofits may allow for more diverse representation on the Board and for members to vote on fundamental matters. Again, the Bylaws must be updated to reflect these types of changes.

(iii) Board Responsibility

As discussed in Part 2, CHAPTER 9, unlike a for-profit entity, a nonprofit has no "owners" or "shareholders". It is created for a community benefit and is governed by community members. The Board of Directors serves as the governing body of the corporation and is responsible for its management and administration. Therefore, any fundamental and substantive change must be approved by the Board. Individual directors have term limits to ensure that the Board has a stable and predictable turnover rate, which should be documented in the nonprofit bylaws.

When exploring or changing to an alternative leadership structure, there must be buy-in by the Board because the Board will need to approve the change and adopt new bylaws that reflect the change. All board members of an organization with a new alternative leadership model must understand what their role and responsibilities are as a board member in the new structure.

(iv) Fiduciary Duties

The Board has fiduciary duties that require them to act in the best interest of the corporation. Directors may be held personally liable if they breach any one of three duties: duty of loyalty, duty of obedience, and duty of care.

> "Duty of Care" means that board members should give reasonable care and attention to their responsibilities, including but not limited to providing organizational oversight. They should, at the minimum, attend all board meetings, review financial statements, and set the parameters for the organization's personnel. Furthermore, before making decisions, Boards should consider all materials available to them. If such material is not enough, they should seek expert professional advice, for example, advice from attorneys, accountants, bookkeepers, and human resource departments. Lastly, Boards should not simply accept the information presented but must assess the information with a critical eye.
>
> "Duty of Loyalty" means that Boards should exercise their independent judgment and act without personal economic conflict. If they believe that they would personally benefit from the transaction, they should refer to their Board Conflict of Interest Policy and follow the procedures to identify and resolve the conflict(s).
>
> "Duty of Obedience" means that the Board has a responsibility to ensure that the nonprofit is following its corporate governance policies and is abiding by the mission/purpose (as stated in its articles of incorporation), and is complying with all local, state, and federal laws and regulations.
>
> Under the Washington Nonprofit Act, officers have an additional duty to convey to a superior officer, board, board committee, or another appropriate person within the nonprofit corporation any actual or probable breach of duty or law.

No matter what leadership structure or model a nonprofit adopts, the Board must retain oversight and comply with the above-mentioned fiduciary duties.

(v) Conflict of Interest Policy

See Part 2, CHAPTER 11 for more on Conflict of Interest Policies. All Boards should adopt a conflict of interest policy. In an alternative leadership model, a Board can rely on a conflict of interest policy to ensure that all conflicts are resolved in a timely manner and that there is no abuse of trust or charitable assets.

(vi) Strategic Direction

In traditional nonprofit structures, the Board is responsible for framing the strategic direction of the organization and has the responsibility of drafting and approving the strategic plan. There is nothing in the law that suggests that a nonprofit cannot adopt a more collaborative strategic planning process. In alternative leadership structures that are community-centered, the strategic planning process includes staff, community members, constituents, and other stakeholders. Employees of an organization represent the leaders within the organization that are closest to the issues the nonprofit hopes to address. Allowing staff to lead and/or actively participate in the strategic planning process would result in more practical, inclusive, and equitable programs. Furthermore, such inclusion would further deepen trust, allow openness, and foster collaboration within the organization.

(vii) Financial Oversight and Accountability

Financial oversight is an aspect of the Board's fiduciary duties that is important and specific enough to discuss separately. The Board's duty of financial oversight includes approving the budget, assessing the income stream, establishing proper financial systems controls, and ensuring the financial stability of the nonprofit. Unlike for-profit entities, nonprofits receive income from different sources. These sources sometimes dictate how the money donated should be used. For example, restricted funds must be used for the specific purpose dictated by the donor. Under a traditional hierarchical structure, the Board approves an annual budget, thereafter the day-to-day financial decisions are the responsibility for the senior management to follow the Board-approved budget. In an alternative leadership model, the organization will have to consider how to distribute financial leadership and accountability in a way that allows the Board to meet its fiscal oversight duties. There are different ways to achieve Board oversight:

a. The nonprofit can design an internal budget process that includes the ability of program staff to participate in the budget process. This can include the program staff submitting budget requests for their own

programs, being involved in the designing and writing of grant proposals that impact their programs and having transparency of the full budget for all staff. The Board can still review and approve the budget to make sure it is prudent and aligns with the mission and vision of the nonprofit organizations.

b. The nonprofit may involve a financial department that guides employees on processes from the transaction level to the big picture and offer financial planning services.

- Offer financial responsibility and accounting training to all employees, or offer individual training focused on enhancing skills in key disciplines relating to organizational operations including budget formation and adaptation.

- Divide accounting tasks among employees, this allows for employee growth and strengthens internal control systems. The Board can meet its financial oversight by distributing financial responsibilities as long as they ensure that there are fiscal policies that reflect appropriate internal controls, those fiscal policies are followed, and finally, that the decision-making process is appropriately documented.

(viii) Policies and Procedures

Personnel policies and procedures are integral to ensuring there is no abuse of power. These policies map out responsibilities, procedures, and procedures for check and balances within the organization. Furthermore, such policies also provide a framework and process for reporting and resolving conflicts. A "Whistle-Blower Policy" provides for Board oversight and offers the affected employees an avenue to directly report to one or several designated board members or an independent third party, such as outside counsel or an HR consultant. In an alternative leadership structure, employees may have more substantive input in the development of the personnel policies. It is always advisable to have an employment attorney provide advice and review the personnel policies for legal compliance.

(ix) Employees

Alternative leadership models allow employees and community members to participate in the decision-making processes that impact them. There are many ways to gather substantive input from employees and community members such as

surveys or interviews. Once the structure is in place, there must be a clear understanding of job descriptions and roles. To encourage strategic thinking organization-wide, communication and understanding about the level of involvement of the employees and their roles in the new structure is essential. Encouraging practices such as shadowing, greater collaboration, on-going feedback, will encourage collaboration and a culture of shared leadership.

Consider creating a robust employee growth plan that is personalized to each employee and their self-defined career path. Creating a growth plan in collaboration with the affected individual will lower turnover rate and increase productivity. The employees should be encouraged to draft individual and team work plans. This will create spaces for clear and open conversations about individual and collective skill sets and career growth plans and allow the organization to maintain oversight and meet its objectives.

(x) Legal Authority

In a traditional structure the Board delegates the authority to certain individuals (traditionally the Executive Director) to execute documents on its behalf. The law does not dictate who should have legal authority within an organization; this is a decision made by the Board. Such authority allows the authorized individuals to execute documents including contracts, checks, and other official documents. The Board can delegate the same authority to more than one individual through Board resolutions. For transparency, accountability, oversight, and internal control purposes, the Board should:

- Delegate the authority to sign legal documents to specific individuals through board resolutions (this would create a clear paper trail),
- Create clear and unambiguous policies on the process to maintain internal controls,
- Document important decisions,
- Redraft job descriptions to incorporate and reflect additional responsibilities, and finally
- Adopt clear processes for quarterly and annual review to review all the decisions and contracts.

Finally, once the organization has made a decision to explore an alternative leadership model, the organization should draft a framing memo or document

exploring the pros and cons, in collaboration with stakeholders such as staff, board members, advisory boards (if any), and representatives of the communities.

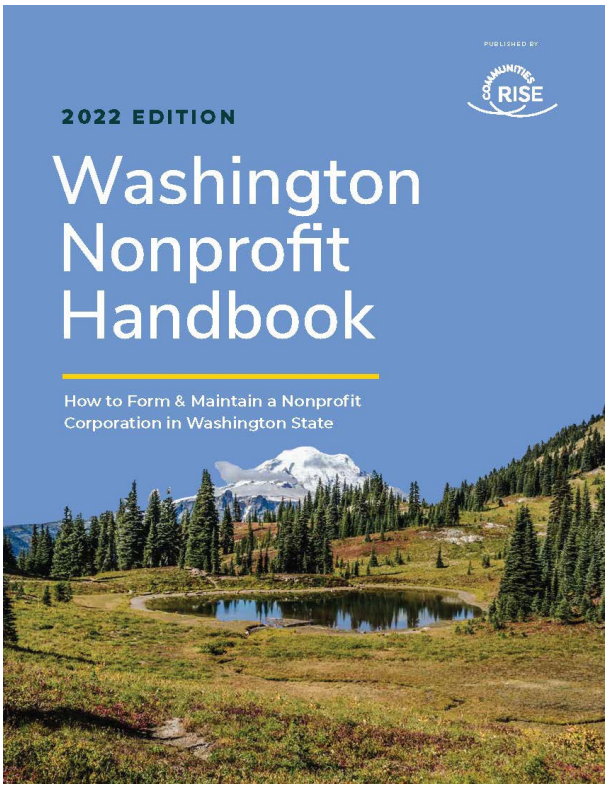
For example, the document could explore:

- Why do they want to explore an alternative leadership model?
- What are the advantages and disadvantages of the current system?
- What triggered this conversation (disgruntled personnel, lack of efficiency, high turnover rate)?
- What Is the input from key stakeholders collected through interviews and surveys?
- How will adopting an alternative leadership model at the nonprofit improve or create more efficient practices?
- How is power and decision-making distributed?
- How will the nonprofit resolve conflicts?
- Address how the Board will maintain oversight of all integral operations and programs of the nonprofit.
- Identify governance policies and procedures that will need to be amended or drafted to ensure legal compliance with state, federal, and local laws, rules, and regulations.
- Review all policies and procedures (such as document retention policy, delegation of decision-making process, board resolutions, conflict of interest policy, HR policies etc.).
- A proposal for a new organizational structure (Map out the reimagined structure).

Lastly, this is a process and will not happen overnight. It will take time as people learn through trial and error. Eventually, the organization will hire people with espoused organizational values resulting in more harmony between the employees and the different programs and services offered by the organization.

Organizational Development Resources:

- Structuring Leadership: Alternative Models for Distributing Power and Decision-Making in Nonprofit Organizations, by McAndres, Kunreuther, Bronznick, Building Movement Project
- Reinventing Organizations: A Guide to Creating Organizations Inspired by the Next State of Human Consciousness, Frederic LaLoux
- Communities Rise Alternative Leadership Toolkit



PART 2 HOW TO FORM A NONPROFIT

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PART 2. HOW TO FORM A NONPROFIT

CHAPTER 7. Common Nonprofit Organizational Structures

a. Types of Nonprofit Corporations

Historically, Washington has had several statutes permitting the formation of nonprofit corporations. When the Washington Legislature adopted the Nonprofit Corporation Act in 1967, it repealed a number of different types of nonprofit corporations. However, several options remain. The best option will depend on the purposes and activities of the corporation to be established. The types of nonprofit corporations include:

(i) The Washington Nonprofit Corporation Act (RCW 24.03A)

Most nonprofit corporations, particularly those that qualify as exempt from federal taxation under section 501(c)(3) of the Code, are incorporated under the Washington Nonprofit Corporation Act (the "Act"). A fuller description of the Act appears in CHAPTER 8.

(ii) Nonprofit Miscellaneous and Mutual Corporation Act (RCW 24.06)

Organizations can be incorporated under RCW 24.06, the Nonprofit Miscellaneous and Mutual Corporation Act, for any lawful purpose including, but not limited to, mutual, social, cooperative, fraternal, beneficial, service, and labor organization. Mutual benefit organizations, such as business leagues, homeowners' associations, and social and recreational clubs, may incorporate under this statute. Corporations may not be organized under this RCW 24.06 for any purposes which by law are restricted to corporations organized under other statutes. These include insurance companies, banks, savings and loan associations and credit unions. In addition, charitable organizations must now be incorporated under the Act and may not incorporate under RCW 24.06.

While this statute is very similar to the Act, RCW 24.06 does not contain the limitations on activities or protections contained in the Act that serve to protect charitable assets. This indicates that the intent of the Legislature was that charitable organizations be organized under the Act rather than RCW 24.06. Additionally, unlike a corporation organized under the Act, a corporation organized under RCW 24.06 may issue shares to shareholders and may distribute surplus funds to members or shareholders. RCW 24.06.025, .070.

RCW 24.06 specifically prohibits a corporation from engaging in any business, trade, vocation or profession for profit. A corporation may accumulate reserves, equity, surplus or other funds through subscriptions, fees, dues or assessments or from charges made to its members or other persons for services rendered or supplies or benefits furnished or from distributing surplus funds to its members, stockholders or other persons in accordance with the provisions of the corporation's articles of incorporation. RCW 24.06.035.

(iii) Corporations Sole (RCW 24.12)

RCW 24.12 permits a bishop, overseer or presiding elder of a church or religious denomination in the state to incorporate for church purposes. This allows recognized churches, particularly those with a hierarchical structure, to conduct their affairs in corporate form.

(iv) Fraternal Societies (RCW 24.20) and Building Corporations Composed of Fraternal Society Members (RCW 24.24)

Under RCW 24.20, fraternal societies, lodges or chapters may incorporate by filing articles of incorporation with the Secretary of State in accordance with RCW 24.20.10. Members of fraternal societies (there must be at least ten members) and fraternal societies themselves may form a separate corporation under RCW 24.24 to construct, maintain and operate a building for fraternal and social purposes.

(v) Employee Cooperative Corporations (RCW 23.78)

This statute facilitates the ownership and control of a business by its employees. Under RCW 23.78, such a corporation can engage in any business in which it could otherwise engage in under the Washington Business Corporation Act, Title 23B RCW. A corporation organized under RCW 23.78 is governed in large part by provisions of the Washington Business Corporation Act.

(vi) Cooperative Associations (RCW 23.86)

Under RCW 23.86, any number of persons may associate together as a cooperative association to operate any lawful business on the cooperative plan. Although the chapter does not define the "cooperative plan," an agricultural cooperative probably presents the best example of such a corporation.

(vii) Other Nonprofit Corporations

Washington law provides for other kinds of nonprofit corporations, many for particular kinds of activities. For example, RCW 24.28 provides for the formation of granges, RCW 24.36 permits the formation of a corporation to market fishery products, and RCW 48.09 provides for the incorporation of mutual insurance companies.

b. Charitable Trusts

A charitable trust may also be recognized as exempt from federal income tax under section 501(c)(3) of the Code. The law covering trusts, which differs in some significant ways from corporate law, will not be covered in this Handbook.

CHAPTER 8. The Washington Nonprofit Corporation Act (RCW 24.03A)

Most nonprofit corporations in Washington, particularly those that also qualify as exempt from federal taxation, incorporate under the Act. Charitable organizations are now required to be incorporated under the Act. The Act provides the legal framework for the formation and operation of a nonprofit corporation in Washington State. As with for-profit corporations formed under the Washington Business Corporation Act, governmental control of the activities of nonprofit corporations is accomplished through other statutes, regulations, and ordinances.

The Act gives nonprofit corporations a broad range of powers. A corporation's articles of incorporation and bylaws may not grant powers in addition to those granted by the Act, although they may limit such powers. Within certain limitations described below, the powers described in the Act are as broad as those conferred on for-profit corporations. Powers include the power to purchase, own, lease, sell, convey, mortgage, and otherwise deal in real and personal property, lend money or credit (except to officers and directors), make contracts, incur liabilities and borrow money, lend money for corporate purposes and invest funds, be involved in legal actions, make donations for charitable purposes and make payments or donations, or do any other acts, not inconsistent with law, that further the purposes, activities and affairs of the corporation.

The Act places several significant limitations upon nonprofit corporations. Under the Act, a nonprofit corporation may not:

- Have or issue shares of stock;
- Make any disbursement of income to its members, directors, or officers; or

- Loan any money or credit to its directors or officers.

In addition, at dissolution or final liquidation, assets must be appropriately distributed. This will be described in more detail in CHAPTER 11 under the discussion of the articles of incorporation.

Nonprofit corporations must be organized under the Act for the purpose of engaging in any lawful activity. Examples of such purpose or purposes, include charitable, benevolent, purposes relating to or dependent on charity (eleemosynary), educational, civic, patriotic, political, religious, social, fraternal, literary, cultural, athletic, scientific, agricultural, horticultural, animal husbandry, and professional, commercial, industrial or trade purposes. The Act prohibits certain organizations from being organized under it. These include organizations subject to any of the provisions of the banking or insurance laws of the state.

CHAPTER 9. Pre-Incorporation Issues

Before moving into the practical legal discussion of how to draft legal documents and incorporate, it is important to understand several organizational issues that frequently arise during the early stages of forming a nonprofit organization. It will be beneficial to the organization to address and resolve these issues in the planning stage of forming your organization. These issues fall into four categories: membership, board of directors, decision-making style and mission.

a. Membership (*see* CHAPTER 10 for more On Membership organizations)

A new nonprofit organization must determine if it will be a membership organization before it incorporates. The Act requires the nonprofit corporation to indicate if it is a membership organization in the Articles of Incorporation. Typical nonprofit membership organizations include social clubs, business leagues, advocacy groups and homeowners' associations.

Considerations to think about before deciding to be a membership organization:

1. What role do you want members to play in the organization?

2. How will having members further the mission of the organization?

3. How are you going to manage the members? Membership requires communication and notices for meetings. This takes internal capacity.

Make sure the organization has capacity to enroll, communicate and track membership.

4. How do you want members to participate?

5. What will you want from members and what will they gain from becoming a member?

6. Will you want to require membership dues and how will you collect them? Again, the organization will need internal accounting capacity to collect and manage the dues.

7. Will you use membership as a fundraising tool?

See CHAPTER 10 below for more on Membership organizations.

b. Board of Directors

Under the Act, the governing body of a nonprofit corporation is called the "board of directors," and the individuals who serve on the board are referred to as "directors." Sometimes nonprofit organizations call their board a "board of trustees" and refer to the members of the board as "trustees." Either form of terminology is permitted in Washington. For purposes of this Handbook, the terms "board of directors" and "directors" will be used.

The board of directors manages the business affairs of the corporation. Usually, this means that the board sets policy, adopts and oversees the budget, hires the executive director and makes other major decisions for the organization. Sometimes, particularly as organizations are just starting up, the board of directors is involved in the day-to-day management of the organization's operations. In alternative leadership structures, the board of directors may have a more limited role or may share decision-making with staff. *See* CHAPTER 6 on Alternative Leadership below.

Before recruiting a board of directors for an organization, it is important to think about the ideal size of the board, the length of a term of board service, and the qualities and skills of individuals you want to have as directors. Factors in making these decisions include:

- Does the board represent the community the organization will serve or the community in which the organization will be active?

- What role the board will take in fundraising? Will individual directors be asked to make a financial contribution and is the contribution a significant one? Do you intend to rely upon board members for connections into resources such as businesses or foundations? Will the board be planning and putting on fundraisers for the organization?

- Whether the organization will need particular skills, such as legal or financial expertise.

- Whether the board will be setting policies on substantive issues that will become important to the organization's mission or function in its community.

- Whether there is a particularly long "learning curve" to become involved in the organization.

c. Decision-Making Style

While focusing on the role of members (in membership organizations) or directors in an organization, it is important to consider how these bodies will make decisions and what decisions they will be making. On a philosophical level, this means thinking through whether the decision-making will be held in a traditional nonprofit board model, where the board sets policy, strategy and other key decision, or whether decision-making will be held in an alternative shared leadership model, where power and decision-making is distributed among board and staff. *See* CHAPTER 6 on Alternative Leadership.

On a procedural level, this issue involves factors such as quorum (the number of persons needed to hold a meeting in which action can be taken) and numbers of votes of those present needed to take action.

First, determine if the organization will be structured in a traditional nonprofit model or an alternative shared leadership model. Second, once you have decided what type of leadership model you will use, clarify the specific types of decisions will be made and by whom. Third, select a decision-making style that considers who will hold power and decision-making, what decisions the board will be responsible for, whether process and consensus decision making is important to the organizers, the level of formality that will be expected in meetings and the numbers of persons expected to participate in membership and/or board meetings. For example, if larger numbers of persons are involved, it may be beneficial to have a lower quorum number to make it easier to hold a meeting and take action. If participation by

members or directors is important, a higher quorum number will ensure that a few active members or directors do not make decisions. If more formality and larger numbers of persons are involved, adoption of Robert's Rules of Order or similar parliamentary rules are recommended to keep the meetings running smoothly.

d. Mission Statement

If you have not done so, it is important to develop a mission statement for the organization. A clear, succinct mission statement becomes the basis for developing purposes of the organization, as well as a necessary tool for raising funds, recruiting directors and volunteers and planning activities and programs of the organization.

CHAPTER 10. Membership Organizations

Under the Act, a nonprofit organization may have members or it may be a "non-membership" corporation. Members may be human individuals or entities, such as corporations or limited liability companies. Under the Act, where the Articles state that the corporation has members, a member is a person who has a right set forth in the articles or bylaws to select or vote for the election of directors to the board of directors, the election of delegates or to vote on at least one type of fundamental transaction. A fundamental transaction includes an amendment to the articles or bylaws, a merger, sale of all or substantially all of the corporation's assets, domestication, conversion or dissolution. For a corporation formed before January 1, 2022, in which the articles do not state that the corporation has members, a person who is defined in the bylaws as a member and has a right provided in the bylaws, not as a delegate, to select or vote for the election of directors or delegates or to vote on at least one fundamental transaction.

The decision whether to have members or not and what rights to give members relates to the nature and purpose of the corporation. Membership is often considered when an organization plans to raise funds from its supporters or seeks active participation by a large group of people. Membership may help encourage supporters to volunteer for the organization because they feel a greater sense of belonging. However, some organizations may find that the burden of obtaining a membership vote to carry out certain organizational actions, such as electing directors, outweighs any benefit to having members. This problem can be particularly burdensome as an organization grows larger.

It is also important to consider the procedures under which membership rights are granted. Such considerations include the amount of notice to give

members for meetings, the number of members needed to constitute a quorum at a meeting, and whether voting by proxy will be permitted.

a. Voting

Persons who meet the definition of "members" under the Act has rights to vote. These rights include the right to elect members of the board, changes to the Articles of Incorporation and Bylaws, and important transactions such as mergers and dissolution. *See* RCW 24.03A.010 (45) for definition of "members" and RCW 24.03A.640-24.03A.942 for list of Fundamental Transactions.

The following are key points to keep in mind with membership voting:

- Voting procedures should be set forth in the nonprofit corporation's bylaws.
- Proxy voting is only permitted if the right is provided in the bylaws. *See* more on voting rights in RCW 24.03A.390-24.03A.485.
- Ballot voting is permitted both at a meeting or outside of the meeting electronically or by mail.
- Member meetings can be in-person or remote. At remote meetings all attending members must be able to hear every attending member speak at the same time.
- Membership organizations can take action by unanimous consent of all the members electronically.

b. Membership Meetings

A. Meeting Notices. The bylaws will set forth the timing of meeting of notices. The organization must have the capacity to send out meeting notices in compliance with the bylaws.

B. Frequency of Meetings. The bylaws will set forth the frequency of the membership meetings. The Act requires an annual meeting for elections.

C. Meeting procedures. The bylaws will set forth the meeting procedures such as what is a quorum, naming particular parliamentary procedures (typically Roberts Rules), how elections will be conducted, etc.

CHAPTER 11. Nuts and Bolts of Incorporating

The actual creation of a nonprofit corporation under Washington law is a straightforward process. The basic steps discussed below will give you information on both the legal requirements and the practical tasks involved.

a. Name

Choose a name for the corporation that signifies a message or feeling. The organization's name should convey a message consistent with its mission. Your corporate name should suggest what your organization is about and should arouse interest in your organization. Sometimes both the name and its abbreviation or acronym can convey a message. For example, both "Progressive Animal Welfare Society" and the abbreviation "PAWS" express the organization's mission to protect animals.

No two organizations may have the same or a confusingly similar name. So once you have chosen a name for the organization, you must determine whether some other organization already has used the name or a name similar to it. If no other organization has chosen the name, it is available for your organization's use.

Legal Requirements for a Name

While your chosen corporate name may be creative and catchy, there are certain things it cannot be under the Act. The organization's name:

CANNOT be existing or reserved corporate name, or limited partnership or limited liability company name.

CANNOT include or end with "incorporated," "corporation," "company," "incorporated," "limited partnership," "Ltd.," or any other corporate designation.

CANNOT describe the purpose of your organization in a misleading way. Any word or phrase that indicates that the corporation is organized for any purpose other than the purpose contained in the Articles of Incorporation is not permitted. For example, if your organization plans to work on AIDS, you cannot call it "The Cancer Foundation."

CANNOT be in a foreign language unless the name is spelled with letters from the English alphabet. For example, "El Centro de la Raza" is permitted because it is spelled with English letters.

Your organization's name can include words such as "club," "league," "association," "services," "committee," "fund," "society," "foundation," or "[your corporate name], a nonprofit corporation." See CHAPTER 59 for further discussion of fiscal sponsorship.

To determine whether the name is available in Washington State, you must check with the Corporations Division of the Secretary of State. It is now possible to conduct a search on the Secretary of State's website. At the same time, you may reserve the exclusive right to use the corporate name so that it will still be available when you file your articles of incorporation.

To confirm that a name is available and reserve an available name, you can submit (on-line, by mail, or in person) a reservation request form or a letter of request to the Corporations Division with the reservation fee. You can submit up to three different names. Upon receipt of the request, the Corporations Division checks the request against its master files. The first available name is reserved for you for 180 days. The reservation can be extended once more for another 180 days. If none of the proposed names can be used or reserved, your reservation fee is returned.

Finally, CHAPTER 75-CHAPTER 77 of this Handbook discuss intellectual property protection (copyright and trademarks) in more detail for your name and logo.

> TIP:
>
> DO NOT order letterhead, stationary, business cards or any other printed materials with the organization's name until you have reserved the name or incorporated the organization.

b. Articles of Incorporation

(i) Generally

The articles of incorporation and the bylaws constitute the organizational and governing documents of a nonprofit corporation. The articles of incorporation create the corporation under state law. The bylaws provide the rules under which the corporation operates. The articles and bylaws should not have provisions that conflict with one another and should interrelate with one another. Except with respect to the number of directors, provisions of the articles will have control over provisions of the bylaws where such provisions are inconsistent.

Sample articles of incorporation can be found at the Communities Rise website. The Secretary of State's office provides a template of articles of incorporation in which information can be written onto the form directly and the form itself filed with the Secretary of State as the corporation's articles of incorporation. This form meets state requirements for incorporation, *but does not* contain provisions required under federal tax law to qualify the corporation as tax-

exempt under section 501(c)(3) of the Code. Therefore, if you plan to apply for tax-exempt status for your organization, do not use this form without ensuring that provisions meeting the requirements of federal tax law are attached.

(ii) Required Provisions

The Act requires that articles of incorporation include the provisions described below:

- **Name**. *See* RCW 24.03A.100(1)(a). The name of the corporation must be listed. *See* the discussion above regarding the legal requirements of a corporate name.

- **Incorporated Under the Act**. *See* RCW 24.03A.100(1)(c). The articles must state that the corporation "is incorporated under Chapter 24.03A RCW, the Washington Nonprofit Corporation Act".

- **Purpose of Organization**. *See* RCW 24.03A.100(1)(d). You must describe the purpose or purposes of the organization. Under the Act, a nonprofit corporation may be organized for any lawful purpose, including, but not limited to, charitable, benevolent, purposes relating to or dependent on charity (eleemosynary), educational, civic, patriotic, political, religious, social, fraternal, literary, cultural, athletic, scientific, agricultural, horticultural, animal husbandry, and professional, commercial, industrial, or trade purposes. The Act prohibits certain organizations from being organized under it. These include organizations subject to any of the provisions of the banking or insurance laws of Washington State. Additionally, if you plan to seek tax-exempt status for your organization, you must ensure that the purposes you choose are consistent with requirements of federal tax law. A discussion of charitable and other permissible purposes for federal tax exemption appears in CHAPTER 26. If your purposes involve international activities, it is important to review the issues discussed in CHAPTER 41-CHAPTER 48.

- **Registered Agent and Office**. You must give the name of the initial registered agent and the address of the initial registered office. The registered agent may be (i) an individual who is a Washington resident, or (ii) a nonprofit or for-profit corporation or a limited liability company. If the registered agent is a corporation or a limited liability company, it must be incorporated or formed in Washington or, if incorporated or formed in another state, it must be authorized to do business in Washington. The

business office of the registered agent is the registered office of the nonprofit organization. It must be at a specific geographic location in Washington State. A post office box is permitted as a mailing address only if the geographic address of the registered office also is provided.

In addition, a consent form should be attached to the articles of incorporation in which the registered agent agrees to serve as registered agent of the corporation. This consent must be filed with the Secretary of State along with the articles of incorporation. An example of such consent appears at the end of the sample articles of incorporation that are available on Communities Rise Resources page. The form of articles of incorporation available on the Washington Secretary of State's website also contains a consent form.

- **Directors**. The board of directors serves as the governing body of the corporation and is responsible for its management and administration. The board has the ultimate responsibility of running the organization. In alternative shared leadership models, the board may delegate some of its authority in running the corporation. The Act requires that you provide the number of directors constituting the initial board of directors and the names and addresses of the persons who will serve as the initial directors. Under the Act, you must have at least one individual on the initial board of directors, and you may have as many additional initial directors as you wish.

  The Act requires that a board of directors be composed of one or more individuals. A corporation or other entity may not serve as a director of a nonprofit corporation under the Act. The number of directors constituting the board of directors can be provided in either the articles or bylaws. Often the articles of incorporation state that the bylaws will provide the number of directors on the board, because the bylaws are more easily amended to accommodate the changes an organization may make in the number of directors on its board over time. The number of directors is often expressed in the bylaws as a range between a minimum and maximum number of directors.

  If the organization is a public charity under section 509 (a) (1) – (4) of the IRS code and seeking tax-exemption, the Act requires the organization to have three directors.

- **Members**. *See* RCW 24.03A.100(1)(f). If the organization will have statutory members who have rights under the Act, the articles of incorporation must state that it will have members. If the organization does not plan to have members or have members with these rights, you must stage that the corporation shall have no members as defined in section 24.03A.010 of the Act.

- **Dissolution**. *See* RCW 24.03A.100(1)(g). You must provide for the distribution of assets in the event the corporation is dissolved. These assets are the funds and other property remaining after payment of all the debts and other liabilities of the corporation. An example of this provision would state that the assets will be distributed upon dissolution to a tax-exempt organization with similar purposes or activities.

  If your organization plans to apply for status as a tax-exempt organization, there are additional requirements that apply to this provision under federal law. For example, federal tax law requires that upon dissolution of a 501(c)(3) organization, any remaining assets must be distributed to another 501(c)(3) organization for one or more exempt purposes. The IRS requires that these requirements be stated in the articles of incorporation of a 501(c)(3) organization. *See* sample articles of incorporation for language that satisfies the federal requirements. Sample articles of incorporation are available on the Communities Rise website. *See* CHAPTER 84 Dissolving a Nonprofit Corporation.

- **Incorporators**. *See* RCW 24.03A.100(1)(h) and (i). The incorporators are the organizers of the nonprofit corporation, but do not need to be part of the organization, such as a board member or officer. Incorporators sign and file the articles of incorporation. A nonprofit corporation may have one or more incorporators. An individual or an entity or the organization's attorney may act as an incorporator. If the incorporator is an individual, the individual must be at least 18 years of age. You must list the names and addresses of the incorporators of the corporation in the articles of incorporation and each incorporator must sign the articles. Until the corporation is formed, any incorporator may act on behalf of the organization. Such incorporator may be personally responsible for any expenses or liabilities incurred prior to the date of incorporation if the nonprofit corporation is never formed or if the acts of the incorporator are not ratified by the board of directors. Therefore, if an incorporator makes any expenditures on behalf of the organization before it is incorporated

and wishes to be reimbursed by the corporation, the incorporator must keep accurate records and receipts of any and all expenses for which he or she will seek reimbursement.

Finally, an incorporator must file accurate information with the Secretary of State. If an incorporator files documents that he or she knows contain false information, the incorporator will be guilty of a gross misdemeanor.

(iii) Recommended Additional Provisions

In addition to the required provisions, your organization may want to include one or more of the following provisions in its articles of incorporation:

- **Initial Members (if applicable)**. *See* RCW 24.03A.100(2)(b). An organization can state the names of its initial members. This may be a way to acknowledge founding members. However, the initial members should be made aware that the articles of incorporation are a public document, and their names will be part of the public domain. In some instances, an entity will serve as the member of an organization. In such case, the organization serving as the member will be named.

- **Governance Limitations**. *See* RCW 24.03A.100(2)(c). The articles of incorporation can include any other provisions that the organization believes are important fundamental guidance or limitations that are not inconsistent with the law regarding (i) managing the business and regulating the affairs of the corporation; (ii) defining, limiting, and regulating the powers of the corporation, its board of directors, and the members, if any; and (iii) the characteristics, qualifications, rights, limitations, and obligations attaching to each or any class of members.

- **Director Liability Limitations**. This provision eliminates or limits the personal liability of directors of the corporation for monetary damages to the corporation for conduct as a director. The sample provision in the form of articles of incorporation limits the liability of directors to the extent permitted in Washington law the Act. The Act forbids eliminating or limiting liability for acts or omissions that involve intentional misconduct by a director or a knowing violation of law by such director or for any transaction from which the director will personally receive a benefit of money, property, or services to which such person is not legally entitled.

- **Indemnification**. *See* RCW 24.03A.100(2)(d). Under an indemnification provision, the corporation promises to pay expenses, liabilities and losses incurred by a director of the corporation in defending such director in any legal action in which such person becomes involved because of actions taken in his or her official capacity as a director of the corporation. A nonprofit corporation may not indemnify a director found by a court to be liable to the corporation. A sample indemnification provision is included in the sample form of articles of incorporation on the Communities Rise Resources Page.

- **Tax Exemption Language (501(c)(3) Requirements).** *See* RCW 24.03A.100(2)(e). An organization seeking federal tax-exempt status under section 501(c)(3) of the Code must satisfy several additional requirements in its articles. In addition to ensuring that the purposes and dissolution provisions meet federal tax law requirements, the articles must prohibit the distribution of any net earnings to members, directors, officers or other private persons and prohibit the organization from carrying on non charitable activities. It is also recommended that the articles contain appropriate language with respect to political action and lobbying activities. The form of articles contains examples of such provisions. However, the form of articles of incorporation available through the Secretary of State's office do not contain these provisions and, therefore, should not be used if you intend to seek 501(c)(3) status for your organization, or if used, these provisions should be attached. In addition, a fuller discussion of these requirements is contained in Part 4 Obtaining Recognition as a 501(c)(3) Organization and Part 5 Maintaining Federal Tax-Exempt Status for your 501(c)(3) Organization.

- **Period of Existence**. You should list the period of duration of the corporation. The period is usually listed a "perpetual," but it may be limited to a specific number of years.

c. Bylaws

(i) Generally

While it is not required that bylaws be prepared prior to filing the articles of incorporation with the Secretary of State, it is recommended that the bylaws be drafted at the same time as the articles to ensure that the documents are consistent with each other and that the particular purposes, mission, and manner of acting are

reflected in both of the organization's governing documents. The articles of incorporation will control if there are any inconsistencies between the articles of incorporation and the bylaws.

Bylaws contain the rules adopted for the regulation and management of your organization. The Act requires that the board of directors of a nonprofit corporation adopt bylaws for the corporation. Provisions in the bylaws may not be illegal or inconsistent with the articles. Bylaws are ***not*** filed with the Secretary of State, but a copy is provided to the IRS with the application for 501(c)(3) status. Most bylaws outline the duties and powers of directors and officers and provide for notice, time, and place of meetings. If the corporation has members, the bylaws contain rules for admission, voting rights and meetings of members. If the corporation requires members to pay dues, then the amount, method of calculation and payment dates may be stated in the bylaws or established in a separate resolution of the board of directors.

There are two forms of sample bylaws available on the Communities Rise Resources page to serve as a guide in developing your organization's bylaws—a sample of bylaws for a corporation with voting members and a sample of bylaws for a corporation without members.

Bylaws can differ greatly among nonprofit organizations, reflecting the different types of nonprofit organizations and organizations' different governing structures and styles. However, when drafting bylaws, you need to pay attention to requirements in Washington law. The Act provides rules on such topics as time and place of members' and directors' meetings, voting rights, quorum, qualifications, and duties of directors and removal of directors and officers. These statutory provisions act as default provisions and will govern the corporation in the absence of such provisions in the bylaws (or articles). In addition, the Act contains certain requirements that must be met by all corporations subject to the Act. These requirements will govern over any inconsistent provisions on the same subject in the bylaws or articles. Therefore, it is recommended that organizers take care to develop bylaws that will suit the purposes, activities, and governing structure of the organization and meet statutory requirements.

To assist in drafting bylaws, the following information provides a description of the provisions in the Act that will govern an organization unless otherwise specified in the organization's bylaws (or articles of incorporation). That is, these are the "fallback" or "default" provisions, which are used in the event that an organization's bylaws do not address a particular topic. For example, if your

organization's bylaws do not contain a provision stating the number of members needed to call a special meeting, then the number will be the number specified in the Act. Therefore, if you would like a different rule for your corporation than any of the following, you must include the rule you want in the corporation's bylaws or, in some cases, its articles.

(ii) Members (Please *see* CHAPTER 10, above, for more information on membership organizations.)

Unless otherwise provided:

- For corporations formed before January 1, 2022, where the articles of incorporation do not state that the corporation has members, but the bylaws mention members, the corporation has members with the rights of members under the Act only if the bylaws: (a) provide that the corporation has members; ***and*** (b) provide that members of at least one class have the right to select or vote for the election of directors or delegates ***or*** to vote on at least one type of fundamental transaction.

- For corporations formed on or after January 1, 2022, the articles of incorporation must provide that the corporation has members in order for the organization to have members with the rights of members under the Act.

- An individual, a for-profit or nonprofit corporation, a general or limited partnership, an association or other entity may be a member of the organization.

- Meetings of members must be held at the registered office of the corporation in Washington State.

- A special meeting of members may be called by members having one-twentieth of the votes entitled to be cast on the subject matter to be considered at such proposed meeting.

- Members of the organization may participate in a meeting of members by means of remote communication or similar communications equipment by means of which all persons participating in the meeting can hear each other at the same time.

- Members of the organization have only those rights, privileges, powers or obligations specifically given or assigned to members in the articles, bylaws or the right set forth in the Act to vote for directors.

- Members of the organization may take any action that may be taken at a meeting of the members without a meeting if a consent, setting forth the action so taken, is executed by all of the members entitled to vote with respect to the subject matter thereof. This unanimous consent may be carried out using mail, fax, or electronic mail. The written resolution (usually the consent is written as a resolution) with the signatures of the members (or return email consents) is filed with the corporate minutes.

- Notice of regular meetings other than the annual meeting need only be made by providing each member with the adopted schedule of regular meetings for the coming year at any time after the annual meeting and ten days prior to the next succeeding regular meeting and at any time when requested by a member.

- Each member has one vote on each matter submitted to members for a vote.

- Members must vote in person (proxy votes are only permitted if provided for in the bylaws).

- Members holding one-tenth of the votes entitled to be cast represented in person or by proxy (proxies are only permitted if provided for in the bylaws) shall constitute a quorum.

- A vote of the majority of the votes entitled to be cast by members present or represented by proxy at a meeting at which a quorum is present, is necessary for any matter voted upon by the members to be legally adopted. (Note: A greater proportion may be required by the bylaws or articles and is required by the Act for certain actions.)

- Electronic communication may be used to give notices, consents or waivers to a member.

- Elections of directors may be conducted in person or by remote communication or by mail and may be conducted by ballot with or without a meeting.

(iii) Board of Directors

Unless otherwise specified:

- An organization may have one director unless the corporation has (1) applied for a determination of exempt status or classification through an application representing that the corporation is described in section 501(c)(3) of the Internal Revenue Code; or (2) the IRS has determined the corporation to be a public charity described in section 501(c)(3). In either of these cases, the corporation can have no fewer than three directors.

- Directors need not be residents of Washington or members of the corporation.

- Directors may be under the age of 18 so long as the underage directors does not exceed three individuals or 1/3 of the total number of directors then in office, whichever is fewer.

- The initial directors named in the articles of incorporation hold office until the first annual election of directors or for any other period specified in the articles of incorporation.

- The default term length for a director is one year unless specified otherwise in the bylaws. Except for organizations formed before January 1, 2022, each term of a director, however elected, may not exceed five years. An organization may stagger the director's terms. Unless specified in the bylaws, a director may be re-elected and may serve for an unlimited number of terms.

- Director Removal:

    - *Nonmember Organization:* A director of a non-membership organization may be removed by the other board members with or without cause, unless the articles or bylaws provide that directors may be removed only for cause or for reasons listed in RCW 24.03A.530(5), the "Outside Causes". A corporation shall give notice of any meeting of directors at which removal of a director is to be considered in accordance with the articles or bylaws governing notice for special meetings, but in no event less than 48 hours before the meeting. Such notice shall state that the purpose, or one of the purposes, of the meeting is removal of a director.

- *Member Organization*: A director of a membership organization may be removed by: (1) the members, with or without cause, unless the articles or bylaws provide that directors may be removed only for cause; (2) the board for the reasons listed below as "Outside Causes"; (3) the board, with or without cause, unless the articles or bylaws provide that directors may be removed only for cause; or (4) the voting group who elected the director.

- *"Outside Causes"*: The board of a membership corporation or non-membership corporation may remove a director for the following outside reasons: (1) who has been appointed a guardian under RCW 11.130.185 or 11.130.265; (2) who has been appointed a conservator under RCW 11.130.360; (3) who is subject to a written certification by his or her attending physician that in the physician's opinion, the director is substantially unable to manage his or her financial resources or resist fraud or undue influence; (4) who has been convicted of a felony; (5) who has been found by a final order of any court of competent jurisdiction to have breached a duty as a director under RCW 24.03A.495; (6) who has missed the number of board meetings specified in the articles or bylaws, if the articles or bylaws at the beginning of the director's current term provided that a director may be removed for missing the specified number of board meetings; or (7) who does not satisfy any of the qualifications for directors set forth in the articles or bylaws at the beginning of the director's current term, if the decision that the director fails to satisfy a qualification is made by the vote of a majority of the directors who meet all of the required qualifications.

- A vacancy in the board and any directorship to be filled by reason of an increase in the number of directors may be filled by the affirmative vote of a majority of the remaining directors even though less than a quorum is present.

- In most nonprofit corporations, a majority of directors constitutes a quorum. (Note: While the bylaws or articles may fix another number for a quorum, it can never be less than one-third of the number of directors.) A quorum will not be present at any time during a meeting unless a majority of the directors present are at least 18 years of age.

- The act of a majority of directors present at a meeting at which a quorum is present shall be the act of the board. (Note: (1) the bylaws or articles may provide for a greater percentage or number than a majority for all actions or for certain actions, and (2) the Act requires a vote of a greater number of directors for certain actions, such as a merger of the organization.)

- Directors may participate in board meetings by means of remote communication or similar communications equipment by means of which all persons participating in the meeting can hear each other at the same time. (Note: This right is also permitted to committee members for committee meetings.)

- Directors may take action without a meeting if a consent, setting forth the action so taken, is executed by all of the directors entitled to vote. This unanimous consent may be carried out using mail, fax, or electronic mail. The written resolution (usually the consent is written as a resolution) with the signatures of the directors (or return email consents) is filed with the corporate minutes. The days between the first and last signature cannot be more than 60 days.

- With respect to electronic transmissions, unless otherwise provided in the articles or bylaws, or otherwise agreed between the organization and the director, an electronic transmission is received when (i) it enters an electronic system that the recipient has designated or currently uses for the purpose of receiving electronic transmissions of the type sent; and (ii) it is in a form capable of being processed by that system. An electronic transmission is received under (a)(i) of this subsection even if no individual is aware of its receipt. So, advise directors to check their spam or junk folders!

Note that directors must be present at a Board meeting to vote whether the meeting is conducted in person or by remote communication. Proxy voting is not permitted for directors.

(iv) Committees

Unless specified in the bylaws (or articles), the board has the authority to create committees of the corporation to which it may delegate its authority to manage the corporation. These committees will be referred to as "Board committees." Additionally, in order for the delegation of authority to be effective, the

committee must have at least two directors as committee members. Other individuals may serve on such committees, but only directors may vote on such committees, except for certain exceptions set forth in RCW 24.03A.575(1)(a)-(c). The Act contains several statutory prohibitions related to Board committees that cannot be changed in the bylaws or articles:

- No committee shall have the authority of the board in reference to (i) adopting, amending, altering or repealing the bylaws; (ii) electing, appointing; or removing any member of any such committee or any director or officer of the corporation; (iii) amending the articles of incorporation; (iv) adopting a plan of merger with another organization; (v) adopting a plan of domestication, for-profit conversion, or entity conversion (vi) authorizing the sale, lease, or exchange of all or substantially all of the property and assets of the corporation not in the ordinary course of business; (vii) authorizing the voluntary dissolution of the corporation or revoking proceedings therefore; (viii) adopting a plan for the distribution of the corporation's assets; (ix) authorizing distributions; (x) amending, altering or repealing any resolution of the board which by its terms provides that it shall not be amended, altered or repealed by such committee; or (xi) in the case of a membership corporation, approving or proposing to the members actions that must be approved by members under the articles or bylaws.

- The designation or appointment of any committee and delegation to it of authority shall not operate to relieve the board or any director of any responsibility imposed by law.

The board of directors may create or authorize the creation of advisory committees whose members need not be directors or meet the qualification requirements to be directors. Advisory committees give advice and/or recommendations to the board or may plan and, if approved by the board, conduct activities or events, but do not have any delegated authority of the board and may not act for the board.

(v) Officers

Unless otherwise specified:

- The officers of a corporation consist of a president, a secretary, a treasurer, and any other officers as may be authorized by the articles, the bylaws, or the board. Vice-Presidents are optional.

- Officers are elected or appointed annually by the board, unless otherwise provided by the articles or bylaws.

- Any officer elected or appointed may be removed by the persons authorized to elect or appoint such officer whenever in their judgment the best interests of the corporation will be served thereby.

- The same individual may simultaneously hold more than one office in a nonprofit corporation, except that the same individual may not hold the offices of president and secretary.

- Officers do not have to be board members. For example, the Secretary can be a staff member without voting rights who will take the minutes at the board meetings.

(vi) Other Bylaw Provisions

There are several topics for which the Act does not specifically provide for and which should be covered in your corporation's bylaws:

- Any specific qualifications for directors.

- Notice requirements for regular and special meetings of the Board and the members, if the organization has members.

- There is no requirement of an annual meeting if the organization is a non-membership corporation or does not have voting members.

- The creation of specific committees, whether board or advisory committees, and their formation, composition and operation are not provided for.

- There is no specified manner or timing of attaining office for officers.

- There is no day and time fixed for the annual meetings of directors and members (this matter should be addressed in the bylaws, if applicable).

- A description of the specific duties of each of the officers of the corporation.

d. Conflict of Interest Policy

Pursuant to the fiduciary duty called the duty of loyalty, a director of a nonprofit corporation is required to put the interests of the corporation before their

personal interests. A conflict of interest policy adopted by the board of directors serves to put in place procedures that will prevent a director with a conflict of interest from personally benefiting from a decision that the director would make or participate in making. *See* CHAPTER 16 for additional discussion regarding conflicts of interest and fiduciary duties of directors. A sample conflict of interest policy is available on the Communities Rise Resource Page. Alternatively, a conflict of interest policy could be included in the organization's bylaws rather than in a separate policy.

e. File Articles with Secretary of State

When the articles are completed, the original of the articles of incorporation must be filed with the Secretary of State. Each of the incorporators must sign the articles, and the registered agent must sign the consent form. The filing fee required by the Secretary of State must accompany the articles. You may mail in documents, file them in person at the Secretary of State's office in Olympia, have a records or messenger service file them for you, or file them online at the Secretary of State's website. If you wish to have the filing effective on the day in which the articles are delivered to the Secretary of State, you must pay an additional fee for expedited filing. A schedule of fees is provided on the Secretary of State's website.

If the Secretary of State finds that the articles of incorporation conform to law, the Secretary shall, when all fees have been paid:

- Endorse on the articles the word "filed" and the effective day of the filing;
- File the articles;
- Issue a certificate of incorporation to which a conformed copy shall be affixed; and
- Return the certificate of incorporation and a conformed copy affixed to it to the incorporators or their representative.

Corporate existence of a nonprofit corporation begins upon the filing of the articles. The date stamped on the articles by the Secretary of State is the effective date of incorporation.

CHAPTER 12. The Organizational Meeting and Post-Incorporation Tasks

The Organizational Meeting. (*See* RCW 24.03A.120). After the issuance of the certificate of incorporation, a majority of the initial directors of the corporation must call an organizational meeting of the board of directors by giving notice to the initial

directors named in the articles of incorporation. The notice must state the time and place of the meeting. This notice may be waived by all the directors; if it is waived, that fact should be stated in the minutes to the organizational meeting.

You should prepare an agenda for the organizational meeting. The initial board of directors should cover the following business items, at a minimum, at the organizational meeting:

- **Adopt Bylaws**. It is helpful to the initial directors and increases the efficiency of the meeting if draft bylaws are provided to the directors well in advance of the meeting for review and comment. Many groups have found it helpful to hold a study session prior to the organizational meeting to collect comments and discuss draft documents.

- **Elect Officers**. The officer positions established in the corporation's bylaws should then be filled in the manner provided in the bylaws. Pursuant to Washington law, the officers required of a nonprofit corporation consist of a president, a secretary, and a treasurer. Many nonprofit corporations also include a vice president among the officers (The Act does not require a Vice President). If permitted by the bylaws, the same person may hold one or more offices, except the offices of president and secretary may not be held by the same person. The directors of the organization can be elected as its initial officers as well. The appointed officers shall serve until their respective successors have been elected or appointed, until their term of office under the bylaws is completed or until their earlier removal or resignation.

- **Adopt a Conflict of Interest Policy**. A draft of this policy should be provided to directors prior to the meeting for review and comment. *See* CHAPTER 11.

- **Decide on a Fiscal Year**. Generally, this will coincide with the calendar year, but it is not required to do so. Often the bylaws contain a provision designating a fiscal year.

- **Select a Bank**. Choose a bank for the corporation's bank account and authorize signatories for the account. It is helpful to prepare for this by obtaining forms from the bank in advance of the meeting. The board of directors must adopt a resolution authorizing the opening of the account and signatories for the account. The bank usually will have a form resolution that you can use. To open a bank account, the organization will

need a federal employer identification number, commonly abbreviated as "FEIN" or "EIN". Information with respect to obtaining an EIN is provided below in subsection (b) of this Chapter. In addition to an EIN, many banks require proof of incorporation and proof you are an officer and governor of the organization. The organization's founding documents authorized by the Secretary of State (Certificate of Formation) can typically provide such proof to the bank, as well as a copy of the minutes of the initial organizational meeting at which the officers are elected.

- **Approve Any Legal Documents**. Approve initial leases, contracts, or other agreements to be entered into on behalf of the organization, if any. Approve the application for 501(c)(3) status, if prepared, and authorize execution of the form by a Director or officer, and authorize payment of the application fee.

- **Ratify Organizers' Actions; Approve Reimbursement of Expenses**. Adopt a resolution ratifying all of the organizers' and/or incorporators' actions taken on behalf of the corporation prior to the date of incorporation and approve reimbursement of their expenses, if any, upon review of the documentation of the expenses.

The secretary of the board or another designated individual should take notes during the meeting and prepare minutes for approval of the board. Upon approval of the board (usually approved by motion adopted at the next meeting of the board), the minutes should be kept among the permanent records of the corporation.

The organizational meeting can occur by unanimous written consent rather than an in-person board meeting or board meeting held by remote communication. Unanimous written consent is a record of the resolutions and decisions made by the board of directors and signed and dated by each director or consented by a director by email or signed electronically. The resolutions become effective on the date on which the last signature or consent is obtained. A copy of the executed unanimous consent should be kept among the permanent corporate records of the corporation. A sample form for a unanimous written consent for the initial meeting of the board of directors can be found on the Communities Rise Resources page.

a. Other Organizational Tasks

Several steps need to be completed after the incorporation of your organization.

- **Federal Employer Identification Number**. A federal employer identification number ("EIN" or "FEIN") is required for the application for tax-exempt status as a 501(c)(3) organization, is required by most banks in order to open bank accounts in the name of the corporation, and is required for a corporation to hire employees. The assignment of an EIN to your corporation is a straightforward process. To obtain an EIN, IRS Form SS-4 must be completed and filed with the IRS. The IRS permits filing of completed forms online through the EIN portal, by mail, or by fax. An EIN may also be obtained by a phone call to the IRS. The phone number is in the instructions to the Form SS-4. No filing fee is currently required to obtain an EIN. If the organization has a return fax number, the IRS will fax an EIN back to the organization. The Form SS-4 and SS-4 instructions are available on the IRS' website and can be downloaded.

- The EIN application requires basic information about the corporation such as name, address, and responsible party. The corporation will also disclose on the EIN application whether the corporation will be hiring employees within the next 12 months, and how the corporation wishes to report employment tax liability. Note that if you are completing the form online through the EIN portal, ensure that you check an "other" box to get to the nonprofit corporation page.

- **Master Business Application**. Upon the filing of the articles of incorporation with the Secretary of State, the Secretary of State's office provides a packet of information regarding new corporations in Washington State, including a Master Business Application form. You must also obtain Master Business Application forms from the Washington State Department of Licensing. Completion and filing of the Master Business Application, either online or through the mail, will provide your organization with its basic state tax registration and employer registration. Basic state tax registration (registration with the Washington State Department of Revenue) is required if the organization plans to engage in any business activity (which is broadly defined and may include a charitable activity that generates a stream of revenue). The Master Business Application form will also register the corporation for payment of certain state employment taxes. These include registration with the Department of Labor and Industries and establishment of an Industrial Insurance Account and registration with the Employment Security Department for purposes of unemployment insurance and workers compensation

insurance. *See* Part 8 on Washington State Taxes and Nonprofit Corporations.

- **Local City and County Licenses.** The Department of Revenue's Master Business Application online portal includes a number of local municipal licenses as well. However, many counties or city level municipalities will have a separate application process through separate portals for a corporation to obtain a license to operate in that municipality. Many municipalities will include a discount or waiver of a business license fee for 501(c)(3) organizations. Check the local municipal code in the city in which the organization is located for regulations regarding business licenses.

  See Chapter Part 8, CHAPTER 55-CHAPTER 61 State Taxes and Nonprofits.

- **Charity Registration**. Organizations within, and outside, Washington State, that solicit contributions from or in the state of Washington may be required to register with the Secretary of State by filing a Charitable Organization Registration. Much like the above forms, the Charitable Organization Registration requires submission of basic information, methods the organization intends to use to solicit donations, and financial information regarding assets at the beginning and end of the year. This registration, like the Annual Report, requires yearly updates with the Secretary of State. *See* CHAPTER 49 and CHAPTER 50 for more information on Charitable Solicitation registration. The Office of the Secretary of State website also has a Self Assessment Guide - Charitable Solicitations chart with information regarding whether an organization is required to make this filing.

CHAPTER 13. Registering and Filing with the Office of the Secretary of State

The Office of the Secretary of State (OSOS) is the government agency in which all corporations, including nonprofit corporations, are registered, created, and monitored through reporting from the corporation. It is also where nonprofits are monitored for their fundraising as a charity. This chapter provides basic information on how to register the nonprofit when it is created, how to file annual reports, and how to file the annual registration as a charity that is doing public fundraising.

The OSOS is also where the public can get information about nonprofits and trademarks for nonprofits that are registered and get information about the validity of charities in Washington state. There is online search capability on the OSOS

website for corporations, nonprofit corporations and charities. The OSOS records business documents (typically Articles of Incorporation and annual reports) for nonprofit corporations according to statutory requirements. This chapter will address the different types of business filings that nonprofits need to make. The OSOS uses the term "charities" which apply to charitable nonprofit corporations. Not all nonprofit corporations are charities. Generally, filings for nonprofit corporations can be submitted online using the Corporations and Charities Filing System (CCFS) or by mailing a completed paper form with payment. Same-day filing services are available in person during office hours for an additional processing fee. Anyone with questions about the filing process or the CCFS filing system can contact the OSOS Corporations division by emailing corps@sos.wa.gov or calling 360-725-0377. For Charity, Trust, or Commercial Fundraiser Filing assistance, please email charities@sos.wa.gov or call 360-725-0378.

a. OSOS Corporations Website

The Secretary of State Corporations website: www.sos.wa.gov/corps contains helpful information about nonprofit filings with OSOS, links to PDF fillable business forms, and a link to the Corporations and Charities Filing System. Information about the office or service disruptions will be announced on the Corporations and Charities homepages.

www.sos.wa.gov/Corps

www.sos.wa.gov/Charities

b. Corporations and Charities Filing System (CCFS)

The online Corporations and Charities Filing System (CCFS) is the primary method for filing business and charities program documents with the Secretary of State. In order to submit most filings a user account will be needed and can be created by any person who needs to file documents with the Secretary of State at any time. A record of completed filings, including payment receipts, confirmation letters, and file-stamped documents submitted by that specific user will be available after login on the user's dashboard. All documents that have been successfully filed with OSOS, except payment receipts, are also viewable for free using the Business Search, Charities Search, or Trademarks Search (with or without a user account).

A user account also allows a person or business to subscribe to specific businesses or charitable organizations. By subscribing, the user will see a quick

overview of the business and/or charitable organization, including the following information:

- Current business/organization name
- UBI/registration number
- Business/organization status
- Due date for the next Annual Report/Renewal
- Date the record was last updated
- Corporation subscriptions only: A countdown to a change in status (delinquent or administratively dissolved)

Video tutorials for Creating a User Account, Search Functionality, Registering a Business, and Filing an Express Annual Report are available on YouTube: https://www.youtube.com/user/secstatewa/playlists.

CCFS is periodically updated with new developments in order to comply with changes in state law and to improve the user experience. Information about changes to the system or updates regarding any disruptions in services will be announced through the OSOS Corporations website: www.sos.wa.gov/corps.

c. Filing with a User Account

After creating a user account and logging in, a user can submit many business and charity filings. To file with a user account, first select the type of filing you wish to submit, then, if applicable, search by the business's/organization's identifying information. Select the desired business/organization and proceed with the filing. A filing can be saved through "Save and Close" for up to 30 days. A saved filing can be accessed through the "Incomplete Filings" folder on the user's dashboard. When a filing is ready to be submitted, make sure the filing is open, then click "Continue" and follow the prompts to add the filing to the Shopping Cart. Finally, provide a credit card for payment and submit the filing. Up to 5 filings can be submitted together with one payment. Auto-completed filings will appear in the "Notices and Filed Documents" folder with a viewable confirmation letter and file-stamped documents. Any submissions that require OSOS staff review will appear in the same folder with the status: "Pending OSOS Review."

d. Registering a New Business or Nonprofit

To register a new business by filing the appropriate origination document, select "Create a Business" from the navigation menu. Next, select the business type and proceed with the original filing. While drafted articles are not required when

filing online, they can be uploaded as part of the online form. If drafted articles are uploaded, it is important to make sure all of the data entered into the online form matches the upload exactly. If there is text that is longer than what is accepted in one field the user may add "full text attached" within that field. Once payment has been provided and the filing submitted, OSOS staff will review the complete submission and return incomplete or unclear submissions for corrections.

e. Filing an Annual Report

To file an Annual Report, select "Annual Report" from the navigation menu, enter the business's name or UBI number, select the appropriate business, and proceed with the filing. Data from the most recently filed record will appear in most, or all, of the data entry fields. The user can edit, add, or remove information as needed in order to make sure the record is accurate. Additional documents are not required, but can be uploaded if necessary. Once payment has been provided and the filing submitted, if attachments were uploaded, OSOS staff will review the complete submission and return incomplete or unclear submissions for corrections. Filings with no attachments will auto-complete and the business's record will be updated immediately to reflect the most recent business information.

Annual Reports are due within 180 days of the business's expiration date, which is determined by the date of incorporation/formation. For example, if a business files Articles of Incorporation in January, the business will need to file an Annual Report within 180 days of January 31 every year in order to maintain an active business record with OSOS.

f. Express Annual Report

Businesses can file an Annual Report online without creating a user account by selecting the "Express Annual Report" option on the CCFS Home Page. Search by business name or UBI and proceed with the filing. An email address is required for the confirmation letter and payment receipt. Other than the records sent via email upon completion, a record of the filed annual report will be viewable only through the public Business Search. If the person filing the Express Annual Report has a user account, a copy of the filed Express Annual Report will not be recorded in that user's account/dashboard.

g. Charitable Nonprofits / OSOS Charitable Registration

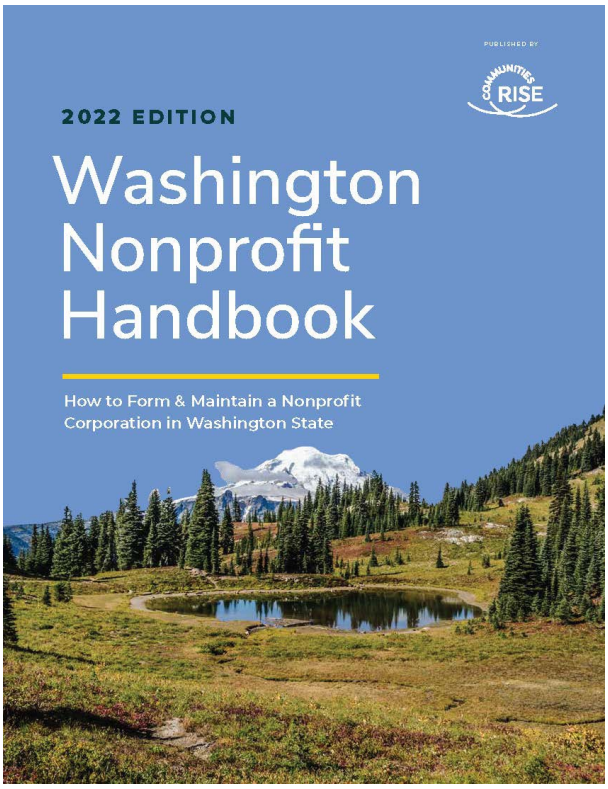
Nonprofit Corporations that are engaged in fundraising activities to support a charitable purpose may also be required to register with the OSOS Charities Program

according to RCW 19.09. Registration with the Charities Program is separate from nonprofit business filings and must also be maintained through a separate annual Charity Renewal. The renewal deadline for charitable filings is determined by the organization's accounting year. The two most common accounting years are explained below.

- An organization with an accounting year of January 1 through December 31 will need to file a Charity Renewal before November 30 of the following year (11 months after the completion of the reported accounting year).

- An organization with an accounting year of July 1 through June 30 will need to file a Charity Renewal before May 31 of the following year (11 months after the completion of the reported accounting year).

The OSOS Charities website: www.sos.wa.gov/charities contains self-assessment guides for filing with OSOS, links to PDF fillable charity, trust, and fundraiser forms, and a link to the Corporations and Charities Filing System. Information about the office or service disruptions will be announced on the Corporations and Charities homepages.



PART 3 GOVERNANCE AND OPERATIONS

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PART 3. GOVERNANCE AND OPERATIONS

CHAPTER 14. Importance of Acting Like a Corporation

a. Limited Liability

A nonprofit corporation is a legal entity separate and distinct from its directors, officers and employees. As such, liabilities and obligations incurred by the corporation, in the absence of unusual circumstances, must be satisfied out of the assets of the corporation and do not "pass through" to its directors, officers or employees. Put another way, a corporation provides a limited shield to its directors, officers and employees against payment of liabilities and obligations incurred by the corporation.

Notes on Terminology for Part III

The terms "director" and "board member" are used interchangeably; the terms "corporation" and "organization" are also used interchangeably; the term "officer" is used when referring to a director that has been elected to a leadership position on the board; and the term "member" is used in reference to those organizations with a membership group voting rights.

b. Personal Liability

In certain circumstances, a director, officer or member of a corporation may become personally liable for the corporation's liabilities and obligations. This may occur if the corporation's officers, directors or members fail to maintain the corporation's separate legal identity by confusing their individual identity with that of the corporation. This confusion of identities generally occurs when one or more of the directors, officers and/or members of the corporation mix their personal, individual interests with the corporation's business or operations, often for personal gain. In such cases, a court may choose to disregard the corporate entity created and hold the individuals acting on behalf of the corporation (i.e., the directors, officers and/or members) personally responsible for the corporation's liabilities and obligations. A court may choose to impose personal liability in this manner even though articles of incorporation creating the corporation, which limit an individual's liability, have been filed.

Courts and the Internal Revenue Service ("IRS") give particular scrutiny to cases involving a small number of individuals who fill multiple roles within the corporation, which is very common for a new nonprofit corporation. In deciding whether liabilities and obligations of a corporation will "pass through" to officers or directors, courts and the IRS scrutinize the corporation and its operation to decide if the corporation

meets certain minimum standards for consideration as a separate entity. For instance, courts examine whether the corporation has adequate funds to pay its creditors, whether the individuals commingled corporate and personal funds on a regular basis, whether the individuals failed to keep proper corporate records and whether the corporation generally failed to act like a corporation. The IRS may assess taxes and penalties personally against the corporation's principals if it concludes the corporation is not a valid separate entity.

A principal of a corporation (usually an officer or director) may also become personally liable for the liabilities of the corporation if the individual fails to make clear to persons with whom he or she is dealing that he or she is acting as an agent of the corporation and not as an individual. All business transactions of a corporation should clearly indicate that they are corporate transactions, and the representative capacity of the officers or directors acting on behalf of the corporation should always be disclosed.

c. Preventative Action

To ensure that a nonprofit corporation is considered a separate entity, regular meetings for both the board of directors and the members (if it is a membership organization) should be held meticulously. The board should also ensure that written minutes of these meetings are prepared and placed in the corporate record book. Nonprofit corporations should also be especially diligent in maintaining sufficient funds to pay their debts and in segregating corporate funds from the personal funds of the corporation's officers and directors. A failure to segregate funds could also result in loss of tax-exempt status or in penalties assessed to the director or officer. *See* the discussion in CHAPTER 33 on private inurement.

In all dealings on behalf of a nonprofit corporation, a director or officer should clarify the capacity in which he or she is acting. In addition, all signatory lines for contracts and other documents should identify the corporation by its full legal name together with the title of the officer or director signing the document. If the name of the corporation and the title of the signatory are not written above or under the signature line, the officer or director should add these by hand under his or her signature.

The following chapters illuminate the importance of explicit and robust policies, systems, and procedures for a nonprofit corporation; clearly defined roles and responsibilities for directors, officers, staff, and volunteers; and open and trusting relationships among all individuals and stakeholder groups. These practices

will preserve the corporate entity and enable it to work more effectively to accomplish your organization's mission.

CHAPTER 15. Function and Authority of the Board of Directors

Operating a nonprofit organization is a complex undertaking that involves multiple stakeholders, including board members, the executive director and other staff, volunteers, persons being served, and funders. The board of directors is responsible for setting overall priorities and ensuring that resources are used wisely in pursuit of the organization's mission.

Under the Act, a nonprofit corporation's board of directors is the governing body of the corporation and is responsible for managing the affairs of the corporation. The board may delegate certain of its responsibilities to committees and officers of the corporation, but the board retains ultimate responsibility for the corporation. A corporation exercises its powers through resolutions and acts of the board. Generally, the board delegates the day-to-day responsibilities of operating the corporation to paid or volunteer staff members.

a. Election, Number of Directors, and Board Terms

Under the Act, a corporation's board of directors must be composed of at least one individual, unless the corporation plans to qualify as a charitable tax-exempt organization under section 501(c)(3). In this case, the corporation must have at least three individuals on the Board. The articles of incorporation ("articles") or bylaws establish the number of and election method of the directors. The number of directors may be a range (e.g., "not less than seven or more than 15") and may be increased or decreased by amending the document that specifies the number. An amendment that decreases the number of directors cannot shorten the term of any current director. The articles or bylaws may provide that directors will be elected by the corporation's members or by the corporation's directors; in some circumstances, directors may be appointed.

The articles or bylaws specify the directors' terms of office. Terms can be for one year or several years. Nonprofit corporations typically choose terms of two or three years for their directors. Each director holds office until his or her successor has been selected and qualified. The terms of the directors may be staggered by providing that only some portion of the board seats are up for election at the same time. Staggering the directors' terms can provide valuable continuity on the board.

If the corporation has a membership with voting rights, the articles or bylaws may require that directors be elected by a majority vote of the corporation's members. Alternatively, the articles or bylaws may provide for a more complex manner of electing directors known as "cumulative voting." Cumulative voting permits each member or director entitled to vote to add all of the votes to which he or she is entitled and apply them toward one candidate's election or distribute the votes among several candidates. Members may vote by proxy if the bylaws permit proxy voting by members.

b. Action by the Board

To be a valid act of the corporation, the act must be approved by a majority of the directors at a board meeting in which a quorum is present. Unless the corporation's articles or bylaws state otherwise, a majority of the directors constitutes a quorum. A quorum may not be less than one-third of the total number of directors. The articles or bylaws may require a greater proportion of votes for certain acts by the board, such as the removal of a director or modification of the corporation's purpose.

A director may vote against (i.e., dissent) or not vote on (i.e., abstain) an action taken by the board. However, if the director is present at the meeting where the action is taken, it is assumed that the director consented to the action unless the director's dissent or abstention is recorded in the minutes or filed in writing with the secretary of the corporation.

Directors cannot appear by proxy or give their proxies to another director. Directors must be present to listen to the discussion, consider each resolution, and vote based on their judgment.

c. Removing Directors and Vacancies on the Board

A corporation's articles or bylaws may contain a procedure for removing directors. If the articles or bylaws provide for the election of any directors by members, yet fail to specify a procedure for removal, the Act specifies the following:

- Any director elected by members may be removed with or without cause by a vote of the members having voting rights with regard to director elections, at a meeting where a quorum is present, unless the articles or bylaws provide that directors may be removed only for cause. The vote must be a majority of the members present at such a meeting, unless the articles or bylaws require a greater vote. Note that members may be

represented in person or by proxy, if permitted by the bylaws (even though this option is not available to directors).

- If a corporation has cumulative voting, a director may be removed if the number of votes cast for removal would have elected the director at an election.

- The board of a membership corporation may not remove a director who has been elected by the members except as provided in the articles or bylaws or in the list of exceptions in RCW 24.03A.530(5).

- The directors may remove, with or without cause, one or more directors who have been elected by the directors in a membership or non-membership corporation, unless the articles or bylaws provide that the directors may be removed only for cause. The articles or bylaws may specify what constitutes cause for removal.

- The notice of a meeting of the members or of the Board at which a removal of a director is to be considered must state that the purpose or one of the purposes of the meeting is the removal of a director.

- If the articles or bylaws do not specify a procedure to fill a vacancy on the board, then a majority of the remaining directors may elect a new director unless the director is appointed by persons other than the members or designated by name in the articles or bylaws.

- The new director that is elected or appointed completes the unexpired term of the vacant position.

d. Committees

The Act provides for the establishment of two different types of committees, Board committees and advisory committees.

Board Committees. Unless the Nonprofit Corporation Act, the articles or the bylaws provide otherwise, the board may designate and appoint Board committees to perform certain activities of the corporation. However, even if the board appoints a committee and delegates duties to the committee, the board and individual directors remain ultimately responsible for duties imposed by law. Additionally, in order for a committee to have delegated authority from the board, it must have at least two directors as committee members. While a board committee may have members who are not directors, only directors may vote on board committees.

The Act prohibits the board from delegating certain powers or responsibilities to committees, including board committees. Committees cannot:

- Authorize distributions;
- Amend, alter, or repeal the corporation's articles or bylaws;
- In the case of a membership corporation, approve or propose to members action that must be approved by members under the articles or bylaws;
- Elect, appoint, or remove any member of the committee, nor any director or officer of the corporation;
- Adopt a plan of merger with another corporation;
- Adopt a plan of domestication, for-profit conversion, or entity conversion;
- Authorize the sale, lease, or exchange of substantially all of the corporation's assets;
- Authorize the dissolution of the corporation;
- Adopt a plan for distribution of the corporation's assets; or
- Amend, alter, or repeal any board resolution that by its terms may not be amended, altered, or repealed by a committee.

Advisory Committees. A nonprofit corporation may create or authorize the creation of one or more advisory committees whose members need not be a director or meet the qualification requirements for directors. The board shall not delegate any of its authority to an advisory committee, and an advisory committee may not exercise any of the powers of the board.

e. Meetings

(i) Annual Meetings

Nonprofit corporations with members must hold at least one annual meeting for members. Although corporations with or without members are not required to hold an annual board meeting, it is recommended that one be held. The annual member meeting is typically held for the purpose of electing directors for the next year and for discussion of general business matters. The annual board meeting is typically held for the purpose of electing directors (unless directors are elected by

members), electing or appointing officers for the coming year, adopting the corporation's budget, approving programs/activities, and forming plans and strategies. Holding an annual meeting ensures that elections necessary to elect directors and officers take place.

The corporation must give notice of the annual meeting to members using one of the methods approved in the bylaws no less than 10 or more than 60 days prior to the meeting. The corporation's bylaws establish the date of the annual meeting of members and directors for membership corporations and of directors for non-membership corporations. Failure to hold an annual meeting at the designated time required under the corporation's bylaws will not bring about a dissolution of the corporation, but it does put the corporation out of compliance with its bylaws and, as such, should be remedied as soon as possible by the board.

(ii) Regular Meetings

Beyond the annual board meeting, most boards will establish a schedule of monthly or quarterly meetings. The bylaws may permit regularly scheduled board meetings to be held with or without notice as long as the schedule of board meetings is approved at a board meeting. Board meetings may be held in or out of Washington State.

(iii) Special Meetings

Special board or membership meetings require that notice be sent to the directors or members. The procedure and timing for giving notice should be stated in the bylaws. Special meetings of the Board must be preceded by at least forty-eight hours' notice of the date, time and place of the meeting. If a director attends a meeting, the director waives the notice requirement, unless he or she attends the meeting solely to object to lack of notice. Notice of special meetings, whether a special meeting of the Board or the members, must include a description of the purpose for which the meeting is called. The bylaws should state whether other notices should include specific information about the business to be conducted at the special meeting.

(iv) Remote Meetings

Regular and special meetings of the membership or the board may be conducted by conference calls or remote meetings or similar methods of communication that allow comment and response by all members or directors at the same time. For any meeting at which one or more directors or members may

participate by means of remote communication, notice of the meeting must be delivered to each director or to each member together with complete instructions for participating in the meeting by remote communication.

(v) Board Action without a Meeting

Unless the articles or bylaws prohibit action without a meeting, action required or permitted by the Nonprofit Corporation Act to be taken by the membership or by the board may be taken without a meeting if each member or director entitled to vote with respect to the subject matter of such action executes a consent in the form of a record (which includes an email message) describing the action to be taken and delivers it to the nonprofit corporation.

f. Officers

Under the Act, the officers of a corporation consist of a president, a secretary, and a treasurer. The corporation may have one or more vice presidents if the Board creates the office of vice president in the articles or bylaws. The articles and bylaws may provide for the time and manner of the election or appointment of the officers; otherwise, the officers are elected or appointed annually by the board. The articles or bylaws may allow any two or more offices to be held by the same person except for the offices of president and secretary. Generally, the articles or bylaws list the specific duties and responsibilities of the officers.

Typical responsibilities of officers include the following:

- The president is responsible for facilitating the effective action of the board in governing and supporting the organization. The president sets the agenda for board meetings (in partnership with the chief executive, if one exists, or with an executive committee, if one exists) and leads board meetings. Often, the president appoints the chairs of all standing and ad hoc committees of the board.

- The primary role of the vice-president, if there is one, is to assume the responsibilities of the president in the event of her/his absence. Often, the vice-president also carries out special assignments as requested by the president or the executive committee. If an organization has multiple vice-presidents, each is typically charged with a set of unique responsibilities.

- The secretary is responsible for maintaining corporate records. The secretary ensures that accurate meeting minutes are recorded and

retained, and that notices are duly given in accordance with the provisions of the bylaws.

- The treasurer is responsible for managing the board's review of, and action related to, the organization's financial health. The treasurer ensures that comprehensive financial reports are made available to the board on a frequent basis (at least quarterly), and identifies opportunities to strengthen the board's ability to carry out its fiscal responsibilities. The treasurer is accountable for maintaining accounts and appropriate fiscal controls and ensuring that appropriate taxes and tax forms are timely filed.

g. Minutes and Other Corporate Records

A nonprofit corporation should keep a written record of all members (if the corporation has members), board, and committee meetings. Such records are kept in the form of minutes. Minutes to a meeting should include the following:

- Identification of the group that is meeting;
- Date of the meeting;
- List of those individuals present; and
- Description of items discussed and action taken on each item (including the wording of the motion or resolution adopted). If there is a conflict of interest with respect to an item, the procedure for a conflict of interest should be followed and recorded. *See* CHAPTER 11 for a discussion of a conflict of interest policy.

Optional items include a list of those absent and/or excused; a summary of the discussion that occurred with respect to each item; information regarding a vote on an item (number in favor, opposed, abstentions), identification of the individuals making and seconding motions or resolutions, and copies of motions and resolutions that failed to pass.

After the meeting, the minutes should be prepared from the notes or recordings taken at the meeting. The draft minutes are then presented at the next meeting of the group for review and approval at the meeting. Some organizations send draft minutes out to the group prior to the meeting for review. Any corrections or revisions to the minutes made by the group at the meeting should be reflected in the minutes as adopted by the group.

h. The Corporate Record Book

Each nonprofit corporation should keep a corporate record book or series of books containing all of its organizational and corporate documents. These documents include the articles and bylaws, any amendments to the articles or bylaws, minutes of all board, membership and committee meetings, waivers of notice or notice of all meetings, all policies, tax-exemption application and determination letters, annual reports, annual financial statements and audited financial statements, membership certificates, all insurance policies, warranties, contracts, leases and other legal documents, and copies of all communications with board members, officers, members and contributors. Corporate records should be kept at the principal office of the corporation.

i. Public Documents

Certain corporate documents are part of the public record. In Washington, all public corporate records are kept in Olympia by the Corporations Division of the Secretary of State. The public corporate documents include the articles of incorporation and any amendments, articles of merger or consolidation, articles of dissolution, the name of the registered agent and the addresses of the registered office and registered agent, the corporate annual report forms that disclose the names and addresses of the corporation's directors and officers, and certain other information such as the Unified Business Identifier (UBI), Employer Identification Number (EIN), the license expiration date, the type of corporation (nonprofit), and, with respect to corporations incorporated in other states that are qualified to do business in Washington, their states of incorporation. The annual reports filed under the Charitable Solicitations Act and the Charitable Trust Act are also part of the public record.

CHAPTER 39 discusses which documents are subject to disclosure under federal law for section 501(c)(3) organizations.

CHAPTER 16. Duties and Obligations of Board Members to the Corporation

a. Duty of Care

A director of a nonprofit corporation should take seriously the responsibility of managing the affairs of the corporation. The Act requires a director to perform his or her duties "in good faith, in a manner such director believes to be in the best interests of the corporation, and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances."

A director must stay informed about the general affairs and finances of the corporation. Directors should examine financial statements regularly—at least quarterly—to ensure that the corporation has adequate funds to pay its debts, and that those funds are being used to further the corporation's mission and goals. An annual budget for the corporation should be approved prior to or at the beginning of each fiscal year.

The Act does not require directors to attend board meetings (though bylaws often include such a requirement). However, a director who is frequently absent from meetings will find it difficult to contribute in a meaningful way and to fulfill his or her duty of care. Organizations that are especially concerned about absenteeism can include a provision in their bylaws specifying that a director who is absent a certain number of times shall be deemed to have resigned from the board.

Directors are expected to use common sense and practical judgment; they are not expected to be experts in every matter the board considers. In performing his or her duties, a director may rely on information, opinions, reports, or statements—including financial statements and other financial data—prepared or presented by an officer or employee of the corporation whom the director believes to be competent and reliable in the matter presented; professionals such as attorneys, accountants, or others, if the matter is within that person's expertise; or a committee on which the director does not serve, if the matters are within the committee's designated authority. However, if a board member has a particular expertise (e.g., accounting), he or she is expected to utilize this deeper knowledge.

Because the board is typically comprised of outsiders who do not participate in the daily management and operation of the corporation, directors often rely on staff or volunteers to provide them with information about the corporation's operations. Directors must carefully evaluate this information to ensure that problems or potential risks or liabilities are not being withheld from or misrepresented to the board.

b. Duty of Loyalty

A director must act with the best interest of the corporation in mind, and not for his or her own personal benefit or the benefit of another person or organization. Conflicts of interest, or potential conflicts of interest, should be avoided. In the event that a conflict of interest is unavoidable, the conflict should be disclosed to the board, and the director with the conflict should abstain from the discussion and the vote. It

is advisable that the director with the conflict leave the room or the call so that the board can have a full discussion regarding the matter.

It is useful and is widely considered to be a "best practice" for a nonprofit corporation to have a written conflict of interest policy. *See* CHAPTER 11. In addition to providing a procedure for disclosing and resolving conflicts of interest, the policy should require that each officer, director and key employee submit an annual disclosure statement specifying such individual's (and his or her family members'):

- Business relationships with any entity that contracts with the corporation;
- Investments in companies from which the corporation obtains goods or services, to which the corporation sells goods or services, or that provides goods or services in competition with the corporation;
- Outside activities involving board, advisory board, or managerial or consulting services for any outside business, government agency, or individual that does business or competes with the corporation;
- Specific transactions with the corporation related to the sale, exchange, or lease of property; lending of money or other extension of credit; furnishing of goods, services, or facilities; payment of compensation, or payment/reimbursement of expenses in excess of $1,000; and the transfer of income or assets; and
- Other activities that might be regarded as a potential or actual conflict of interest in connection with his or her position with the corporation.

Directors are prohibited from entering into any transaction that involves the flow or transfer of income or assets through or away from the corporation for the benefit of anyone associated with the corporation. Additionally, the Act prohibits the corporation from lending money or extending credit to any of its directors. Any director engaging in such a transaction and any director participating in the making of such a loan or extension of credit is liable to the corporation for the amount of the loan until it is paid.

Confidential matters of the corporation should be respected by all directors. Questions related to whether or not something is confidential should be discussed with the board and/or legal counsel.

c. Duty of Obedience

Directors must act lawfully when conducting business on behalf of the corporation. Directors must also act within the scope of authority and purpose of the corporation as specified in the corporation's governing documents. Finally, directors should ensure that the corporation is in compliance with laws and other regulations.

d. Other Obligations

1. Duty to share relevant information. In addition to the duties described above, directors and officers of the organization each have an additional duty to convey information to the board, committee members or, in the case of officers, their superiors if such information is either known by the director or officer to be material to the operations of the organization or relates to a violation or probable violation of any law or regulation and involves the organization. This duty is explicitly stated in the new act that went into effect on January 1, 2022.

2. Additional obligation to act as a group. A board of directors functions as a group. A director cannot speak on behalf of the board or act for the board outside a meeting, unless authorized by the board as a whole. Any director attempting to act on behalf of the board without explicit authorization is exceeding his or her authority. However, officers and some committee chairs may have implicit authority to perform certain routine tasks associated with their jobs.

e. Models of Governance

In an effort to clarify the roles and responsibilities of nonprofit boards, several organizations and academic researchers have developed "models of governance" for nonprofit corporations. Most of these models go beyond simply restating the legal duties of boards and directors, aiming to set forth critical functions and processes of nonprofit boards. Alternative forms of governance models are being explored that share governance and leadership functions across the board and staff of the organizations. *See* CHAPTER 6 Alternative Leadership. Whether the model of governance is traditional as described below in the "CompassPoint Board Model for Governance Support, " discussed below, or in an alternative shared leadership model, board members must meet their fiduciary duties as required under Washington Nonprofit Corporation Act.

A widely used traditional model is The CompassPoint Board Model for Governance and Support (CompassPoint, 2003). As the name implies, the CompassPoint Model suggests that boards and directors fulfill two roles: governance and support. The objective of governance functions is to represent the community's interest within the organization, asking, "Is our organization using public and private resources to benefit the community?" The objective of support functions is to represent the organization's interest in the community, posing the question, "How can I, as a member of the board, best represent the organization in the community?"

The entire board acts as a unit when fulfilling governance functions. Board members generally act individually or through committees when fulfilling support functions.

Governance responsibilities include the following:

- *Direction*—determine mission/purpose and vision. In a traditional model, the Board determines the mission/purpose and vision. In an alternative shared leadership model, staff and community may participate in setting the mission, purpose and vision of the organization.

- *Legal Affairs*—ensure compliance with laws and regulations and fulfillment of contractual obligations; manage risk; obtain adequate insurance coverage. Under the law, board members have a fiduciary duty to make sure the organization is in compliance with all laws and regulations. In both traditional and alternative shared leadership models, the board must monitor legal compliance. Often, executive and/or operational staff play a role in obtaining adequate insurance coverage.

- *Finances*—approve annual budget; review financial statements; safeguard assets from waste and misuse; review audit (if applicable); manage investments (if applicable). Under the law, the board has a duty to oversee the finances of the organization including making sure that there are policies in place to prevent fraud, ensuring there is enough money to cover expenses, tax obligations are met and audits are appropriately conducted. In traditional governance models, the board and Executive Director prepare the budget, often without input from staff and the board approves the budget. In an alternative shared leadership model, program staff may play a role in developing the budget for their programs and may provide input on spending priorities.

- *Human Resources*—hire/fire, support, evaluate, and set compensation for the executive director; ensure that the organization has appropriate personnel policies. In traditional models, where there is just one Executive Director, the board hires and fires the Executive Director, evaluates the Executive Director's performance and sets compensation. In an alternative shared leadership model, staff may provide input and have a role in decision-making on developing personnel policies and may sit on the hiring committee for the executive leadership. For example, if the staff are unionized, the staff, through the union, may approve personal policies.

- *Fundraising*—approve fundraising strategy and monitor progress. In a traditional model, the board may play an active role in fundraising, including approving fundraising plans. In an alternative shared leadership model, staff dedicated to fundraising and program staff may play a role in decision-making on fundraising strategy especially with respect to whether to pursue grants and contracts that are directly impacting the programs they are working on.

- *Planning*—determine overall priorities/objectives (and related strategies). In a traditional model, the Board may set the strategic direction of the organization. In an alternative shared leadership model, staff and community may provide input and even be involved in decision-making on strategic and programmatic planning.

- *Programs*—approve new programs; support the use of program evaluation to measure impact. In a traditional model, depending on the size of the organization, the board may approve new programs and funding for new programs. In an alternative shared leadership model, staff who are closest to the program work play a large part in designing and making decisions on programs.

- *Impact/Efficiency*—maximize the use of resources. In traditional models, the board may conduct evaluations on the programs and overall effectiveness of the organization. In alternative shared leadership models, staff often will play a role in evaluation of the programs.

Support responsibilities do not generally require decision making by the board. In both traditional and alternative shared leadership models the board can provide varying levels of support to the organization. Support responsibilities can include the following:

- *Fundraising*—contribute to the organization's resource development efforts (e.g., make a contribution according to one's own means; plan and volunteer at fundraising events; solicit cash and noncash contributions; share contacts).

- *Public Relations*—act as an ambassador on behalf of the organization and its clients/customers.

- *Volunteerism*—recruit and encourage volunteers (including new board members).

- *Advice*—serve as a sounding board; advise staff in areas of expertise.

- *Reputation*—lend name and personal credibility to the organization for use in brochures, grant proposals, and the like.

It is important to note that, when fulfilling support functions, directors will typically be taking direction from staff. Board members should be cognizant of this important distinction.

Various factors—organizational culture, leadership structure, size of the corporation and board, stage of organizational growth, financial resources (and constraints), and many others—will dictate the amount of time that directors will spend on governance versus support functions.

f. Board Member Job Description

Clarifying expectations for individual board members is critical in both traditional and alternative shared leadership models. It is also important to be clear on the time and financial expectations. Many organizations have found it useful to create a "job description" or "contract" for directors. Directors are not usually compensated for their board service. However, some organizations provide reimbursement of expenses incurred during the performance of board duties, including attendance at board-authorized meetings and conferences.

CHAPTER 17. The Role of the Executive Director

a. Typical Responsibilities

In traditional governance and leadership models, the executive director (or chief executive officer) reports to the board of directors and is responsible for the overall management of the organization. The executive director should receive a

formal evaluation from the board on an annual basis. In new alternative shared leadership models, the executive functions and responsibilities of an organization are usually shared among two or more people in the organization and can even rotate among staff. *See* CHAPTER 6 Alternative Leadership.

In traditional governance models, the Executive Director works in collaboration with the board, and assumes responsibility for overall organizational leadership, visioning, and long-range planning, as well as board development.

Strategic planning and decision-making on programs and direction of the organization is an area that alternative leadership models diverge from traditional models. Typically, in alternative shared leadership models, strategic and program planning and decision-making is shared among staff who are closest to the work and the community the organization is serving. Philosophically, alternative leadership models value decision-making that is closely informed, aligned and made by the individuals who are closest to the problems the organization is trying to address. Ideally, alternative shared leadership structures make sure that decisions are made with the best information from the people closest to the work and other parts of the organization that may have important information that impact the decision, like financial and human resources considerations.

In traditional governance models, where there is singular leadership by one Executive Director or in alternative shared leadership models where executive leadership is distributed across two or more individuals, the following executive responsibilities must be covered:

- Financial management, including budgeting, financial forecasting, and fiscal oversight;
- Fundraising and resource development;
- Program development, implementation, and evaluation;
- Community relations, including outreach, marketing, communications, and advocacy;
- Human resources management, including the development of sound personnel policies and practices;
- Staff and volunteer recruitment, selection, evaluation, and development; and

- Compliance with federal, state, and local regulations.

Compensation among executive directors varies considerably—based on budget size, number of staff, interest area, cost of living, and a host of other factors. One free source for salary data for King County is the 501 Compensation Tracker. There are several other national surveys that provide regional data for a cost. *See* 501 Commons Nonprofit Salary Information.

In "The Nonprofit ED's First 100 Days," *The Nonprofit Quarterly* offers advice and guidance for new executive directors. In general, the authors suggest that these critical days should be focused on gathering information, expressing curiosity and interest about the details of the work of new colleagues, and preparing to lead the organization toward the future in light of the goals and commitments expressed during the hiring process. These questions can be used a resource for anyone or group of people involved with executive leadership.

The article proposes "Eleven Questions for a New Leader." They are:

(a) How should I sequence these first 100 days?

(b) Am I confident that I understand the organization's current situation?

(c) What are this organization's top three opportunities and challenges? To what extent is there agreement, dissent, or indecision about priorities?

(d) Which relationships are most critical for me to sustain? Who would expect to hear from me early in my tenure?

(e) How should I allocate my time among internal and external relationships? How do others view this distribution?

(f) What information and sources of information do I need to master to understand the field and environment of this organization?

(g) Does my newness open avenues for changed relationships, new support, or repaired bridges?

(h) What symbolic moves could I take to denote a new era?

(i) Who else applied for this position whom I should now call on?

(j) What might I later regret that I didn't do early on?

(k) What weaknesses in my own personality or style do I need to compensate for?

Oliver Tessier & Ruth McCambridge, *The Nonprofit ED's First 100 Days*, Nonprofit Q., Spring 2008, at 38-43.

b. The Executive Director/Board Partnership

An effective partnership between the board and the executive leadership can, among other things, enhance the prospects of success for the executive director and increase levels of satisfaction and retention among board members. Suggestions for enhancing this partnership include:

- Take time to establish relationships (and renegotiate "ground rules") with each change in board president or executive director;
- Clarify and respect roles;
- Minimize surprises;
- Communicate regularly between board meetings;
- Work together to develop board meeting agendas;
- Collaborate on board orientation, training, evaluation, and leadership development; and
- Show appreciation for one another's contributions to the organization.

c. Serving on the Board

When the executive director or any executive leader serves on the board, it is typically in a nonvoting role. If the executive director has a voting position on the board, he or she will need to abstain on all matters related to the board's personnel functions (e.g., setting the compensation for the executive director) as well as other matters where a potential conflict of interest may exist.

Regardless of whether the executive director serves on the board, he or she should help set agendas for board meetings and attend and actively participate in these meetings.

CHAPTER 18. Board Development

a. Recruitment of Directors

Every nonprofit desires and deserves a committed, knowledgeable, and effective board of directors. A nonprofit corporation should choose its directors carefully, in light of the needs of the corporation as well as the talents and characteristics of current and prospective board members. Areas to consider include:

- *Representation from the communities the organization is serving.* This is a key factor in board composition. The board should have a connection and understanding of the challenges and assets that the communities they serve have. There is no better way to have that connection and understanding than having the community representation on the board. Many funders want to know if the staff and board represent the communities that are served.

- *Personal qualities* such as enthusiasm, creativity, passion for the cause(s) of the organization, and interpersonal skills;

- *Skills and knowledge* in areas such as marketing, evaluation, human resources, legal affairs, finance, fundraising, management, leadership, and the organization's service area(s); and

- *Diversity in demographics* such as age, gender, and race/ethnicity.

b. Orientation and Training

The foundation of an effective board of directors is orientation and education. A board orientation program should be provided for all new board members, and the orientation should include time for socializing and relationship building. Potential topics for an orientation program include:

- Organizational history;

- Vision, mission, values;

- Current programs;

- Organizational priorities and significant issues/challenges;

- Budget, including an overview of major sources of funding;

- Expectations of board members;
- Parliamentary procedure (if followed); and
- An overview of board manual contents.

All directors should receive a board manual, and the contents of the manual should be updated on a regular basis. The board manual is typically developed by staff in consultation with board officers or the board development committee. For new board members, the manual serves as an orientation handbook that provides useful information about the organization. For the remainder of a director's term, the manual becomes a central resource about the organization and the activities of the board. Contents may include:

- Vision, mission, and values statements;
- Brief written history of the organization and/or an organizational fact sheet;
- Brochures, newsletters, or other publications;
- Articles of incorporation, bylaws, and IRS determination letter;
- Key policies (e.g., conflict of interest, investment, travel/meeting expense reimbursement);
- Most recent annual report;
- Most recent audited financial statements and form 990;
- Current strategic plan and/or other long-range planning documents;
- Current annual budget;
- Board meeting minutes;
- Written expectations/responsibilities of board members (both individually and collectively);
- Committee descriptions;
- Directors' and officers' insurance coverage summary;

- List of current directors and officers (with titles and affiliations and contact information);
- Brief biographies of the ED/CEO and other management staff; and
- Organizational chart.

Nonprofit organizations should make a commitment to the on-going education of board members. Training can be offered to the board as a whole (e.g., as part of an annual board retreat) or individual board members can be given the opportunity to attend conferences and trainings in the community. Common training topics for board members include:

- Financial management (understanding financial statements);
- Board roles and responsibilities;
- Cultural competency;
- Parliamentary procedure (if applicable);
- Fundraising (especially individual donor cultivation); and
- Strategic thinking and planning.

c. Evaluation

Boards have a responsibility to assess the effectiveness of both executive leadership and the board as a whole. This is commonly handled through an annual board self-evaluation process. Areas to review include board composition, board recruitment, committee structure, meetings, decision-making processes, relationships with staff and other key stakeholders, and overall strengths and weaknesses.

CHAPTER 19. Annual Reporting Requirements

Each year, the Washington Secretary of State sends an annual corporate report form to every Washington nonprofit corporation. The corporation must return the report with the required fee to the Secretary of State by the due date to preserve its corporate status. Generally, the Secretary of State sends the report to the corporation's registered office at least 30 days prior to the required filing date. The report requests a list of the corporation's officers and directors, any change to the address of the corporation's registered office or agent and other basic

information. A corporation's failure to file the report within the required time period results in automatic dissolution of the corporation by the Secretary of State. A nonprofit corporation may also be required to file annual reports pursuant to the Charitable Trust Act (*see* CHAPTER 20), if the organization holds charitable assets in a trust or the Charitable Solicitations Act (*see* CHAPTER 49). Finally, the corporation may be required by federal tax law to file a Form 990. *See* CHAPTER 39 for a discussion of this form.

CHAPTER 20. Entities to Report as Charitable Trusts

The Charitable Trust Act ("CTA"), codified in RCW 11.110, applies to all entities, including corporations that meet the definition of a "trustee." A nonprofit corporation meets this definition if it is formed for the administration of a charitable trust. Although nonprofit corporations hold charitable assets, they may not be holding that property in a charitable trust. Only nonprofit corporations holding assets in a charitable trust are subject to the CTA.

a. The significance of the CTA include:

(i) Attorney General Enforcement Powers

The CTA empowers the attorney general to enforce the terms of the trust as the statutory representative of its public beneficiaries. Trustees are required to give the attorney general notice of all judicial proceedings affecting the trust or its administration in which the attorney general is a necessary party. The attorney general is authorized to investigate transactions and relationships involving the trust. This includes the authority to issue administrative orders requiring any person to appear to answer questions regarding trust administration. *See* CHAPTER 25 for Attorney General enforcement powers for nonprofit corporations that are not holding property in charitable trusts.

(ii) Registration Requirement

Perhaps of greater day-to-day importance, some trustees are also required to register and report annually to the Secretary of State concerning the trustees' affairs. While the law defines "trustee" for purposes of the attorney general enforcement powers very broadly, it requires only some trustees to register with the Secretary. The registration requirement applies when:

- The trustee holds assets that are invested for income-producing purposes. Even though assets are invested, all or part of the principal or income of

the trust must be presently available for charitable purposes. A trustee is not required to register if the trust's terms require that the assets be entirely expended for a charitable purpose within one year; and

- The assets have a value of at least $250,000.

b. How to Register and Report Under the CTA

To register under the CTA, the trustee must file with the Secretary of State a copy of the instrument establishing the trust, an inventory of assets, and a registration form provided by the Secretary.

The annual reporting requirement is satisfied by filing with the Secretary a copy of the corporation's publicly available United States tax or information return, such as a Form 990 or 990 PF. A corporation that is not required to file either of these returns can instead file a separate form provided by the Secretary, describing the corporation's financial affairs.

CHAPTER 21. Amending Governing Documents

a. Generally

It is advisable for the board of directors of a nonprofit corporation to review its articles of incorporation and bylaws on a regular basis to ensure that the provisions in these documents are still accurate and not out of date. For example, the board will want to confirm that all of the activities conducted by the organization fall within the organization's purposes set forth in the articles. The procedures set forth in the bylaws should be confirmed as current practices of the organization.

b. Amending Articles; Restatement

A nonprofit corporation may need to amend its articles of incorporation at some time after its formation. The most common reasons for an amendment to the articles include (a) a change of name, (b) addition of or a revision to one or more of its purposes, or (c) addition of one or more of the provisions required by federal tax law to satisfy the organizational test necessary to qualify as a 501(c)(3) organization. *See* CHAPTER 26 for a description of the requirements of the organizational test.

The Washington Nonprofit Corporation Act sets forth the statutory procedure for amending articles of incorporation. In addition, the corporation's bylaws and articles should be checked for any additional requirements, such as more stringent notice or additional approval requirements. A document containing the revised or

additional language, called "Articles of Amendment" must be drafted. The procedure for a nonprofit corporation to adopt the Articles of Amendment differs for corporations with voting members and corporations with no members or no voting members:

- For corporations with voting members, the board of directors first passes a resolution approving the proposed Articles of Amendment and directing a vote of the members. The board may also need to call a special meeting of the members for the vote in accordance with the notice requirements in the Nonprofit Corporation Act. The members of the corporation then vote on the proposed Articles of Amendment at a regular or special membership meeting duly called in accordance with the bylaws or by mail-in or electronic ballot unless this is restricted in the bylaws. The proposed Articles of Amendment must receive a vote of the number of the members present at a meeting in which there is a quorum of members that is set forth in the Articles or Bylaws of the corporation.

- For corporations with no members or no voting members, the board approves the proposed Articles of Amendment at a regular or special meeting of the board held in accordance with the bylaws. The vote to approve the Articles of Amendment must be by a majority of directors in office at a meeting in which a quorum is present. Such a vote can also be held by unanimous consent resolution.

After receiving the required corporate approval, the Articles of Amendment, signed by an officer of the corporation, are filed with the Secretary of State with the appropriate filing fee. A closing paragraph of the Articles of Amendment recites the corporate approval obtained, including the date such approval was received. The Secretary of State's website contains a helpful form reciting the required information. The Articles of Amendment become effective on the date of filing with the Secretary of State or on the later date stated in the Articles of Amendment.

If a corporation has amended its articles of incorporation several times or has significantly revised the articles, it may prepare and file restated articles, which integrate all of the amendments into a single document. The restated articles must be approved using the process described above and filed with the Secretary of State with the appropriate filing fee.

c. Bylaws

Nonprofit corporations amend their bylaws more frequently than they amend their articles of incorporation. The bylaws are amended in accordance with the procedure set forth in the bylaws themselves or in the articles of incorporation. If there is a procedure for amending the bylaws in both the articles and the bylaws, the procedure in the articles must be followed. Generally, amendments to the bylaws are effective with board approval alone. However, it is common for nonprofit corporations with voting members to require approval of bylaw amendments by the members. Even if a membership vote is not required, it is not unusual for the procedure for amending bylaws to call for a supermajority vote of the board or for special notice or meeting requirements. In addition to amending the bylaws, the board may also repeal one or more of the bylaws or adopt new bylaws. Once adopted, the bylaws continue to govern the affairs of the corporation until the bylaws are either amended or repealed.

CHAPTER 22. Sarbanes-Oxley, Documentation Retention, Financial Controls, Whistleblowers, and Audits

With the passage of the Public Company Accounting Reform and Investor Protection Act of 2002 (often referred to by the names of its principal sponsors as "Sarbanes-Oxley," or "SOX" for short), corporate America was prompted to give more attention to governance and financial accountability. This law focuses primarily on the financial affairs of publicly traded corporations. Two of the provisions of Sarbanes-Oxley have very broad application, though, and directly pertain to the operations of most nonprofit organizations.

Preservation of Records

Title VIII of the Sarbanes-Oxley Act (SOX) extends criminal penalties to anyone who "knowingly alters…any record…with the intent to…obstruct…the investigation or proper administration of any matter within the jurisdiction of any department or agency of the United States." (section 802). Destroying or altering documents related to an IRS investigation of a nonprofit organization's Form 990 (*see* CHAPTER 35) is an example of the kind of behavior this section is designed to punish. Nonprofit organizations may frequently be required to file other reports with federal agencies that fall within the scope of this section. Adopting policies that guard against violating SOX is good business practice for any organization that files reports with the federal government.

Every nonprofit organization should preserve the documentation used to prepare any reports and, in particular, make clear to all volunteers and employees that documents cannot be destroyed or altered in any way if an investigation of the organization's affairs are on the horizon or underway.

Protections for Whistleblowers

Title XI of SOX establishes penalties for anyone who "knowingly, with the intent to retaliate, takes any action harmful to any person…for providing to a law enforcement officer any truthful information relating to the commission or possible commission of any Federal offense." (section 1107). Policies and procedures that protect whistleblowers and prevent retaliation are important and guard against potential violations.

If it is easy for clients, volunteers, employees, and vendors to bring attention to suspicious behavior in ways that avoid embarrassment and risk of retaliation, they are much more likely to do so. In turn, the risks that an organization's assets will be misused, misappropriated, or misreported is greatly reduced. There are firms that operate confidential whistleblower reporting systems using toll-free telephone numbers. It is also possible to ask volunteers to collect confidential tips and reports. Compliance with SOX requires assurances that reporting in good faith, even if it turns out to be a mistake, will not expose the whistleblower to adverse consequences.

Financial Reporting and Charitable Solicitations

The Washington Charitable Solicitations Act (RCW 19.09) requires most organizations that solicit contributions from the public for charitable purposes to register and report on their activities annually to the Charities Program in the Office of the Secretary of State; there are penalties for false or misleading reports. (*See* CHAPTER 49 for a description of the requirements of the Charitable Solicitations Act.) Section 541 of the Act requires all soliciting organizations to follow certain financial reporting requirements (specified in RCW 19.09.075). Those with amounts over $1 million in gross receipts (averaged over three years) are required to provide specific financial information – which may include the Form 990 the organization has filed with the IRS – to the public either in response to inquiries or on a publicly available website. Soliciting organizations with more than $3 million in revenue are required to have an independent, third-party audit performed annually and to make the resulting report readily available. (*See* more on Washington's charitable solicitations law online RCW 19.09,Exposure and Risks of Directors and Officers).

CHAPTER 23. Exposure and Risks of Directors and Officers

a. Directors' and Officers' Liability and Exposure

A director or officer is not automatically liable simply because the corporation is sued. Rather, liability arises because the director or officer is charged with some breach of a duty owed either to the corporation or to a specific party. Suits against directors or officers typically are brought in one of three ways:

- An outside party may sue a director or officer directly, claiming some injury by the corporation.
- A party may assert some right of the corporation against a director or officer, suing to enforce the right of the corporation. This type of suit is referred to as a "derivative action." In effect, the corporation is suing the director or officer to enforce the corporation's rights, typically because of an alleged breach of the director's or officer's duty of care or duty of loyalty to the corporation.
- A director or officer may be held independently liable under various statutory provisions concerning issues such as employment practice claims, environmental claims, tax delinquencies or antitrust claims.

Another source of possible liability arises in the context of corporate loans. Washington law prohibits nonprofit corporations from making loans to directors or officers. Any director who votes for or assents to such a loan and any officer who participates in making such a loan will be jointly and severally liable to the corporation for the loan amount until the loan is repaid.

Directors and officers may also be held personally liable for failure to pay federal payroll taxes to the IRS.

b. Indemnification

Directors and officers of a nonprofit corporation typically will want the corporation to have a program of indemnification to the maximum extent permitted by applicable law. In Washington, a nonprofit corporation may indemnify its officers and directors to the same extent as a for-profit.

A corporation may indemnify its directors and officers whether or not they successfully defend against a suit, so long as the director or officer acted in good faith and reasonably believed that actions taken on behalf of the corporation were in the

corporation's best interests, and that any other actions (i.e., actions taken in their individual capacities) were not opposed to the corporation's interests.

In a criminal proceeding, indemnification is allowed only if the director or officer had no reasonable cause to believe the conduct was illegal. A corporation may not indemnify a director or officer if the director or officer is found to be liable to the corporation or if the director or officer received an improper personal benefit.

A nonprofit corporation may pay for or reimburse the reasonable expenses incurred by a director or officer who is a party to a proceeding in advance of the final settlement of the proceeding if the director or officer states in writing that he or she acted in good faith and reasonably believed that his or her conduct was in the corporation's best interests and the director or officer states in writing that he or she will repay the advance if it ultimately is determined that the standard of conduct described above was not met.

The corporation must authorize an advance of expenses by a provision in its articles of incorporation or bylaws or by resolution adopted by the board of directors.

If a corporation indemnifies or pays the expenses of a director's or officer's defense against liability, the corporation must provide a written report to its members (if any) before the next members' meeting (note: this provision only applies if a corporation has "members").

c. Statutory Protections

A corporation's articles of incorporation or bylaws may contain certain provisions that eliminate or limit the personal liability of a director to the corporation. Such provisions, however, may not eliminate or limit the liability of a director for acts or omissions that involve:

- Intentional misconduct by a director;
- A knowing violation of law by a director; or
- Any transaction from which the director will personally receive a benefit in money, property or services to which the director is not legally entitled.

Limiting a director's personal liability is discretionary on the part of the corporation, and may be incorporated into an organization's articles. There is no similar provision for officers.

Both officers and directors of nonprofit corporations are afforded some protection against personal liability to third parties under Washington's special immunities law. A director or officer of a nonprofit corporation is not individually liable for any discretionary decision or failure to make a discretionary decision within his or her official capacity as a director or officer unless the decision or failure to decide constitutes gross negligence.

A federal statute entitled the Volunteer Protection Act of 1997 (the "Volunteer Act") may also provide some protection to directors and officers of nonprofit corporations. This statute, which took effect in September 1997, provides immunity from personal liability to volunteers, including unpaid directors and officers, working for nonprofit corporations for acts or omissions within the scope of their assigned responsibilities. To qualify for protection under the Volunteer Act, certain criteria must be met:

- A person seeking protection under the Volunteer Act must be a "volunteer." The Volunteer Act defines a volunteer as a person who provides services to a nonprofit organization but does not receive compensation or anything of value in excess of $500 per year for his or her services. Thus, if a nonprofit corporation's directors or officers receive compensation for their services, the Volunteer Act's protection will not apply. A director or officer may, however, receive reimbursement of his or her expenses.

- The volunteer must have been acting within the scope of his or her responsibilities for the organization at the time the harm took place. In other words, the officer or director must have been acting in his or her capacity as an officer or director of the corporation, rather than in some other capacity, such as volunteering at a fundraising event.

- The officer or director must show that the harm in question was not caused by his or her willful or criminal misconduct, gross negligence, reckless misconduct or a conscious, flagrant indifference to the rights or safety of others. Although these terms are all legal terms with specific meanings under Washington law, generally, merely being careless or inattentive is not considered willful, gross or reckless conduct.

There are several important things that the Volunteer Act does not do. Perhaps most importantly, the Volunteer Act does not prevent individuals acting as volunteers from being sued or being named in a lawsuit. Instead, the Volunteer Act provides an affirmative defense to liability, which lawyers for the volunteer would

raise in the course of the litigation. Although a volunteer might be named as a defendant in the initial stages of the case, it is very likely that the claims would be dismissed early in the process, assuming all the criteria of the Volunteer Act are satisfied.

The Volunteer Act does not protect the nonprofit organization itself from liability for harms suffered in the course of its activities. The organization may be held responsible for the acts or omissions of the persons working for it, even if the persons cannot be held individually liable. Finally, the Volunteer Act does not prevent nonprofit organizations from suing their volunteers for misconduct. Thus, if an officer or director harms the organization in some way, the organization still can bring suit against such officer or director without the protection provided by the Volunteer Act being invoked.

CHAPTER 24. Directors' and Officers' Insurance

A nonprofit corporation may purchase liability insurance on behalf of its directors and officers to cover certain claims. A directors' and officers' insurance policy ("D&O insurance") will generally provide coverage for liability claims against a director or officer whether or not the corporation indemnifies that individual. Directors and officers will often want the corporation to provide D&O insurance even if the corporation's articles of incorporation or bylaws have generous indemnification provisions.

D&O insurance provides three types of coverage: (1) coverage for the corporation's directors and officers when the corporation does not indemnify them; (2) coverage for the corporation for amounts the corporation actually pays directors and officers for indemnification; and (3) coverage for claims brought against the corporation. D&O insurance policies usually cover defense costs as well as liabilities arising from individual officers or directors allegedly committing "wrongful acts," which will be defined in the policy. Most D&O insurance policies exclude claims based on:

- Dishonest, fraudulent, or criminal acts. Even if the policy does not specifically exclude coverage for claims based on such conduct, most definitions of "wrongful act" specifically include only negligent conduct;
- Fines, penalties or punitive damages;
- Intentional conduct such as libel and slander—as a general rule, insurance does not cover intentional conduct;

- Bodily injury or property damage;
- A director or officer gaining any personal profit or advantage to which he or she was not legally entitled;
- ERISA claims;
- Employment claims;
- Claims brought by the corporation against its own directors or officers; or
- Losses covered by other insurance.

D&O insurance policies are generally claims-made policies. That is, a claim must be both made and reported during the policy period for there to be coverage. Therefore, it is extremely important to notify the carrier the moment the corporation or its directors or officers recognize that a claim may be made. D&O insurance policies may give the insurer the right to choose defense counsel, or, more often, may limit the policyholders' choice of counsel. D&O insurance policies generally require the policyholder to notify the carrier of all settlement offers and obtain its consent before accepting them. It is very important to recognize that, while D&O insurance policies generally require a carrier to pay ongoing defense costs, such payment can be charged against the policy's liability limit, reducing the amount available for payment of a judgment or settlement.

The elements of D&O insurance such as deductibles, co-insurance levels, exclusions and other aspects can vary significantly. The board committee dealing with insurance issues should review such items carefully and should consider consulting an insurance broker knowledgeable in this field. Except for exclusions for intentional conduct, other exclusions and coverage features can often be changed through negotiation with the carrier and/or payment of additional premium.

CHAPTER 25. Enforcement of State Governance Requirements – Office of the Attorney General

The Washington Attorney General plays a critical role in the life of a nonprofit corporation; particularly those holding charitable assets. Charitable nonprofit organizations have the privilege of taking donations and using volunteers. In exchange for that privilege, charitable nonprofit organizations and their leaders must use the nonprofit's assets to benefit the public and may not use the assets to benefit any individual personally. Another way of understanding this concept is that the nonprofit corporation holds its charitable assets in trust for the community. There

are no individual owners of the nonprofit organization nor of the assets held by the nonprofit organization. Often the Attorney General is the only representative of the public with standing (has a legal right) to invoke the power of the courts to protect charitable assets and ensure their proper administration. Enforcement and oversight authority under the Washington Nonprofit Corporation act is intended to ensure charitable corporations and other nonprofit corporations holding charitable assets fulfill their charitable missions and use charitable assets for their intended purposes.

With limited exceptions, major changes by charitable corporations (those that significantly alter the mission or purpose of the organization) are required to be reported on annual reports, which are submitted to the Secretary of State and provided by the Secretary to the Attorney General. In addition to reporting major changes, nonprofit corporations must provide notice to the Attorney General of certain activities and transactions, which are outlined in the Nonprofit Corporation Act and later in this chapter.

The Attorney General is vested with the authority to investigate and bring legal actions to secure property held for charitable purposes and to intervene in any legal proceeding initiated by another person if the Attorney General is otherwise authorized to bring such action. In ensuring that charitable assets are properly administered, the Attorney General may issue civil investigative demands to obtain information prior to commencing an action or proceeding; enter into Assurances of Discontinuance; commence proceedings to protect charitable assets; seek civil penalties for violations of the act; and recover costs and fees incurred in connection with a legal action. These investigative and enforcement powers allow the Attorney General to secure compliance with provisions of the Nonprofit Corporation Act that govern the distribution, disposition, management, or expenditure of, or reporting obligations relating to, property held for charitable purposes.

a. Notice to the Attorney General

The new Nonprofit Corporation Act requires notice of various transactions and activities to the Attorney General. The Office of the Attorney General is working on a strategic plan implementing many of the provisions of the new act. Notice to the Attorney General may be made in accordance with RCW 24.03A.944(1), via United States mail, postage prepaid and sent to the Attorney General's official address. The Attorney General will also accept notice by email to: charities@atg.wa.gov.

Every notice to the Attorney General must identify the provisions of the Nonprofit Corporations Act relevant to the subject matter of the notice. For example, if a charitable corporation is providing notice of its intent to dissolve, the notice needs to include a reference to the relevant voluntary dissolution portion of the act (RCW 24.03A.908). Some transactions require specific information to be included in the notice to the Attorney General. Corporate officers must be sure to include all relevant information and the contact information for the person or persons the office of the Attorney General may reach out to for more information should it be necessary.

In addition to the notice(s) required to the Attorney General for fundamental transactions, any person that commences any proceeding under the Nonprofit Corporation Act that could have been brought by the Attorney General, must serve notice of the proceeding on the Attorney General and the Attorney General has the right to intervene.

Notice to the Attorney General is effective when given, if sent by email to charities@atg.wa.gov or five days after deposit in the United States mail if postage is paid and it is correctly addressed. The office of the Attorney General endeavors to respond to all notices, however, for most transactions if notice is properly delivered and an objection is not received during the statutory period, the proposed transaction is deemed approved.

b. Release or Modification of Restricted Gifts and Fundamental Transactions Requiring Notice to the Attorney General

In general, charitable corporations or corporations holding assets for charitable purposes must provide notice to the Attorney General of their intent to modify or release restrictions on charitable gifts. Notice is also required when undertaking certain fundamental transactions (*see* section on Fundamental Transactions below). Notice to, and review by, the Attorney General helps ensure charitable assets are used as they were intended by the donor and for the mission of the charitable corporation. The Attorney General's oversight also serves to protect those assets from waste, misapplication, mismanagement or abuse.

(i) Restricted Gifts – Modification or Release of Restrictions

A nonprofit corporation is bound by any material restrictions or requirements contained in a gift instrument (ex. grant agreement, donor letter, or other written document). For example, if a donor provides instructions that their gift be used to support clean water initiatives, the charitable corporation cannot use that gift to

build a new swing set in a public park even if both missions are a part of the corporation's charitable purpose. If a nonprofit corporation fails to comply with any material restriction or requirement contained in a gift instrument, and fails to seek a modification, then the Attorney General may bring a proceeding to enforce the terms of the gift instrument. In most instances, if the gift is restricted to one or more charitable purposes, the Attorney General must be a party to a binding agreement to modify or release the restriction, must receive notice of any proposed "safe-harbor" release or modification, or must receive notice of any application to the court for a judicial modification or release of charitable gift restrictions.

(ii) Fundamental Transactions

Fundamental transactions undertaken by a charitable corporation or a nonprofit corporation that holds assets for charitable purposes require notice to the Attorney General prior to completing the transaction. *Fundamental transactions are those that may dramatically affect the operations of the corporation and include mergers, domestication, conversion, dispositions of assets outside the ordinary course of business, and voluntary dissolutions.* The requirements for such transactions can be technical and, as always, it is a good idea to consult with an attorney to obtain advice with respect to the particular circumstances or requirements of any fundamental transaction for your organization. Questions regarding notices of fundamental transactions may be sent to charities@atg.wa.gov.

The following is a brief summary of fundamental transactions requiring notice to the Attorney General and the notice requirements.

(a) Merger

A merger is a transaction between two or more corporations in which they agree to combine into a single corporation. The single corporation left at the end of the merger is called the "surviving corporation." In any merger, property held for charitable purposes by a nonprofit corporation may not be diverted from its charitable purpose(s). A corporation that is not a charitable corporation but holds property for charitable purposes is required to deliver notice to the Attorney General of its intent to consummate a merger unless the survivor of the merger is a charitable corporation. For example, if Corporation A maintains a charitable scholarship fund and it wants to merge with Corporation B, Corporation A must provide notice to the Attorney General unless Corporation B is a charitable corporation. Notice must be provided to the Attorney General at least 20 days before the meeting at which the

proposed merger is to be approved. Notice to the Attorney General must contain the following:

- A statement describing (1) how the merger will deal with any restrictions on charitable assets whether subject to a charitable trust or to gift restrictions and (2) how it will ensure property held for charitable purposes is not diverted. *See* RCW 24.03A.715.

- A brief description of:

    - Real property held by the corporation for charitable purposes and its nature and location;

    - Cash, bank deposits, brokerage accounts, or other financial assets held by the corporation for charitable purposes, and their approximate total fair market value;

    - Other personal property held by the corporation for charitable purposes, and its nature and approximate fair market value; and

    - All gift restrictions applicable to any of the above described property and the nature of such restrictions.

If the Attorney General does not deliver notice of an objection to the corporation within 20 days after delivery of the notice, the Attorney General is deemed to have approved the transaction.

(b) Domestication and Conversion

Sometimes a nonprofit corporation might choose to change the State in which it is incorporated, which is referred to as a "domestication." In other instances, a nonprofit corporation may decide to change into a different type of business entity – this is called a "conversion." In any transaction involving domestication or conversion by a nonprofit corporation, property held for charitable purposes may not be diverted from charitable purposes. In addition, no transaction to domesticate or convert may modify any restriction on property held for charitable purposes unless proper steps are taken to modify the restriction through the processes discussed above (*see* "Restricted Gifts"). A charitable corporation or a nonprofit corporation that holds property for charitable purposes must notify the Attorney General of its intent to complete a domestication or conversion transaction.

A nonprofit corporation holding property for charitable purposes must provide notice to the Attorney General of its intent to convert or domesticate at least 45 days before the meeting at which the proposed transaction is to be approved. The transaction may not be implemented without the approval of the Attorney General, or the approval of the court in a proceeding in which the Attorney General is made a party.

Notice to the Attorney General must contain:

- A statement specifying how the transaction will comply with the requirements relating to charitable assets (specifically that charitable assets will not be diverted from charitable purposes and how restricted assets will be dealt with). *See* RCW 24.03A.770.

- A brief description of:

    - Real property held by the corporation for charitable purposes and its nature and location;

    - Cash, bank deposits, brokerage accounts, or other financial assets held by the corporation for charitable purposes, and their approximate total fair market value;

    - Other personal property held by the corporation for charitable purposes, and its nature and approximate fair market value; and

    - All gift restrictions applicable to any of the above described property and the nature of such restrictions.

If the Attorney General does not deliver notice of an objection to the corporation within 20 days after delivery of the notice, the Attorney General is deemed to have approved the transaction.

Except for reasonable compensation in exchange for services rendered, persons affiliated with a charitable corporation or an unincorporated entity with charitable purposes may not receive a financial benefit from a domestication or conversion transaction, directly or indirectly, unless the person is a charitable corporation; an unincorporated entity with charitable purposes; or a federal, state, local, or tribal governmental entity or subdivision.

(c) Disposition of Assets

In any transaction involving the sale, lease, exchange, or other disposition of assets (collectively "disposition") of a nonprofit corporation, property held for charitable purposes may not be diverted from charitable purposes and restricted assets may not be diverted from their restricted purposes or conditions, unless appropriately modified before completion of the transaction.

A charitable corporation or nonprofit corporation holding property for charitable purposes must provide notice to the Attorney General of its intent to consummate a disposition at least 20 days before the meeting at which the proposed disposition is to be approved. The disposition may not be implemented without the approval of the Attorney General, or the approval of the court in a proceeding in which the Attorney General is made a party.

Notice to the Attorney General must contain:

- A statement specifying how the disposition will comply with the requirements relating to charitable assets (specifically that charitable assets will not be diverted from charitable purposes and how restricted assets will be dealt with). *See* RCW 24.03A.900.
- A brief description of:
    - Real property held by the corporation for charitable purposes and its nature and location;
    - Cash, bank deposits, brokerage accounts, or other financial assets held by the corporation for charitable purposes, and their approximate total fair market value;
    - Other personal property held by the corporation for charitable purposes, and its nature and approximate fair market value; and
    - All gift restrictions applicable to any of the above described property and the nature of such restrictions.

If the Attorney General does not deliver notice of an objection to the corporation within 20 days after delivery of the notice, the Attorney General is deemed to have approved the disposition.

(d) Voluntary Dissolution

A nonprofit organization might decide to stop operating all together, which is referred to as a voluntary dissolution. As addressed in other chapters, a nonprofit corporation must create a plan of distribution and articles of dissolution to complete the process. Charitable corporations and nonprofit corporations holding property restricted to charitable purposes, may not deliver articles of dissolution to the Secretary of State until a plan of distribution authorizing any transfer or conveyance of property held for charitable purposes is adopted and notice of the intent to dissolve and the plan of distribution are provided to the Attorney General. Notice to the Attorney General must be delivered at least 20 days before the meeting at which the proposed plan is to be adopted. A plan of distribution may not be implemented without the approval of the Attorney General or the approval of the court in a proceeding to which the Attorney General is made a party. If the Attorney General does not deliver notice of objection within 20 days after delivery of the plan, the plan is deemed approved.

The proposed plan of distribution must be consistent with RCW 24.03A.906 and 24.03A.914 and must include a brief description of the following:

- Real property held by the corporation for charitable purposes and its nature and location;
- Cash, bank deposits, brokerage accounts, or other financial assets held by the corporation for charitable purposes, and their approximate total fair market value;
- Other personal property held by the corporation for charitable purposes, and its nature and approximate fair market value; and
- All gift restrictions applicable to any of the above described property and the nature of such restrictions.

In undertaking a voluntary dissolution, the assets of a nonprofit organization are subject to the statutory requirements regarding application and distribution of assets found in RCW 24.03A.906. Property held for charitable purposes by a corporation, including all assets of a charitable corporation remaining after all liabilities and obligations of the corporation have been satisfied, must be applied and distributed consistent with the corporation's articles, such that property is not diverted from charitable purposes.

If the corporation holds charitable property in trust, the distribution of that property is subject to the terms of the trust and the Washington charitable trust act – any modification of trust restrictions must be made through an appropriate order of the court or the agreement of all parties including the Attorney General pursuant to chapter 11.96A RCW (the Washington Trust and Estate Dispute Resolution Act (TEDRA)).

Charitable property held subject to restrictions on its use, investment, or management that does not require modification upon dissolution must be transferred or conveyed subject to all restrictions (unless the restrictions are formally modified prior to distribution). Property that is held subject to charitable use, investment, or management restrictions that must be modified at the time of dissolution must be modified before distribution. Property held for charitable purposes subject to a condition requiring its return, transfer, or conveyance on dissolution must be returned, transferred, or conveyed in accordance with the condition.

Property owned outright (not in trust or subject to any restrictions) and held for charitable purposes must be transferred or conveyed to: (1) one or more entities operated exclusively for charitable purposes; (2) a federal, state, local, or tribal government for a public purpose; or (3) subject to restrictions requiring the property to be used exclusively for the same charitable purposes for which the dissolving corporation holds the property.

In addition to a copy of the proposed plan of distribution that includes information about the entity's assets and how any restricted assets will be dealt with, the notice to the Attorney General must provide the names and phone numbers of individuals available to answer questions regarding the dissolution and proposed plan of distribution.

c. Other Actions the AG May Take

In addition to the notice and review provisions outlined above, the Attorney General is vested with authority to investigate and take certain actions in the oversight of nonprofit corporations.

(i) Ultra Vires Actions

The Nonprofit Corporations Act authorizes the Attorney General to bring an action to challenge an ultra vires action of a corporation. In other words, if a

corporation acts outside its legal authority, the Attorney General may ask a Court to undo the action.

(ii) Judicial Dissolution

The Attorney General also has the authority to seek a judicial dissolution of a nonprofit corporation. The court may dissolve a nonprofit corporation in a proceeding by the Attorney General if it is established that:

- the corporation obtained its articles through fraud; or
- the corporations has exceeded or abused, and is continuing to exceed or abuse, the authority conferred upon it by law; or
- the directors are deadlocked in the management of the corporate affairs, the members, if any, are unable to break the deadlock; and irreparable injury to the corporation or its purposes is threatened or being suffered because of the deadlock; or
- the corporation is misapplying or wasting property held for charitable purposes.

(iii) Vacancy on Board of Directors

Unless the articles or bylaws of an entity provide a different method for electing, appointing, or designating at least one director, if no directors remain in office and no members have the right to elect directors, then the Attorney General has the power to appoint one or more directors selected for their interest and ability to carry out the purposes of the corporation.

(iv) Removal of Officers and Directors by Judicial Proceeding

The Attorney General may commence an action to remove an officer or director of a corporation that holds property for charitable purposes and the court may remove the officer or director if it finds that the director or officer engaged in fraudulent conduct with respect to the corporation or its members, knowingly inflicted harm on the corporation, or engaged in acts or omissions constituting gross negligence with respect to the director's or officer's duties and removal would be in the best interests of the corporation. If a party commences a proceeding to remove a director or officer of a charitable corporation, the plaintiff must give the Attorney General notice of the commencement of the proceeding.

(v) Actions by the Attorney General to Secure Property Held for Charitable Purposes

The Attorney General may commence any proceeding or action to: (1) ensure compliance with provisions of the nonprofit corporation act governing the distribution, disposition, management, expenditure or, or reporting obligations relating to any property held for charitable purposes; (2) secure the proper administration of a charitable corporation or property held for charitable purposes when it is reasonably necessary to protect the charitable assets; and (3) restrain and prevent any act that violates provisions of the nonprofit corporation act governing the distribution, disposition, management, or expenditure of, or reporting obligations relating to, any property held for charitable purposes.

(vi) Intervention as of Right

The Attorney General has the right to intervene in any proceeding commenced by a person other than the Attorney General if the Attorney is otherwise authorized to bring such a proceeding under the Nonprofit Corporation Act. Intervention in this context means that the Attorney General can join the lawsuit as a party to the proceeding.

d. The Attorney General's Investigative and Enforcement Powers

The Attorney General may institute an investigation upon reasonable suspicion that there has been a violation of any provision of the Nonprofit Corporation Act governing the distribution, disposition, management, or expenditure of, or reporting obligations relating to, any property held for charitable purposes, or that a charitable corporation or property held for charitable purposes by a nonprofit corporation has been improperly administered. In securing compliance with the provisions of the nonprofit corporation act governing property held for charitable purposes the Attorney General may issue civil investigative demands (CID's), enter into Assurances of Discontinuance (AOD's), commence a civil proceeding and in doing so may seek the imposition of civil penalties of up to $5,000 for each violation, and may seek to recover its costs and attorneys' fees incurred in securing compliance.

(i) Civil Investigative Demands (CIDs)

In connection with an investigation, the Attorney General has the authority to issue civil investigative demands (CIDs). CIDs can require any person who may have any relevant knowledge related to the investigation to answer questions through

interrogatories or oral deposition. A CID can also require the production, inspection, and/or copying of documents and other items that may be relevant to the investigation. CIDs can be directed to any person who may have knowledge potentially relevant to the investigation or to any person who may be in possession, custody, or control of any potentially relevant document or other item.

CIDs are new to the Nonprofit Corporation Act but have been used by the Attorney General in investigations pursuant to the Consumer Protection Act and Charitable Solicitations Act for many years. In fact, the new Nonprofit Corporation Act cross references the Consumer Protection Act when it describes CIDs. Failure to respond to a CID may result in an enforcement action which can involve the imposition of sanctions by the court. A CID recipient should read the CID carefully including the instructions and definitions, review the CID provisions in both the Nonprofit Corporation Act and Consumer Protection Act, and consult with an attorney if they have questions.

Assurance of Discontinuance (AOD)

An assurance of discontinuance (AOD) is a formal agreement with the Attorney General to discontinue any act or practice deemed to be in violation of the provisions of the Nonprofit Corporation Act governing the distribution, disposition, or expenditure of, or reporting obligations relating to property held for charitable purposes. It is not an admission that any violation has occurred. The AOD must be in writing and is filed with, and subject to the approval of, the court. Failure to comply with an AOD is evidence that a violation has occurred and may be used in an enforcement action.

(ii) Civil Penalties, Costs, and Fees

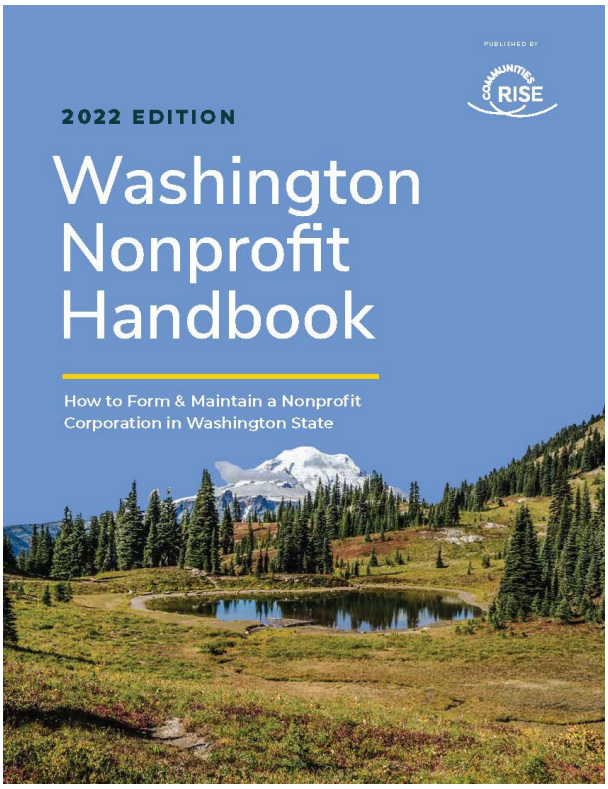
If a person knowingly or intentionally engages in conduct that violates the provisions of the Nonprofit Corporation Act governing the distribution, disposition, management, or expenditure of, or reporting obligations relating to, property held for charitable purposes, the court, in an action by the Attorney General, may impose a civil penalty of up to $5,000 for each violation. In addition, the same civil penalties may be assessed against a director or officer who votes for or agrees to a distribution of charitable assets that would subject them to liability for unlawful distributions under the Nonprofit Corporation Act, or receives any part of such distribution knowing it violated the Nonprofit Corporation Act.

A violation of any injunction issued pursuant to an action by the Attorney General may result in the court ordering civil penalties of up to $25,000 for each

violation. In any action by the Attorney General to secure compliance with the provisions of the Nonprofit Corporation Act governing property held for charitable purposes the court in its discretion may award the Attorney General recovery of its costs and fees.

(iii) Limitations of the AG's Authority with Respect to Religious Corporations

It is important to note that when it comes to religious corporations, as defined in the Nonprofit Corporation Act, there are limitations on the Attorney General's enforcement authority. The Attorney General may only commence an action against, or intervene in an action involving, or serve a CID on a religious corporation in the following circumstances: (1) the Attorney General knows of facts or circumstances indicating that the religious corporation's charitable assets have been, will be, or are threatened to be unlawfully distributed; (2) the board of directors of the religious corporation has adopted a resolution requesting the Attorney General's involvement in an action or investigation; or (3) the Attorney General knows of facts or circumstances indicating the religious corporation has no directors in office in which case the Attorney General may investigate and if necessary appoint one or more directors.



PART 4 OBTAINING RECOGNITION AS A 501(C)(3) ORGANIZATION

Chapter 26 Considerations in Determining Whether (and When) to Seek Code Section 501(c)(3) Status
Chapter 27 Assembling Your Application
Chapter 28 Obtaining Recognition for a Publicly Supported Charity
Chapter 29 IRS Processing of Exemption Applications
Chapter 30 Applying with the Form 1023Z

PART 4. OBTAINING RECOGNITION AS A CODE SECTION 501(C)(3) ORGANIZATION

CHAPTER 26. Considerations in Determining Whether (and When) to Seek 501(c)(3) Status

Obtaining recognition as an organization exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (also referred to as a "501(c)(3) organization") requires (1) forming a nonprofit corporation or other suitable nonprofit entity under the law of a state or the District of Columbia, and then (2) completing and filing IRS Form 1023 or IRS Form 1023EZ. This Part describes the preparation of Form 1023 or IRS Form 1023EZ. *See* CHAPTER 30 Applying with the Form 1023EZ, for more information on the Form 1023EZ.

Federal tax-exempt status under section 501(c)(3) provides advantages including (1) tax benefits for some contributors to the organizations, (2) eligibility for private foundation grants, and (3) an exemption from the federal income tax on most net income. However, to obtain this tax-exempt status, an organization must operate in compliance with certain restrictions: (1) its purpose must be charitable, (2) it cannot provide financial benefits to private individuals, (3) it cannot promote or oppose candidates for public office, and (4) its lobbying activities are restricted. Before deciding to proceed with an application for 501(c)(3) status, it is worth considering whether the advantages of this status are important to achieving the organization's goals, and whether the restrictions would materially impede the organization's ability to accomplish its goals. Also, it is worth considering whether the organization will meet the criteria necessary to qualify as a public charity and, if not, what the effect would be of needing to comply with the more restrictive rules applicable to private foundations.

a. Why Seek Code Section 501(c)(3) Status

A 501(c)(3) organization enjoys a variety of tax-related and other benefits.

(i) Individual and Gift and Estate Tax Deduction

One of the biggest advantages of being a 501(c)(3) organization is that the organization may receive contributions that also benefit the donor—in fact, 501(c)(3) organizations are the only organizations to which people can make tax-deductible charitable contributions. A donor who contributes to a 501(c)(3) organization may be entitled to an income tax deduction, a gift and estate tax deduction, or both. Donors are subject to limitations on the deductions they can claim for charitable

contributions in any given year. Donors should consult their tax advisors regarding the tax implications of their gifts.

(ii) Grants From Private Foundations

Private foundations, which often are grantmaking organizations, typically will distribute funds only to 501(c)(3) organizations that qualify as "public charities." (Private foundation status and public charity status are discussed below.) It is worth noting that private foundations are, in fact, permitted to make grants to any type of entity, provided that such grants are made in furtherance of the private foundation's 501(c)(3) purposes and provided that the private foundation complies with certain administrative requirements under section 4945 of the Code; however, because these administrative requirements can be burdensome, many private foundations choose to make grants only to 501(c)(3) public charities.

(iii) No Tax on Net Revenue

501(c)(3) organizations and the organizations described under other section 501(c) categories in the Code share the advantage of exemption from paying federal income tax on income related to their tax-exempt function and often on investment income as well.

(iv) Other Advantages

Other advantages include:

- Federal tax-exempt status is necessary for certain state and local tax benefits (e.g., exemptions from property tax, B&O tax and admissions taxes, as further discussed in CHAPTER 55-CHAPTER 61).
- 501(c)(3) organizations are exempt from federal unemployment tax ("FUTA").
- Exempt organizations may qualify for bulk mailing rates.
- 501(c)(3) organizations may be permitted to engage in bingo or other gaming activities that otherwise would be prohibited.

b. Requirements and Limitations on 501(c)(3) Organizations

Organizations that obtain 501(c)(3) tax-exempt status must operate in accordance with specific rules applicable to 501(c)(3) organizations.

(i) Permissible Purposes

In order to gain recognition as a 501(c)(3) organization, an organization must be organized and operated exclusively for one or more of the purposes specified in section 501(c)(3) (e.g., charitable, educational, religious, literary or scientific purposes, fostering national or international amateur sports competition, testing for public safety or prevention of cruelty to children or animals). In addition, a 501(c)(3) organization must serve public rather than private interests. Generally, this means that its activities benefit a large and indefinite class of individuals (e.g., the general public, homeless people, youth), rather than a small identifiable group (e.g., residents of a single neighborhood, employees of a small company). The organization may not be organized or operated for impermissible private interests such as those of specifically designated individuals, the creator of the organization or his/her family, or persons (including companies) controlled, directly or indirectly, by such private interests.

Treasury Regulations provide that "charitable" 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 the burdens of government; and the promotion of social welfare by organizations designed to accomplish any of the above purposes." *See* Treas. Reg. Section 1.501(c)(3)-1(d)(2). Some of these purposes are described in more detail below; however, a comprehensive discussion of permitted section 501(c)(3) purposes is beyond the scope of this Chapter. A more detailed discussion of permissible Code section 501(c)(3) activities is included in Chapter 3 of IRS Publication 557.

Descriptions of Common Categories of Charitable Purposes
Relief for the poor, distressed or underprivileged includes: a. helping low-income persons find employment; b. promoting the rights of public housing tenants; or c. providing other social services like low-income housing, food, or health services. Advancement of religion includes: a. constructing or maintaining a church building, monument or burial grounds, or b. peripheral services like providing music, distributing religious literature and maintaining missions.

Descriptions of Common Categories of Charitable Purposes
Advancement of education includes the instruction or training for the purpose of improving or developing capabilities and/or the instruction of the public on subjects useful to the individual and beneficial to the community. Educational organizations might: a. operate a primary or secondary school, a college, or a professional or trade school that has a regularly scheduled curriculum, a regular faculty, and a regularly enrolled body of students in attendance at a place where the educational activities are regularly carried on; b. present public discussion groups, forums, panels, lectures, or other similar programs; c. operate museums, zoos, planetariums, symphony orchestras, theaters, and other similar organizations; or d. produce arts performances such as plays, music or dance. Organizations formed to beautify and maintain the community may: a. preserve a park or lake for public use; b. promote city beautification projects; or c. educate the public about advantages of planting trees in public areas. Examples of the promotion of health include hospitals, outpatient clinics, homes for the elderly, and advancing medical knowledge through research. Organizations engaged in promoting social welfare generally are involved in solving urban problems, easing racial tensions, furthering historic preservation, or improving the environment. Examples include organizations that: a. construct low-income housing and renovate existing housing for low-income persons; b. furnish low-interest loans to local businesses in depressed inner-city areas; c. convert blighted inner-city property into industrial parks and give rental preference to employers who employ otherwise unemployed individuals; or d. promote youth sports to combat juvenile delinquency.

(ii) No Private Inurement

A 501(c)(3) organization may not distribute its revenue or assets to benefit any private individuals. Called "inurement," this applies to those who have an opportunity to control or influence the organization's activities, such as directors or

officers. *See* CHAPTER 33 and CHAPTER 34 for a more detailed discussion on private inurement and intermediate sanctions.

(iii) Restrictions on Lobbying and Prohibition of Political Activities

A 501(c)(3) organization has limitations on its ability to participate in lobbying activity and is prohibited from certain political activities. *See* CHAPTER 36 for the rules and restrictions 501(c)(3) organizations must follow with respect to lobbying and CHAPTER 35 for more on political activities.

(iv) Limitations on Unrelated Business Activity

As discussed in CHAPTER 37, an organization that engages in unrelated business activity ("UBI") may have some taxable income and may jeopardize its tax-exempt status if such activity is substantial relative to the organization's tax-exempt activity.

(v) Public Disclosure Requirements

As discussed further in CHAPTER 39 a 501(c)(3) organization must make certain documents available for public inspection.

(vi) Nondiscrimination

A 501(c)(3) organization should not discriminate. Race discrimination is strictly prohibited. An institution that racially discriminates cannot qualify for tax-exempt status as a charitable organization. In 1993, the United States Supreme Court held in the famous case of *Bob Jones University v. United States* that private schools that racially discriminate may not be tax-exempt and are not eligible for deductible charitable contributions. The rule against racial discrimination applies to all entities seeking tax-exempt status, not just private educational institutions.

c. Public Charities and Private Foundations

501(c)(3) organizations are divided into two broad categories: private foundations and public charities. An important consideration in applying for 501(c)(3) status is determining whether the organization will qualify for one of the enumerated public charity categories. If an organization qualifies as a 501(c)(3) organization but cannot establish that it qualifies for one of the public charity categories specified under section 509(a) of the Code (as discussed further below), the organization is, by default, a private foundation. Generally, a private foundation

receives most of its support from one or a limited number of sources, such as a single family or corporation. Unlike public charities, private foundations pay tax on their investment income. Also, private foundations are subject to additional rules and restrictions that do not apply to public charities.

(i) Public Charities

Public charities are covered in sections 509(a)(1) through 509(a)(4) of the Code. They include (a) entities that are considered inherently public by virtue of their activities (i.e., churches, schools, hospitals and medical research organizations); (b) publicly supported organizations (including both (i) organizations that normally receive a substantial part of their support from gifts, grants and contributions from the general public and (ii) organizations that normally receive more than one-third of their support from grants, contributions, membership fees, and gross receipts derived from activities related to their exempt function); (c) supporting organizations that are controlled by or in connection with one or more public charities; and (d) organizations organized and operated exclusively for testing for public safety.

Chapter 3 of IRS Publication 557 includes a detailed discussion of how private foundation status and public charity status are determined. It is worth spending time with this section of Publication 557 and determine which, if any, of the public charity categories apply to your organization before you begin drafting your organization's Form 1023 (application for 501(c)(3) status). This information will help you ensure that you present information in your application that is relevant to the type of public charity or private foundation status you hope to obtain.

(ii) Disadvantages of Private Foundation Status

Federal tax law treats private foundations less favorably than public charities. Unlike public charities, private foundations must pay tax on their investment income, are prohibited from engaging in any lobbying activity and are subject to a variety of other highly technical and complicated requirements regarding how to invest their assets and conduct operations. Failure to comply with these rules can result in excise taxes imposed on the private foundation as well as on its officers, directors or trustees. If your organization is a private foundation, you should consult a legal professional.

The special restrictions and excise tax rules applicable to private foundations are set forth under sections 4940 through 4944 of the Code. They include:

- **Excise Tax Based on Investments.** Section 4940 imposes a 1.39% excise tax on investment income, such as interest, stock dividends, capital gains and other passive income.

- **Taxes on Self-Dealing.** Under section 4941, transactions between a private foundation and certain organizational insiders (including private foundation managers, large contributors and companies owned by large contributors) generally are prohibited unless a special exception applies.

- **Taxes on Failure to Distribute Income.** Each year a private foundation must distribute a minimum amount of its income for charitable purposes. If it does not, it will be subject to an excise tax under section 4942.

- **Taxes on Excess Business Holdings.** A private foundation may be subject to an excise tax under section 4943 if it owns more than a certain percentage of a trade or business enterprise.

- **Taxes on Investments that Jeopardize Charitable Purposes.** Under section 4944, a private foundation may be subject to excise tax if it cannot carry out its charitable purposes by making high-risk investments. This tax provides an incentive for private foundation managers to be prudent when investing private foundation funds.

- **Taxes on "Taxable Expenditures."** Section 4945 imposes a tax on amounts spent by private foundations that are used for carrying on propaganda or otherwise attempting to influence legislation, influencing the outcome of political campaigns, and making expenditures for noncharitable purposes. Section 4945 further regulates the use of private foundation funds for certain other activities by placing limitations on grants to individuals for travel, study, or other similar purposes (unless the private foundation follows certain procedures approved in advance by the IRS) and by taxing grants made to organizations other than public charities (unless the grantor private foundation exercises expenditure responsibility with respect to such grants).

d. When to Seek 501(c)(3) Status

New organizations normally have up to 27 months after formation to submit a Form 1023 or a Form 1023EZ to the IRS. When a new organization timely files its Form 1023 or Form 1023EZ within the 27 month period, and a favorable determination is issued by the IRS, the favorable determination is retroactive to the

date of incorporation. When a Form 1023 or a Form 1023EZ is filed late (after the 27 month period) and no exception applies, the IRS grants 501(c)(3) status effective as of the date the Form 1023 or Form 1023EZ is submitted online at www.pay.gov.

TIP:

New organizations should begin filing their Form 990 Return of Organization Exempt From Income Tax (annual tax return) even if the organization has not filed their Form 1023 or Form 1023EZ or received approval of their tax-exemption application. *See* CHAPTER 39 for more information on the Form 990. Note that if an organization does not file the Form 990 for three consecutive years, their 501(c)(3) tax-exempt status will be automatically revoked and the organization will have to refile a Form 1023 to reinstate the organization's tax-exemption.

e. Considerations for Organizations Not Required to File for 501(c)(3) Status

Even though churches, organizations created before October 1969, and publicly supported organizations whose gross receipts average less than $5,000 per year are not required to file, there are benefits to filing:

- Section 508 of the Code provides deductibility of contributions for churches and small organizations, but the burden of proof for tax deductibility is on the donor. A church or small organization might choose to apply for 501(c)(3) recognition to save donors inconvenience during an audit.

- Almost every grantmaking agency, public or private, requires a 501(c)(3) determination letter from grant applicants regardless of whether the nonprofit is a church or a small organization.

- Other state and federal agencies, such as the Postal Service or the Washington Gambling Commission, may require proof of exempt status before issuing permits or exemptions. Each agency has its own rules, which may not provide exceptions for churches and small organizations. Such organizations might have to apply for 501(c)(3) recognition to satisfy other governmental agencies.

- Failing to apply for tax-exempt status can sometimes undermine an organization's credibility with the press or the public. Obtaining 501(c)(3) recognition may be an important part of the image it wants to convey.

- An organization that expects to have employees can save a small amount of payroll taxes by applying for 501(c)(3) recognition, because it is exempt from federal unemployment tax.

CHAPTER 27. Assembling Your Application

An organization applies for 501(c)(3) status by submitting Form 1023 (also known as the Application for Recognition of Exemption Under Section 501(c)(3)). In addition, depending on the organization's circumstances, it may submit other IRS forms along with this application (e.g., a power of attorney, if the organization is represented by someone other than an officer in connection with filing its application and/or an election to make lobbying expenditures). This Chapter describes the information you will need to complete your Form 1023, as well as the documents and other forms that you may submit with your application. In addition, it provides tips that will help you compile your application in a manner that facilitates IRS review.

TIP:

All IRS forms discussed in this Chapter, other than Form 1023, are available at http://www.irs.gov by searching for the appropriate Form and/or Form Instructions.

Form 1023 is an electronic form that must be completed at Pay.Gov (https://www.pay.gov/). Users must register for an account with Pay.Gov. Search for "1023" from the Pay.Gov homepage.

a. Before Assembling Your Application: Form SS-4

An organization should use Form SS-4 (Application for Employer Identification Number) to apply for its EIN before submitting its Form 1023. The quickest and easiest way to obtain an EIN is through http://www.irs.gov/formss4.

TIP:

Download and complete the Form SS-4 before completing the online application for EIN, so that you have all the information you need on hand. The online application is timed. Search for "Apply for an Employer Identification Number (EIN) Online" from the IRS homepage.

Alternatively, download the Form SS-4 from the IRS website, complete it, have it executed by an officer of the organization and then fax it to the IRS at 855-641-6935. Be sure to enter a "fax-back" number on the SS-4. Once the EIN is assigned, enter it on all attachments to the Form 1023.

b. Ancillary Forms: Form 5768 and Form 2848

Depending on the organization's circumstances, it may file one or both of the following forms along with its Form 1023:

(i) Form 5768 Election/Revocation of Election to Influence Legislation

This is required if the organization has decided to elect to make expenditures to influence legislation under section 501(h) of the Code. *See* CHAPTER 36 for a more detailed discussion regarding deciding whether to make this election.

(ii) Form 2848 Power of Attorney

This is required if the organization will be represented, or the various IRS forms signed, by someone other than an officer or director, such as the organization's lawyer.

> **TIP:**
>
> When submitting a Form 2848, be sure that the date accompanying the officer's signature (Part I, line 7) is the same date as, or an earlier date, than the date accompanying the signature of the authorized representative under Part II.

c. Gathering Necessary Documents and Information

Form 1023 asks for information regarding the organization's activities and finances. Although daunting, it may be useful to think of this application as analogous to a business plan. Hopefully, the exercise of responding to the detailed questions posed by the application will help establish a well-thought-out road map to the organization's development. Below, is a list of the documents and information that should be gathered to prepare for Form 1023.

(i) Required Documents

Before drafting responses to Form 1023, gather the following documents, which will be incorporated into the final submission:

- **Articles of Incorporation.** A copy of the articles of incorporation must be submitted (bylaws alone are not enough). Articles of incorporation should have the Secretary of State's date stamp on the first page. The articles of incorporation must meet the "Organizational Test" two requirements:

(a) the statement of purposes in the articles of incorporation must be limited to one or more tax-exempt charitable purposes and may not authorize the carrying on of any activities that are not in furtherance of one or more exempt purposes (unless they are insubstantial), and (b) the organization must dedicate its assets to one or more exempt purposes, which occurs in the dissolution provision of the organization's articles. Such a provision may require that the organization's assets be distributed for one or more exempt purposes, be distributed to the federal government or to a state or local government for a public purpose, or be distributed by a court to another organization to be used in a manner as in the judgment of the count will best accomplish the general purposes for which the dissolved organization was organized. A sample articles of incorporation is available on the Communities Rise Resources Page.

- **Bylaws.** The bylaws are a legal document that governs the board of directors and how decisions are made at the board level. The bylaws must be adopted by the board of directors. A sample bylaws is available on the Communities Rise Resources Page.

- **Conflict of Interest Policy.** Although an organization is technically not required to have such a policy, the IRS strongly suggests that every organization adopt one, and the Instructions to Form 1023 include a sample document that can be adopted and included as part of the application. A sample conflicts of interest policy is available on the Communities Rise Resources Page.

(ii) Required Information

Before drafting responses to the Form 1023, gather the following information:

- **Description of Activities.** Form 1023 requires a description of the organization's past, present and planned activities. With respect to each activity, describe (a) what the activity is; (b) who conducts it; (c) where it will take place; (d) what percentage of the organization's total time is dedicated to such activity; (e) how it will be funded; and (f) how it furthers the organization's tax-exempt purposes.

- **Financial Data.** Form 1023 requires historical and/or projected financial data. If the organization has been in existence for five or more years, it must provide information regarding its revenues and expenses regarding the past five years. If it has been in existence for more than one year, but

less than five years, it must provide revenue and expense information for each year it has been in existence, plus projected revenue and expense information for a total of four years of financial information. If the organization has been in existence for less than one year, it must provide projections of its likely revenues and expenses for the current year and the two subsequent years, based on reasonable and good faith estimates of its future finances.

(iii) Information to Include if Applicable

Form 1023 asks for a variety of other documents and information, which may or may not be applicable to your organization. Gather the following documents if they are relevant to the organization and its activities:

- **Printed materials.** Printed materials that describe the organization's history, its activities and/or its plans for the future, which might include newsletters, brochures, pamphlets, descriptive literature, published materials, etc.

- **Materials Prepared for Members.** If the organization is a membership organization, any materials prepared for members, such as membership application forms, promotional materials, sample membership certificates or identification cards, sample copies of member-only publications, etc.

- **Clippings.** If the organization has received media coverage, include copies of newspaper clippings, transcripts of interviews, etc.

- **Events.** If appropriate, a "schedule of events," showing where and when the organization has held informational, educational, performance or other events during the last 12 months, including approximate attendance.

- **Fundraising Activities.** Information regarding the organization's fundraising plans, including how it plans to raise funds and in which jurisdictions it will undertake such activities.

- **Grantmaking Activities.** If the organization will be making grants to other organizations:

    - Copies of any grant agreements;

    - A description of grant records;

- Information regarding the selection process, including whether a grant proposal or application is required; and

- A description of procedures for oversight of distributions to ensure that resources are used for tax-exempt purposes (e.g., conducting pre-grant inquiry and/or requiring periodic or final reports regarding the use of grant funds).

- **Scholarships or Grants.** If the organization will have a scholarship or grant program:

  - A description of how potential applicants will hear about the program;

  - A description of eligibility requirements;

  - A sample of required application form(s);

  - A description of the selection process, including a description of any selection committee and how members are chosen;

  - Any guidelines prepared for the selection committee's use;

  - Conditions placed upon grants or scholarships, including any requirements for reports and a description of action that will be taken if the terms of the grant are violated; and

  - Records the organization keeps regarding its grants or scholarships.

- **Other Materials.** If relevant, gather the following:

  - Copies of leases, loan agreements or other contracts between the organization and its officers, directors, highest compensated employees, highest compensated independent contractors or any entity in which any of the above individuals owns more than a 35% interest;

  - Independent appraisals or other data substantiating the value of any assets the organization is renting or purchasing from related parties; and

- Copies of any agreements pursuant to which another individual or organization will raise funds for the organization or pursuant to which the organization will raise funds for any other organization.

- **Information Required for Schedules.** Form 1023 has a number of schedules, including special schedules if the organization is a church, school, hospital or supporting organization or provides low-income housing or provides scholarships. If any of the Form 1023 schedules applies to the activities of your organization, be sure to review the applicable schedule and gather the required information.

d. Tips for Completing Form 1023

(i) General Considerations

Since March of 2020, Form 1023 must be completed online using Pay.gov. The application does not need to be completed in one session and your progress can be saved. However, the electronic application can close unexpectedly and progress since the last save will be lost. For this reason, it is recommended to complete all narrative responses in a word document and copy over the completed responses.

See the discussion in Part X, below, regarding digitally signing the application before entering any responses in the Form 1023.

If the Form 1023 does not permit enough characters to answer the question posed, say "Please See Attachment" or "Please See Exhibit Attached" and include a document or spreadsheet in the "Supplemental Responses" attachment, which is described in more detail below. Be sure to label each attachment with the organization's name and employer identification number and the question number to which the attachment relates.

In completing the application, it is important to be as transparent as possible regarding the organization's activities, finances, etc. If information relevant to a question has been provided in a prior part of the application, cross-referencing is acceptable. For example, if an organization intends to make grants to support other charitable organizations, it might describe this activity in detail in its narrative description of activities under Part IV, Line 1. The organization's responses to Part IV, question 9, might then cross-reference to Part IV, Line 1."

(ii) Walk Through Form 1023

Refer to the Instructions for Form 1023 for guidance in completing the application. The instructions, unlike Form 1023 itself, can be downloaded from http://www.irs.gov by searching for "1023 Instructions." This Chapter does not provide line-by-line instructions for completing Form 1023. Instead, below are tips intended to supplement the IRS instructions.

Part IV. Your Activities

- **Line 1**

This is the heart of the application. The narrative can make or break the application. One approach is to start with the formula:

> [Name of organization] is organized exclusively for [religious, charitable, scientific, literary or educational (choose one or more)] purpose(s) within the meaning of Code section 501(c)(3). Specifically, [Name of organization] (describe in one or two sentences what the organization does).

In succeeding paragraphs, define the problem the organization hopes to solve, using specific data or statistics if available. Try to cover WHO, WHAT, WHEN, WHERE, HOW, etc. Examples:

- Who will the organization's members, clients or patrons be? Who will carry on the activities of the organization?
- What will the organization offer to these individuals or entities? What will the organization charge? What will take place at a typical meeting or event of the organization?
- When did the organization's founders begin working to further the organization's purposes? When will the organization be fully operational? When will regular meetings, events or other program activities be held?
- Where will the organization be based? Where will the organization obtain its funding?
- How will members, clients or patrons hear about the organization's activities?

- How many members, clients or patrons does the organization expect to serve?

- How is the organization distinguishable from for-profit entities, if any, with similar activities?

If your organization plans to engage in activities or operate in a manner that may raise concerns for the IRS, it is best to address these issues head-on. For example, explain that "The organization accepts paid advertising in its newsletter and will file Form 990-T, and pay any tax due," or "Although the organization performed referral services for members in the past, this activity never constituted more than 1% of the organization's overall activities, and the board voted to discontinue this activity on [insert date]."

- **Line 2**

If you decide to select the organization's NTEE code, carefully review the descriptions of the activity codes published by the National Center for Charitable Statistics, available at https://nccs.urban.org/publication/irs-activity-codes, to ensure the NTEE code describes a qualified exempt activity.

- **Line 3**

If the answer to this question is "yes," indicate that the class of individuals to whom the organization provides services is a large and indefinite group (e.g. homeless people, youth), rather than a small, identifiable group (e.g. the organization's members, residents of a single neighborhood, employees of a small company).

- **Line 4**

Generally, the answer to this question should be "no." If the answer is "yes" (for example, because you are starting a community orchestra and you expect that relatives of your directors and officers will be among the members of the general public that will attend performances), you should explain that goods or services will be provided to such individuals only on the same terms as they are provided to the general public.

- **Line 5**

The answer to this question should be "no."

- **Line 6**

If the answer to this question is "yes," provide information to show that the organization is aware of and will comply with the limitations on lobbying activity applicable to Code section 501(c)(3) organizations.

- **Line 7**

If the answer to line 10 is "yes," the organization should own the intellectual property. If the organization will not own intellectual property that it produces, this may raise a yellow flag for the IRS. Consult with an attorney.

- **Line 9**

If the answer is "yes," the IRS will require appropriate safeguards to ensure that the funds granted to other organizations will be used only in furtherance of 501(c)(3) purposes. If grants are made only to other 501(c)(3) organizations, the IRS will not require the same safeguards (e.g., applications, grant agreements and detailed record-keeping) that it expects of grants to non-501(c)(3) organizations. If the organization is a private foundation, grants to non-501(c)(3) organizations will be taxable expenditures that trigger excise tax penalties under section 4945 unless you comply with certain additional administrative requirements (e.g., expenditure responsibility or equivalency determination procedures). Thus, if the organization is a private foundation that intends to make grants to non-501(c)(3) organizations, seek advice from an attorney.

If the answer to line 9a is "yes," the answer to lines 9c and 9d should be "yes." If the answer to line 9b is "yes," the answers to lines 9d, 9e, 9g, 9h, and 9i should be "yes". *See* CHAPTER 41-CHAPTER 48 for a discussion regarding international grantmaking.

- **Line 10**

If the answer to line 10 is "yes," the answer to lines 10a through 10c should be "yes."

- **Line 11**

If the answer to this question is "yes," seek advice from a lawyer or accountant to be sure that you understand and can comply with the complex rules applicable to donor-advised funds.

- **Lines 12 - 15**

If the organization is required to complete an additional schedule, please refer to the relevant Form 1023 instructions.

Part V. Compensation and Other Financial Arrangements

- **Line 1**

Line 1 asks for compensation and other information regarding any officer, director, or trustee, or any employee or independent contractors who will receive more than $50,000 per year from the organization. If the organization does not expect to pay such compensation in the foreseeable future, answer "no." If the answer is "yes," you will need to explain your compensation practices through the questions that follow.

Form 1023 indicates that practices regarding compensation for officers, directors, trustees and highly compensated employees and independent contractors reflected in these questions are recommended, but not required. Nevertheless, answering "no" to any of these questions is likely to raise a red flag (or at least a yellow one) for the IRS agent reviewing the application. If the answer to any of these questions is "no", it is advisable to provide additional information describing why the organization has not adopted a particular practice and what other safeguards it has put in place to ensure that compensation paid to officers, directors, trustees and highly compensated employees and independent contractors is reasonable.

- **Line 2**

As noted above, although an organization is technically not required to have a conflict of interest policy, the IRS strongly suggests that every organization adopt such a policy. The Instructions to Form 1023 include a sample document that can be adopted and included as part of the application. A sample conflicts of interest policy is available on the Communities Rise Resources webpage.

- **Line 3**

While 501(c)(3) organizations are not prohibited from compensating individuals through non fixed payments, such as discretionary bonuses or revenue-based payments, such arrangements must be carefully designed to ensure that they are reasonable and consistent with the rules applicable to 501(c)(3) organizations. *See* the discussion regarding intermediate sanctions in CHAPTER 34, if the

organization intends to pay discretionary bonuses or make revenue-based payments, particularly if the organization will make such payments to directors, officers or highly compensated employees. It is advisable to do market research of similar organizations to determine whether compensation arrangements are appropriately structured.

- **Lines 4 & 5**

Lines 4 and 5 ask whether the organization has a business relationship with any of its officers, directors or trustees, other than through their position as an officer, director or trustee. Answer "yes" to this question if, for example, the organization plans to contract with one of its directors to provide services to the organization, or if the organization plans to contract with another organization with which you share an officer, director, trustee.

A "yes" answer will likely raise a red flag with the IRS. As indicated in the IRS instructions, you do not need to answer "yes" to Line 4 simply because directors, officers or other persons described in this question can purchase or sell goods or services from the organization on the same terms as the general public. Nevertheless, if the answer is "yes", you may be able to alleviate IRS concern by indicating that the purchase or sale of goods or services between the organization and the officer, director or other person described in this question will be approved consistent with the rebuttable presumption set out under the intermediate sanctions regulations. *See* CHAPTER 34.

- **Lines 6 & 7**

Generally, the answer to Lines 6 and 7 will be "no." If the answer is "yes," provide the IRS with sufficient information to show that the arrangement does not result in undue benefit to private interests and that the organization retains sufficient control over its assets. If needed, provide information regarding any business or family relationship to establish that any such arrangements are approved pursuant to the organization's conflict of interest policy.

- **Line 8**

If the answer is "yes," seek advice from an attorney.

Part VI. Financial Data

- **A. Statement of Revenues and Expenses.**

The IRS usually requires both actual financial information to date and a two-year projected budget. It is difficult to predict what the financial future holds; however, the IRS requires a projected budget even if it is difficult to prepare. A good-faith estimate of future revenues and expenses is sufficient.

Some organizations find that it works best to start with the goals the group wants to accomplish, estimating, goal by goal, what the planned activities will cost, and then creating a strategy to come up with the necessary income. For other organizations, it makes more sense to start with projected income when budgeting. For instance, a membership group can estimate the number of people who might join, as well as the amount in dues members might be willing to pay, and then decide how much of the available money will be spent on planned programs. Make sure that the description of the organization's programs in Part IV of the Form 1023 is consistent with the financial information presented here.

- **B. Balance Sheet**

The Statement of Revenues and Expenses is a summary of the organization's financial activity over a period of time, while the Balance Sheet is a snapshot of what the organization owns and owes on a given date. The IRS prefers that an organization's Balance Sheet reflect its assets and liabilities at the end of its most recently completed tax year. If the organization has not completed a tax year, provide information that is effective as of the last day of the most recent month before filing the Form 1023 with the IRS.

Part VII. Foundation Classification

When the IRS issues a favorable 501(c)(3) determination letter, it is actually two rulings in one. In addition to recognition of 501(c)(3) status, the IRS rules on "Foundation Status," a sort of subcategory under section 501(c)(3). As discussed above in CHAPTER 26, all 501(c)(3) organizations fall into one of two broad categories—public charities or private foundations.

An organization that cannot show that it qualifies for public charity status will be considered a private foundation. Generally, private foundations receive most of their support from a limited number of sources, such as one family, one corporation, or investments. It is generally less favorable to be a 501(c)(3) private foundation, which must pay tax on income from interest, dividends, capital gains and other passive income and subject to a wide variety of investment and operating restrictions. For a more detailed discussion of this distinction, *see* "Public Charities and Private Foundations" in CHAPTER 26. Also, Chapter 3 of IRS Publication 557 and

the instructions to Part IX of the Form 1023 provide useful information to help you determine the appropriate category for your organization.

Organizations are "public charities" because they receive at least 33⅓% of their support from the general public. Organizations whose public support is mostly in the form of gifts, grants and contributions are described in sections 509(a)(1) and 170(b)(1)(A)(vi) of the Code should select the first option. Organizations whose public support is mostly in the form of payments for goods or services, such as fees for admission to cultural events or educational seminars, are described in section 509(a)(2), should select the second option. Many organizations have various sources of income. Check the second to last option to let the IRS decide between these, and other, categories.

Some organizations are "public charities" solely because of the activities they carry on (such as churches, schools, hospitals, or supporting organizations). If one of these options is selected, complete the appropriate schedule.

If the organization will not qualify for one of the public charity categories listed under Line 1, consult with an attorney to understand and comply with the rules applicable to private foundations.

- **Line 1c- Private Operating Foundation**

True "private operating foundations" are rare. An organization that believes it is a private operating foundation should have its application professionally prepared.

Part VIII. Effective Date

- **Line 1**

The answer to this question should be "no." Once an organization obtains tax-exempt status, this status generally will be retroactive back to the date of the organization's formation (i.e., incorporation), provided the organization submits its Form 1023 within 27 months of the end of the month in which it was incorporated.

Part IX. Annual Filing Requirement

- **Line 1**

This question asks if you are exempt from filing the Form 990 annual return. Most charitable organizations are not exempted from filing the Form 990. Exempt organizations include churches, certain church affiliated organizations and certain

affiliates pf a governmental unit. The answer to this question is typically "no". Check "yes" only if you are claiming that the organization is exempt from filing a Form 990.

Part X. Signature

An officer, director, or trustee identified in Part 1 must digitally sign the application by typing his or her name and checking the box in Part X. The instructions to Form 1023 disallow an authorized representative who is not also an officer, director, or trustee of the organization to sign Form 1023. If a third party has completed the pay.gov application, that person could turn over his or her Pay.gov account details to the organization to allow for this digital signing. This would require the officer, director, or trustee to click through the entire application before reaching Part X, as there is no way to jump to a particular part of the application. To take this path, the third party should establish a separate pay.gov profile for each application he or she prepares.

Part XI. User Fee Information

The IRS charges a nonrefundable processing fee for exemption applications. The fee charged is currently $600. These amounts are subject to change, so check the IRS website at https://www.irs.gov/ and type "Exempt Organizations User Fee" in the search box.

A new IRS revenue procedure announcing the User Fee comes out each January; if you are submitting your application late in the year, there may be some benefit to submitting it before January 1.

The fee may be paid directly from a bank account or by credit or debit card.

e. Attachments to Form 1023

After completing the Form 1023 and relevant attachments, refer to the "Upload checklist" (after Part X). This checklist describes the additional documents that may be submitted along with the Form 1023. All of these documents should be saved as part of a single PDF file. Each attachment should be labeled with the organization's name and employer identification number and, if applicable, the question number to which the attachment relates.

TIP:

After electronically submitting the application, download a copy of the submitted application from Pay.gov. No receipt of your submission, other than a receipt for the user fee, will be supplied. In addition, the application package becomes subject to public disclosure once the determination letter is received from the IRS.

CHAPTER 28. Obtaining Recognition for a Publicly Supported Charity

A new organization will be classified as a public charity by virtue of its public support if it can show on its Form 1023 that it reasonably can be expected to meet the applicable public support test or it attests that it will be classified as a public charity on its Form 1023EZ. (*See* CHAPTER 26 for discussion of the differences between public charities and private foundations). During the first five years of operation, the organization retains its status as a publicly supported organization without regard to the calculation of the "public support test" on Schedule A of the Form 990. Beginning with the organization's sixth taxable year, the organization must show that it meets the public support test based on prior years' public support in order to remain classified as a publicly supported organization.

CHAPTER 29. IRS Processing of Exemption Applications

a. Submission

As discussed above, of January 31, 2020, the IRS requires that Form 1023 (Application for Recognition of Exemption Under Code Section 501(c)(3)) be submitted electronically online at Pay.gov. Specific instructions are available at the Pay.gov website. To submit Form 1023, you must: (1) Register for an account on Pay.gov; (2) Enter "1023" in the search box and select Form 1023; and (3) Complete the Form. Note, as part of the submission you will need to attach your supporting documents into one PDF to upload. The file may not exceed a size of 15MB. Adding bookmarks or a table of contents to the PDF file will facilitate IRS review by making it easy for the IRS agent to find the correct attachment in the file. Be sure to label each attachment with the organization's name and employer identification number.

b. Expedited Handling

The IRS is reluctant to consider any application out of turn but will sometimes be persuaded if an organization can show that it will lose funding from an unrelated third party, such as a grantmaking foundation, if the organization does not receive an expedited ruling. The request for expedited handling must be made in writing

and must fully explain the compelling reasons. A copy of the letter should be included with the attachments. In addition, after the application has been filed, the written request must be mailed to the IRS. Please visit the IRS webpage on Expediting Application Process for instructions and the correct address for mailing. *See* page 3 of the Instructions for Form 1023 also has information about requesting expedited review.

c. User Fee

As noted above, the IRS does not begin processing an application until the payment for the User Fee has cleared. Payments can be made directly from a bank account or by credit or debit card. The Form 1023 cannot be submitted online without paying the fee. The amount of the user fee can be found online at the IRS webpage on Form 1023 and 1023EZ Fees.

d. Processing

The IRS receives a large volume of applications for tax-exempt status each year. If a Form 1023-EZ application is submitted, expect to be contacted within 90 days from the date of submission. If a Form 1023 application is submitted, expect to be contacted within 180 days from the date of submission. Contact Customer Service at 877-829-5500 if there are concerns regarding processing.

e. Inquiry Letter

Applications that cannot be closed immediately based on the information initially provided require additional development. Processing of an application that requires additional development may take as long as six to eight months (or longer) to complete.

When an inquiry letter is sent, the applicant will normally have 28 days to respond. Upon request of the applicant, accompanied by an explanation as to why an extension is required, the agent handling the case will sometimes grant an extension of ten days to two weeks. An extension is not guaranteed. If a timely response is not received by the IRS, the IRS will close the case and will not refund the User Fee. If information is submitted late after the case has been closed, the IRS could, in its discretion, potentially open the file but it is not guaranteed.

f. Final Disposition

Once all of the IRS agent's questions are satisfactorily answered, the IRS will issue a favorable determination letter.

If the IRS denies an application, the IRS must provide a written explanation of the facts, law, and argument upon which its decision is based, as well as an explanation of appeal rights.

g. Public Disclosure of Form 1023

A 501(c)(3) organization must furnish a copy of its Form 1023 exemption application (including any attachments, questions asked by the IRS subsequent to the submission of the initial application and the organization's responses to such questions) to any person who requests a copy. More details about the disclosures required and the process for disclosures can be found in CHAPTER 39.

CHAPTER 30. Applying with the Form 1023Z

a. General Information about the Form 1023EZ

The IRS has provided a simplified Form 1023 for small organizations, called the Form 1023EZ for organizations that meet the certain eligibility requirements. The application is made online through the IRS website. You must register for a Pay.gov account and pay the application fee of $275 by credit or debit card or bank account payment. The form must be filed within 27 months after the end of the month of the organization's incorporation date.

b. Eligibility to use Form 1023EZ:

To meet the threshold eligibility requirements, the organization must:

- Have annual gross revenue of $50,000 or less; and
- Have assets of $250,000 or less.

The Instructions for Form 1023EZ contain an eligibility worksheet, located at the back of the instructions. The worksheet should be completed by hand before completing the Form 1023EZ. The responses to the worksheet questions will determine whether the organization will qualify to apply for tax-exemption using the Form 1023EZ.

The following organizations do not qualify:

- Foreign organizations
- Limited liability companies

- For-profit entities
- Organizations with a previously revoked tax-exempt status, except if it was an automatic revocation for failing to satisfy Form 990 filing requirements
- Churches, school, hospitals or HMO's
- Agricultural research organizations
- Supporting organizations
- Credit counseling organizations
- Joint ventures with for-profit entities
- Private operating foundations

If the organization answers "Yes" to any of the worksheet questions, it is not eligible to use Form 1023EZ to apply for exemption under section 501(c)(3). Organizations that are not eligible to file the Form 1023EZ can use the full Form 1023 to apply for tax-exempt status under section 501(c)(3).

c. Preparation and Completion of the Form 1023EZ

TIP:

It is helpful to download and print a copy of the Form 1023EZ from pay.gov and complete the form by hand before you attempt to complete the form online. *See* Preview Form 1023EZ.

In preparation for filing the Form 1023EZ, gather the organization's articles of incorporation, as filed with the Secretary of State's office, the bylaws and the names, titles and addresses of the members of the board of directors. Review the instructions to resolve any issues or questions before going online and attempting to complete the application.

The Form requests a description of the organization's tax-exempt 501(c)(3) purposes and the activities to be conducted to further those purposes. This description is limited to 255 characters, so a response must be carefully considered.

TIP:

It may be helpful to type up the description of the organization's purposes and activities using Microsoft Word or other word processing software that counts text characters, so that you can determine when you are at 255 characters. You will then be able to cut and paste from your Word document to the online Form 1023EZ.

The Form 1023EZ contains the following specific sections (*See* a preview of the Form 1023EZ here):

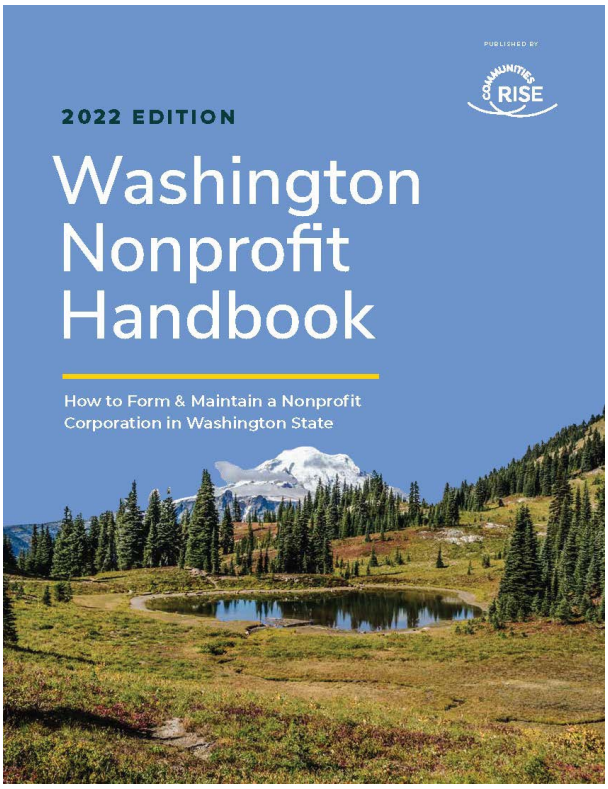
- Attestation of eligibility
- Part I – Identification of the applicant
- Part II – Organizational structure
- Part III – Specific activities
- Part IV – Foundation classification
- Part V – Reinstatement after Automatic Revocation
- Part VI – Signature

To file the form, log in to https://www.pay.gov/public/home and fill out the actual Form 1023EZ based on the prepared draft. An officer, director or a person so authorized by the board of directors should sign the form electronically when it is completed and pay the filing fee of $275 using one of the online methods.

TIP:

Save your work and download a PDF version for the corporation's records.

According to the IRS website, you can expect to be contacted within 90 days from the date the Form 1023EZ was submitted. If you haven't been contacted after the 90 days, you can call the toll-free IRS Customer Account Services number at (877) 829-5500 to check on the status. Be sure to have the organization's full name and EIN with you.



PART 5 MAINTAINING FEDERAL TAX-EXEMPT STATUS FOR YOUR 501(C)(3) ORGANIZATION

Chapter 31 Continuing Obligations Under Federal Tax Law
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PART 5. MAINTAINING FEDERAL TAX-EXEMPT STATUS FOR YOUR 501(C)(3) ORGANIZATION

CHAPTER 31. Continuing Obligations Under Federal Tax Law

When an organization receives a determination from the Internal Revenue Service that it is qualified under section 501(c)(3) of the Internal Revenue Code of 1986, as amended (also referred to as "section 501(c)(3)"; organizations exempt from federal taxes under Code section 501(c)(3) also referred to as a "501(c)(3) organization"), it is the beginning, not the end, of a compliance process that will continue throughout the organization's life. An organization must continue at all times to comply with tax law requirements in order to maintain its tax exemption. Specifically:

- The organization must be organized and operated at all times exclusively to further charitable purposes;
- It must not allow any of its assets or net income to "inure" to the benefit of an "insider";
- It must not participate in any campaign for or against any candidate for political office;
- It must not engage in attempts to influence legislation as a substantial part of its activities;
- It must report and pay tax on any net unrelated business income; and
- It must comply with a variety of annual reporting and public disclosure requirements.

Each of these issues is addressed in more detail below. In general, this Part addresses nonprofit organizations exempt from federal taxes under section 501(c)(3) of the Internal Revenue Code of 1986, as amended (also referred to as "501(c)(3) organization(s)') that are qualified as public charities, and not private foundations, under federal law. A more restrictive set of rules applies to 501(c)(3) organizations that are private foundations. The private foundation rules are beyond the scope of this text, but are introduced and discussed briefly in CHAPTER 22. A special set of rules also applies to public charities that are classified as "supporting organizations." An organization is a supporting organization if its IRS determination letter identifies it as an organization described in Code section 509(a)(3). The supporting organization rules are beyond the scope of this Handbook.

CHAPTER 32. Charitable Purposes

Federal tax law provides that for an organization to qualify for tax exemption as a 501(c)(3), it must be organized and operated exclusively for charitable, religious, scientific, educational, and certain other purposes. In order to maintain its tax-exempt status, a 501(c)(3) organization must comply with this standard throughout its entire period of existence. If its purpose changes – either in how its purposes are stated in its articles of incorporation and bylaws, or in the activities the organization actually conducts – its qualification for exemption may also change.

The tax law recognizes a wide variety of purposes and activities as being "charitable." While section 501(c)(3) enumerates other qualified purposes, such as religious and educational purposes, the law interprets these as subsets of the general category of charitable purposes, not as separate categories. Charitable purposes include relief of the poor, the advancement of religion, the advancement of education or science, the erection or maintenance of public buildings or monuments, lessening the burdens of government (in limited circumstances), promoting social welfare, lessening neighborhood tensions, eliminating prejudice and discrimination, defending human and civil rights secured by law, combating community deterioration and juvenile delinquency, and protecting the natural environment. Educational purposes, as a subset of charitable purposes, include both instruction of the public and the individual. Educational activities include scholastic publications as well as visual and performing arts.

In order for an organization's activities to qualify as charitable, they must benefit the general public or a segment of the general public that is broad enough to be considered a charitable class. A charitable class must be large or indefinite. For example, an educational organization formed to educate the children of one family will not qualify as charitable. In addition, activities that violate public policy, such as the provision of education on a racially discriminatory basis, will not qualify as charitable.

"Exclusively" for Charitable Purposes Means "Substantially." While the tax law specifies that a 501(c)(3) organization must be organized and operated "exclusively" for charitable purposes, the Treasury Regulations provide that an 501(c)(3) organization may also engage in activities that do not specifically further a charitable purpose, provided that such activities do not constitute more than an "insubstantial" part of the organization's total activities. Accordingly, a 501(c)(3) organization may engage in a limited amount of activities that are not strictly

charitable, so long as the activities do not violate any of the rules described in CHAPTER 29, CHAPTER 31, CHAPTER 32, and CHAPTER 33.

The Activity Itself Must Be Charitable. Each of the organization's activities must be evaluated separately to determine whether it furthers a charitable purpose. The fact that funds generated from an activity may ultimately be used to further a charitable purpose will not by itself cause the activity to be charitable. For example, the operation of a sandwich shop on a commercial basis for paying customers is not charitable even though all net income from the shop may be used for charitable purposes. The operation of a soup kitchen for the homeless, on the other hand, is charitable.

CHAPTER 33. Private Inurement

a. General Prohibition

A 501(c)(3) organization must be operated in such a manner that none of the organization's assets "inures to the benefit" of any private individual. An "insider" is an individual that has influence over the organization, such as an officer or director, or an officer or director's family member. Private inurement occurs when a person who is an "insider" with respect to the organization derives a benefit from the organization without giving something of at least equal value in return.

The determination of whether a person is an insider is based on all relevant facts and circumstances and will generally depend on the level of influence that the individual has over the organization. Entities such as corporations and partnerships that are controlled by insiders may also be treated as insiders with respect to an exempt organization. For example, a corporation that is wholly owned by a board member of the organization is an insider with respect to the organization.

In order to identify and avoid potential private inurement situations, an organization should adopt a conflict of interest policy and should annually survey its board members, officers and senior staff to identify all organizations in which they or their family members have substantial interests and to identify all situations in which the organization has financial dealings with potential insiders. The organization must take care to ensure that all such arrangements are entered into at "arm's length" and are in the best interest of the organization. The IRS publishes on its website a model conflict of interest policy. For a sample conflicts of interest policy, *see* Communities Rise Nonprofit Resources webpage.

The IRS may revoke an organization's 501(c)(3) status if any private inurement occurs. As a technical matter, there is no *de minimis* exception. Private inurement may arise in many ways. Some of the most common situations are described below.

b. Compensation Arrangements

A 501(c)(3) organization may pay reasonable compensation to employees or others for services rendered. Excessive compensation, however, such as compensation that exceeds payments made by similar organizations for similar services, may result in inurement. In order to avoid private inurement, an organization should put into place procedures to create a "rebuttable presumption" of reasonableness discussed below in CHAPTER 30.

As a general rule, a 501(c)(3) organization should not pay any person a salary or other compensation that is calculated as a percentage of the organization's net earnings. For example, a 501(c)(3) organization cannot pay its executive director a salary calculated as 10% of the organization's net income. This would be private inurement and could result in revocation of the organization's federal tax exemption.

c. Purchases and Sales

If a 501(c)(3) organization purchases property or services from an insider for more than adequate consideration, or pays rent in excess of fair market value, either of these examples may constitute private inurement. Similarly, if a 501(c)(3) organization furnishes property or services to an insider without receiving adequate consideration in return, inurement may result. If the 501(c)(3) organization provides property or services for less than fair market value to the general public in the course of fulfilling its tax-exempt purposes (e.g., an orchestra performing free concerts), private inurement generally will not result.

d. Loans

If a 501(c)(3) organization borrows money from an insider at a rate of interest that is above market rate, or loans money to an insider without receiving adequate security or reasonable interest, this may also result in private inurement.

Loans by nonprofit corporations to their officers and directors are prohibited under Washington State law, even if the terms are favorable to the corporation.

e. Joint Venture Arrangements

Inurement may also arise from joint venture arrangements between 501(c)(3) organizations and for-profit entities, especially in situations where, under the joint venture arrangement, the for-profit entity has control over the exempt organization's assets or operations or receives a percentage of the exempt organization's net earnings.

CHAPTER 34. Intermediate Sanctions

a. Overview

The penalty for private inurement, as discussed above, is revocation of the organization's tax-exempt status. The tax law also imposes punitive excise taxes on individuals who engage in impermissible transactions with charitable organizations. The IRS may impose such excise taxes as an intermediate step instead of revoking the organization's exempt status, or it may penalize individuals in addition to revoking exempt status.

b. Outline of Penalties

The tax law imposes a punitive excise tax on any "disqualified person" (defined below.) who engages in an "excess benefit transaction" (defined below) with a 501(c)(3) organization that is not a private foundation (or a 501(c)(4) organization), and on "organization managers," which includes board members, officers and the executive director, who knowingly and willfully approve such transactions.

Initially, the tax on a disqualified person is 25% of the excess benefit that the disqualified person received. For example, if the person sold property to the organization for $10,000 when the fair market value was really $4,000, the excess benefit is $6,000 and the initial tax is $1,500 (25% of $6,000). If the transaction is not "corrected" or undone to the extent possible, the disqualified person is subject to an additional tax of 200% of the excess benefit. In the above example, the additional tax is $12,000 ($12,000 is 200% of the excess benefit, which was $6,000).

In addition, an "organization manager," may be subject to a separate tax if the manager approves an excess benefit transaction knowing that it is improper, unless the action is not willful and is due to reasonable cause. The tax on the organization manager is 10% of the excess benefit, up to a maximum of $20,000 for each excess benefit transaction. In our example, the tax on an organization manager would be $600 ($600 is 10% of the excess benefit, which was $6,000).

The intermediate sanctions rules do not impose a penalty tax on the exempt organization itself.

c. "Disqualified Person"

A "disqualified person" is a person who is in a position to exercise substantial influence over an organization with respect to a transaction. Once a person is classified as a disqualified person, he or she will continue to be a disqualified person for a period of five years after ceasing to exercise such influence. A member of a disqualified person's family is also a disqualified person, as is a corporation, partnership, trust or estate in which a disqualified person directly or indirectly owns more than a 35% interest.

Under Treasury Regulations, a voting member of a 501(c)(3) organization's governing body is automatically a disqualified person, as are the organization's president, chief executive officer, chief operating officer, treasurer, chief financial officer, and any management company that performs services for the exempt organization. An individual's authority and responsibilities, rather than the person's title, determines whether he or she holds one of these positions. An individual who has or shares ultimate responsibility for implementing the governing body's decisions or supervising the organization's management, administration or operations will be a disqualified person, as will anybody who has or shares ultimate responsibility for managing an organization's financial assets, including check-signing authority, and authority to authorize electronic fund transfers.

Treasury Regulations provide that an employee who receives economic benefits from an exempt organization of less than $120,000 per year is not a disqualified person, so long as the individual is not otherwise a disqualified person under one of the categories above. For example, an executive director who receives $50,000 per year will be a disqualified person by virtue of his/her role, regardless of the fact that his/her salary is less than $120,000.

In cases not covered by the rules above, whether a person is a disqualified person is determined on the basis of all relevant facts and circumstances bearing on the person's level of influence over the organization.

d. "Excess Benefit"

An "excess benefit transaction" is any transaction in which a 501(c)(3) or 501(c)(4) organization provides an economic benefit, either directly or indirectly, to a disqualified person, where the value of that economic benefit exceeds any value that

the organization receives in return, including the value of services performed for the organization. For example, the payment of a salary of $50,000 for services, where the fair market value of the services is $25,000, is an excess benefit transaction.

Reasonable expenses for board members to attend meetings, as long as these do not include luxury travel or payments for spouses, do not constitute excess benefit transactions. Similarly, benefits provided to the public in exchange for an annual membership fee of $75 or less, such as discounted admission to events or receipt of a newsletter, do not constitute excess benefits.

e. Rebuttable Presumption of Reasonableness

An organization can establish a rebuttable presumption that a transaction is reasonable (and therefore not an excess benefit transaction) when the three requirements set out below are satisfied. In general, organizations should seek to satisfy the rebuttable presumption in approving any transaction with or compensation involving a potential disqualified person, including payment of a salary. If an organization is unable to establish the rebuttable presumption, however, there is no inference that the transaction is an excess benefit transaction. The three requirements are:

1) **Approval by Independent Board or Committee.** The transaction must be approved by a board or committee authorized under state law and composed entirely of individuals who do not have a conflict of interest with regard to the transaction and are not related to or under the direction and control of a disqualified person who does have a conflict of interest.

2) **Appropriate Comparability Data.** The board or committee must rely on appropriate comparability data. The issue of what data is appropriate is critical.

   - Where the transaction involves the purchase or sale of property, an independent appraisal is appropriate data.

   - Where the transaction involves the payment of executive compensation, the board or committee should obtain a compensation survey that considers a variety of factors, including geographic location, the size of the organization, relevant experience, and comparability of services. A special rule applies for organizations with annual gross receipts of less than $1 million. In

this case, comparability data for compensation is appropriate if it consists of compensation paid by three comparable organizations in the same or similar communities for similar services. Such data can be obtained through an informal survey of similar organizations.

3) Adequate and Concurrent Written Documentation. The board or committee must adequately and concurrently document the basis for its decision in writing (e.g., through minutes) For the documentation to be adequate, it must include the terms of the transaction; the date it was approved; the members of the board or committee who were present during debate and those who voted on it; the comparability data obtained and relied on, and how it was obtained; and member of the board or committee member with a conflict of interest. For the decision to be documented concurrently, the records must be prepared by the next board or committee meeting or 60 days after the initial action and must be approved within a reasonable period.

CHAPTER 35. Political Activity

Federal tax law prohibits any 501(c)(3) organization from participating in any political campaign on behalf of or in opposition to any candidate for public office. This prohibition is absolute and any violation may result in loss of an organization's exempt status. The prohibited activity includes publishing or distributing written statements or making oral statements on behalf of or in opposition to a candidate, and paying salaries or expenses of campaign workers.

Section 501(c)(3) organizations must avoid any inadvertent violation of this prohibition. For example, an organization should not invite a candidate to speak at an organization-sponsored function during an election cycle, because this may be treated as participation in a campaign. Organizations should also refrain from publishing voter education materials that may create an appearance of bias regarding issues that are significant to the organization, e.g., a "voter's guide" that compiles incumbents' voting records only on issues that are important to the organization.

CHAPTER 36. Legislative Activity ("Lobbying")

a. "No Substantial Part" Limitation

The tax law distinguishes political activity (i.e., participating in campaigns for political office) from attempts to influence legislation (commonly referred to as

lobbying). An organization engages in attempts to influence legislation if it contacts legislators or their staff – or urges the public to do so – for the purpose of proposing, supporting or opposing legislation.

A 501(c)(3) organization that is a public charity may engage in lobbying, but only if such activities do not constitute a "substantial part" of the organization's activities. If the IRS determines that a public charity has attempted to influence legislation as a substantial part of its activities, the organization's exemption may be revoked. It is unclear when lobbying activity will be deemed to constitute a substantial part of an organization's activities since there is no precise standard.

Certain other types of tax-exempt organizations, e.g., social welfare organizations qualifying under section 501(c)(4), are not subject to limitations on legislative activities. If an organization wishes to engage primarily in lobbying, it should seek exemption under a category other than section 501(c)(3).

TIP:

Washington State has additional registration requirements for lobbying activities that are separate and distinct from Federal IRS rules. *See* RCW 42.17A.600-655 for more on State law requirements. For more information on Washington State requirements for lobbying go to https://www.pdc.wa.gov.

b. Section 501(h) Election

(i) Generally

Most section 501(c)(3) organizations that are public charities, other than churches, may elect to become subject to a more objective standard for lobbying activities than the vague "substantial part" test. This is called a section 501(h) election. Section 501(h) provides specific dollar limits on lobbying expenditures. An organization that makes the election may spend up to 20% of the first $500,000 of its annual operating budget on lobbying (however, only 25% of that amount may be spent in "grassroots" lobbying, however, as defined below). As an organization's annual budget increases over $500,000, the percentage that may be spent on lobbying decreases. There is an absolute annual maximum on lobbying expenditures of $1 million, which is reached when an organization's annual budget is $17 million.

If an organization exceeds its limit in any year, it will be subject to an excise tax of 25% on the excess amount. An organization that has made a section 501(h)

election will lose its tax exemption on the basis of excessive lobbying only if the organization exceeds its permitted expenditures by 150% over a four-year period.

The election is made by filing Form 5768 with the IRS, which is available at http://www.irs.gov/pub/irs-pdf/f5768.pdf.

(ii) Advantages of the Section 501(h) Election

The principal advantage of the section 501(h) election is that it avoids the ambiguity of the vague "substantial part" test. The election also allows an organization to take advantage of specific exceptions to what constitutes lobbying under the tax law. In general, the section 501(h) election allows an organization to plan lobbying expenditures with much greater certainty regarding the tax result. In addition, the excise tax that applies to excessive lobbying expenditures of an electing organization is much less harsh than the loss of tax-exempt status that can apply to a non-electing organization. An organization that anticipates any regular attempts to influence legislation is advised to make the section 501(h) election unless its annual revenues exceed $17 million.

TIP:

The section 501(h) election filing is relatively easy to do and makes it clear to the organization and to the IRS that the organization is compliant with the lobbying restrictions under section 501(c)(3).

c. "Attempts to Influence Legislation" Under Section 501(h)

(i) Legislation

Legislation includes action by the Congress, state legislature, county or city council, or similar legislative body, or by the public in a referendum, ballot initiative, constitutional amendment or similar procedure. It includes both legislation that has already been introduced in a legislative body and a specific legislative proposal that the organization either supports or opposes. It does not, however, include executive action, judicial processes, or the work of administrative agencies or boards such as school boards, housing authorities, sewer and water districts and zoning boards, whether elective or appointive. Attempts to influence the actions of regulatory agencies accordingly are not considered lobbying, even where the agency is primarily concerned with effectuating legislative mandates.

(ii) Direct Lobbying Communication

Attempts to influence legislation include direct lobbying, such as: (1) communications with any member or employee of a legislative body; (2) communications with any governmental official or employee who may participate in formulating legislation, if the principal purpose of the communication is to influence legislation; or (3) communications with the public with respect to a ballot measure. A communication with a legislator or governmental official will be treated as a direct lobbying communication if it (1) refers to specific legislation (including legislative proposals), and (2) reflects a view regarding the legislation. Similarly, a communication with the public will be treated as a direct lobbying communication if it (1) refers to a specific ballot measure up for a public vote, and (2) reflects a view regarding the ballot measure.

(iii) Grassroots Lobbying Communication

Attempts to influence legislation also include "grassroots" lobbying communications. These are communications that attempt to affect the opinion of the general public or a segment of the public and that (1) refer to specific legislation (including legislative proposals); (2) reflect a view regarding the legislation; and (3) encourage the recipient to take action.

A communication encourages the recipient to take action if it (1) encourages the recipient to contact a legislator; (2) gives the legislator's addresses, telephone number or other contact information; (3) provides a petition or tear-off postcard for the recipient to communicate with the legislator; or (4) specifically identifies one or more legislators who will vote on the legislation. Paid mass media advertisements within two weeks before a vote on a highly publicized piece of legislation will be presumed to constitute grassroots lobbying if the advertisement reflects a view and encourages communication with legislators, even if it does not encourage the recipient to take action.

d. Exceptions to "Attempts to Influence Legislation"

(i) Nonpartisan Analysis, Study or Research

A 501(c)(3) organization may provide the public or legislators the results of any of its "nonpartisan analysis, study or research." This includes any independent and objective exposition of a particular subject matter, including educational materials. The materials may advocate a particular position, so long as they present sufficient facts to allow the audience to form independent conclusions. If the communication

directly encourages the recipient to take action with respect to specific legislation, then it is excluded from this exception.

(ii) Technical Advice or Assistance

An organization that has developed a particular expertise in a given area may be called upon to render technical advice or assistance to a legislative committee or subcommittee. Provided that the invitation is issued in writing by the committee or subcommittee, rather than an individual member, the organization's response to that request will not constitute lobbying activity.

(iii) Self-Defense Exception

An organization may appear before or communicate with any legislative body with respect to decision which might affect the organization's existence, its powers and duties as a tax-exempt organization, its tax-exempt status, or the deductibility of its contributions.

(iv) Examinations and Discussions of Broad Social, Economic and Similar Problems

The participation in, or sponsorship of, public discussion on issues of general concern will not constitute lobbying, provided that such discussion does not address the merits of a specific legislative proposal and does not directly encourage participants to take action with respect to legislation.

CHAPTER 37. Unrelated Business Income ("UBI")

a. Tax Liability

While a 501(c)(3) organization is not generally subject to federal income taxation, it will be taxed on any net income derived from an "unrelated trade or business." Such income is referred to as unrelated business income, or "UBI." UBI is taxed at graduated rates similar to those that apply to taxable corporations or trusts (depending on the legal form of the organization involved).

The purpose of the UBI tax is to treat exempt organizations in the same manner as their taxable counterparts when they are regularly engaging in income-producing activities that do not further a charitable purpose. An organization's tax exemption may be jeopardized if a substantial part of its activities constitutes UBI. As with lobbying activities, there is no precise standard for how much unrelated business activity is too much.

b. Unrelated Trade or Business

An exempt organization's activity is an unrelated trade or business if all of the following three factors are present:

(i) Trade or Business

A "trade or business" activity is defined as any activity carried on for the production of income from selling goods or performing services;

(ii) Regularly Carried On

The trade or business activity is frequent, continuous, and pursued in a manner similar to comparable activities of non-exempt organizations; and

(iii) Not Substantially Related

The trade or business is not substantially related to the organization's exempt purpose. An activity is substantially related if the activity has a substantial causal relationship to the organization's exempt purposes (other than the production of income). In short, the activity must contribute importantly to the organization's exempt purposes. It is not enough that the net income from the activity will be used to further charitable purposes. The conduct of the activity must itself be charitable. For example, the operation of a restaurant where all net income will be used for charitable purposes is not charitable. On the other hand, the operation of a restaurant used exclusively as a job-training program for indigent persons may be charitable.

c. Multiple Unrelated Trades or Businesses Treated Separately

If an organization carries on two or more unrelated trades or businesses that are in different lines of activity, then losses arising from one unrelated trade or business may not be used to offset income from a different unrelated trade or business. All unrelated business income and losses arising from portfolio investments are treated as if they were derived from a single unrelated trade or business.

d. Exceptions for Certain Activities

Certain activities are excluded from the definition of an unrelated trade or business, and income from these activities accordingly is not UBI.

(i) Volunteer Exception

A business where substantially all of the work is performed by uncompensated volunteers does not generate UBI. For example, operation of a retail store where all of the work is performed by unpaid volunteers is not an unrelated trade or business, and any income generated is not UBI.

(ii) Convenience Exception

A business carried on primarily for the convenience of an exempt organization's members, students, patients, officers or employees is not an unrelated trade or business and does not generate UBI. For example, a hospital cafeteria for employees, patients and visitors does not generate UBI.

(iii) (iii) Donated Merchandise

Selling merchandise, substantially all of which has been donated to the organization, is not an unrelated trade or business, and does not generate UBI. For example, a retail thrift store in which all merchandise sold is donated to the organization does not generate UBI.

(iv) (iv) Exclusions for Investment Income

The following categories are excluded from UBI, and therefore generally are not taxable, on the grounds that they are passive income from investment assets:

- Dividends, royalties, interest and annuities;
- Rents from real property are excluded, subject to a variety of exceptions, (although income from debt-financed property, discussed below, may be UBI); or
- Gains from the sale or exchange of property are generally excluded. For example, a 501(c)(3) organization generally is not subject to tax on gain on its sale of stock. If the organization regularly sells items that constitute inventory, however, and the sales activity does not further charitable purposes (e.g., sales of commercial magazines), then the income may be taxable.

(v) Deductions

501(c)(3) organizations are permitted a standard deduction in the amount of $1,000 against any UBI earned in a taxable year, which effectively amounts to an exemption from tax on the first $1,000 of UBI. Organizations may also deduct expenses attributable to each unrelated trade or business in calculating the net UBI for that trade or business.

(vi) Debt-Financed Income

While the types of income described above are generally excluded from UBI, income from debt-financed property is not. For example, net rental income from real property, or net gain from sale of stock may be subject to tax in whole, or in part, because the underlying property is subject to debt financing. The rules regarding debt-financed property are complex and confusing, and a full discussion is beyond the scope of this text.

Essentially, the policy behind the rules is as follows: It may be appropriate generally not to tax an organization on traditional investment income such as interest, dividends and rents, because this is the type of income that a charity typically earns from investment of its endowment. Such items should be taxed, however, to the extent that the organization borrowed to acquire the income-producing property, where the use of the property is not considered charitable.

For example, assume that an organization acquires a building, subject to a mortgage for 80% of the purchase price, and uses half of the building for its administrative offices and its charitable purposes, while it leases the other half of the building to other unrelated organizations. The rental activity itself is not charitable. Under the debt-financed income rules, 80% (the percentage that was debt-financed) of the net rental income (after deduction of related expenses) will be taxed as UBI.

e. Excessive UBI May Jeopardize Exemption

An exempt organization's tax-exempt status may be jeopardized if more than an insubstantial part of its activities constitutes unrelated business activities. While there is no precise quantitative test for substantiality, the IRS has ruled that there is no quantitative limit so long as an organization carries on a charitable program "commensurate in scope with its financial resources." The IRS has also ruled that UBI constituting 5% of an organization's gross income does not jeopardize its tax exemption.

If an exempt organization's status is threatened by the extent of its unrelated business activities, it should consider spinning off the unrelated activity into a for-profit corporate subsidiary. Assuming that proper corporate formalities are observed, the corporate subsidiary's activities should not affect the parent's exempt status. The subsidiary will be taxed on net income from its activities. A subsidiary formed as a single-member limited liability company ("LLC") is not effective for these purposes.

CHAPTER 38. Federal Filing Requirements

a. Annual IRS Form 990

(i) Filing Requirement

Most tax-exempt organizations must electronically file an annual information return with the IRS. For 501(c)(3) organizations that are public charities — as well as most other types of tax-exempt organizations — the information return is made on IRS Form 990 or Form 990-EZ, depending on the type and size of the organization. *See* the instructions to Form 990, available at https://www.irs.gov/pub/irs-pdf/i990.pdf

Failure to file the return for three consecutive years will result in automatic revocation of tax exemption. The organization will have to reapply for 501(c)(3) tax exemption to reinstate the organization's 501(c)(3) tax exemption.

(ii) Annual Notice Requirements for Small Organizations

Small organizations (i.e., those that do not normally receive more than $50,000 in annual gross receipts) may file an annual electronic notice with the IRS reporting basic organizational information, called the Form 990-N "e-Postcard", if they meet the Form 990-N requirements. The e-Postcard is available at https://www.irs.gov/charities-non-profits/annual-electronic-filing-requirement-for-small-exempt-organizations-form-990-n-e-postcard. Failure to file the electronic notice for three consecutive years will result in automatic loss of tax exemption.

(iii) Exception for Churches and Certain Religious Organizations

Churches and certain religious organizations that are affiliated with a church are not required to file an information return. For these purposes, "church" encompasses synagogues, temples, mosques, and other charitable houses of worship.

(iv) Filing Date

The return of the electronic notice must be filed on or before the 15th day of the fifth month following the close of an organization's annual tax accounting period (i.e., May 15 for a calendar-year organization). Organizations may request one six-month extension of the due date by filing Form 8868. The Form 8868 must be filed no later than the initial due date for the Form 990.

(v) Professional Preparation

An organization may choose to either prepare its own Form 990 returns or hire a professional service. Both private foundations and section 501(c)(3) charitable organizations that rely on a public support test for public charity classification, supporting organizations described in section 509(a)(3), should seriously consider engaging a professional accountant with experience in preparing this type of return.

(vi) Treatment as a Public Relations Document

Form 990 information returns are public documents. A 501(c)(3) organization must disclose to the public upon request of its Form 990 returns for the three most recent tax years. Form 990 returns are available at the Guidestar website.

(vii) Penalties

Failure to file a Form 990 in a timely manner may result in penalties of $20 per day, with a cap of $10,000 or 5% of the organization's gross receipts for the year, whichever is less. For large organizations (those organizations whose gross receipts exceed $1 million for any year), the penalty is $100 per day, with a cap of $50,000. The penalty may be abated if reasonable cause is shown. An incomplete Form 990 information return may be treated as a failure to file, with penalties assessed.

TIP:

A tax-exempt organization should consider its Form 990 information returns to be public relations tools and should treat the preparation process as an opportunity to promote the organization's programs and good works to the public.

(viii) Organizations With a Tax Exemption Application Pending

Organizations that have applied for tax exemption but have not yet received a determination letter should file a Form 990 or other applicable form as if their tax-exempt status has been recognized. Small organizations that meet the requirements

to file the Form 990-N e-Postcard but are still waiting for their determination letter will need to call the IRS at 877-829-5500 to notify the IRS that they are eligible to use the Form 990-N filing system.

b. Form 990-T: Organizations with Unrelated Business Income (UBI)

A tax-exempt organization that has $1,000 or more in gross UBI in a taxable year must report such income on Form 990-T, which must be filed in addition to the informational Form 990. Exempt organizations are also required to make quarterly estimated UBI tax payments, calculated at rates similar to corporate rates. Penalties apply for late filing, late payment, or underpayments of taxes on income reportable on Form 990-T. Organizations generating UBI should consult an accountant.

c. Federal Returns and Reports Required of Organizations with Employees

(i) Federal Income Tax Withholding

Most tax-exempt organizations are required to withhold and pay federal income tax on their employees' wages in the same manner as for-profit organizations. Organizations should consult a bookkeeper, accountant, or payroll management advisor regarding this and the other requirements listed in this section. *See* CHAPTER 71.

(ii) Social Security Taxes

Most tax-exempt organizations are required to withhold and pay Federal Insurance Contributions Act (FICA) taxes in the same manner as for-profit companies. *See* CHAPTER 71.

(iii) Federal Unemployment Taxes

A 501(c)(3) organization is not required to pay federal unemployment taxes, but may elect to participate in a state program. *See* CHAPTER 71.

(iv) Information Returns for Payees

Tax-exempt organizations are required to prepare and file certain forms annually for purposes of reporting amounts paid to employees and others, in the same manner as for-profit companies. These include, but are not limited to, Forms W-2 and 1099.

d. Reporting Material Changes within the Organization to the IRS

(i) Changes to Legal Structure

Any organization that makes material changes to its legal structure may be required to file a new exemption application to ensure continued qualification for exemption. For example, a new exemption application is generally required if a nonprofit corporation is administratively dissolved by a state and a new corporation is formed to carry out its activities.

(ii) Amendments to Articles or Bylaws

If an organization amends its articles of incorporation or bylaws, it should notify the IRS and describe the amendments on its annual Form 990. If an organization has changed its name, the organization should submit a copy of amendments of its organizing documents that show the name change with the annual Form 990. Organizations that are not required to file a Form 990 should notify IRS Customer Account Services of any such change, at the address provided at https://www.irs.gov/charities-non-profits/political-organizations/eo-customer-account-services.

CHAPTER 39. Public Disclosure of Exemption Application and Form 990 Returns

a. Information Disclosure

A 501(c)(3) organization must provide copies of its Form 1023 or Form 1023-EZ exemption application to any person who requests it. A limited exception applies to an organization that filed its application before July 15, 1987, but only if the organization does not have a copy of the application on July 15, 1987. A 501(c)(3) organization that is a public charity must also provide copies of its annual IRS Form 990 or Form 990-T (UBI return) for its three most recent tax years upon request.

A public charity is not required to disclose Schedule B of Form 990, which is the portion of the Form 990 that identifies the names and addresses of contributors to the organization. In addition, the organization may redact certain information from the Form 990 if the public availability of the information would adversely affect the organization (for example, information that relates to the organization's trade secret, patent, process, or style of work). Similar rules apply to private foundations, except that the list of contributors is subject to disclosure.

If the request for a copy of the Form 990 is made in person, the organization must provide a copy on the day the request is made. In unusual circumstances where this would be unreasonably burdensome, the organization may provide the copy on the next business day. If the request is made in writing, the organization must provide a copy within 30 days.

b. Fees

An organization may charge a reasonable fee for providing copies (currently set as $0.20 per page) plus postage costs. An organization may collect payment before providing the requested copies.

c. Exceptions

A 501(c)(3) organization can avoid the requirement to provide copies by making the necessary documents widely available, which includes posting them on the organization's website, or by having the documents posted on another organization's website as part of a database of similar materials. A limited exception to the disclosure rules also applies to organizations that have been subject to a harassment campaign by the public, in which situation a waiver of the rules would be in the public interest.

d. Penalties for Failure to Disclose

A penalty of $5,000 applies for any failure to provide copies of the required Form 990 returns or the Form 1023 exemption application.

CHAPTER 40. Documentation of Contributions

For additional information regarding substantiation and disclosure requirements, *see* CHAPTER 39 and IRS Publication 1771, Charitable Contributions, at http://www.irs.gov/pub/irs-pdf/p1771.pdf, and for issues to consider when fundraising, *see* CHAPTER 49-CHAPTER 54.

a. Donor Substantiation for All Gifts

In order for a donor to claim a charitable contribution deduction for any gift paid by cash or check, the donor must maintain a record of the gift in the form of a bank record, or a written communication from the charity showing the charity's name, the date of the contribution, and the amount of the contribution.

b. Donor Requirement: Written Receipts for Donations of $250 or More

In order for a donor to deduct a contribution of $250 or more, the donor must obtain a written receipt from the recipient charity. The receipt must verify the amount of the contribution and must specifically state whether the charity provided any goods or services, such as a dinner or concert, in consideration for the contribution. If so, the receipt must include a good-faith estimate of the value of the goods or services provided. If the donation is of property other than cash, the receipt must describe the property, but is not required to specify the value of the property. The charitable organization may provide a separate acknowledgment for each contribution, or provide donors with an annual or more frequent acknowledgment that sets out the required information for each contribution of $250 or more. A canceled check will not satisfy this substantiation requirement.

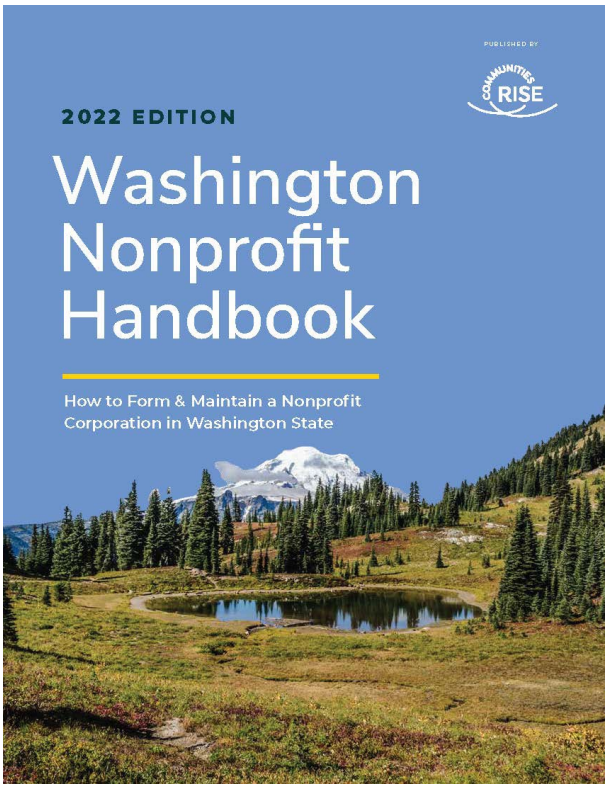
c. Charity Requirement: Receipts for "Quid Pro Quo" Contributions

A charity that receives a payment partly as a contribution and partly as payment for goods or services has received a "quid pro quo" contribution. A charity that receives a quid pro quo contribution in excess of $75 must provide the donor with a written statement setting out the amount of the payment that is deductible as a contribution. This statement must indicate that the deduction is limited to the excess of the amount of the contribution over the value of the goods or services provided to the donor and must include a "good-faith estimate" of the value of the goods or services. Failure to make this required disclosure can result in penalties of $10 per contribution, with a total maximum penalty of $5,000. An exception to the quid pro quo rules may apply if a charity provides only token goods and services, such as mugs or calendars.

d. Sale or Exchange of Donated Property

An individual or entity which contributes property to a 501(c)(3) organization and claims a deduction for more than $5,000 must in most cases obtain an appraisal that meets specific requirements set out in the Treasury Regulations and report the donation on IRS Form 8283. If the recipient organization disposes of the property within three years after its receipt, the organization must file IRS Form 8282, indicating the property's sale price, and must provide a copy to the donor.

Cannabis and donations: It is important to remember that although use and sale of recreational marijuana is legal under Washington State law, it is illegal under Federal law. Nonprofits with 501(c)(3) tax-exemption should be careful not to be in violation of any federal laws, this includes being a part of any cannabis transactions including, but not limited to, donations of cannabis or money from a cannabis business. You may receive a financial donation from a retailer or producer (grower) of cannabis if there is no advertisement associated with that donation. Remember, cannabis remains illegal at the federal level, so you should be careful if the donation is significant enough to be claimed on your IRS Form 990.



PART 6 INTERNATIONAL ACTIVITIES AND GRANTMAKING

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PART 6. INTERNATIONAL ACTIVITIES AND GRANTMAKING

CHAPTER 41. Ability of 501(c)(3) Organizations to Carry on Foreign Activities - Non-U.S. Charitable Activities Qualify as 501(c)(3) Activities

A U.S. organization exempt from federal income taxes under section 501(c)(3) of the Internal Revenue Code of 1986, as amended (also referred to as "section 501(c)(3)") can conduct international activities without jeopardizing its section 501(c)(3) status, provided that the foreign activities would have been viewed as charitable within the meaning of section 501(c)(3) if they had been carried on in the United States and the conduct of such activities outside the United States does not preclude the organization from qualifying as an exempt organization under that section. *See* Revenue Ruling 71-460, 1972-2 CB 231.

The holding of Revenue Ruling 71-460 is consistent with the position of the IRS in Revenue Ruling 68-165, 1968-1 CB 253, which held that a domestic nonprofit organization that joined with a counterpart group in Latin America to provide technical and material assistance for self-help projects intended to improve living conditions of the underprivileged and operates a student exchange program qualifies as a section 501(c)(3) organization based on its activities in Latin America.

Similarly, in Private Letter Ruling 200408035 (02/20/2004), the IRS stated that a private foundation's proposed grant to the government of an impoverished foreign country to provide housing for residents for the foreign country satisfied the requirements of section 501(c)(3). And in Private Letter Ruling 200121078 (05/29/2001) the IRS stated that a private foundation's proposed grant to a foreign orphanage satisfied section 501(c)(3). Both such Private Letter Rulings cited Revenue Ruling 71-460 for the proposition that a section 501(c)(3) organization may conduct part or all of its charitable activities in a foreign country.

CHAPTER 42. Indirect Contributions of Gifts to Be Used Outside the United States - Earmarking

a. Earmarking Issues

Because of the inability of U.S. donors to take an income tax deduction under I.R.C. section 170 for direct contributions to non-U.S. organizations, and because of the expenditure responsibility rules of I.R.C. section 4945(h) and the qualifying distribution rules of I.R.C. section 4942 applicable to private foundations, donors

often make contributions to U.S. public charities with the intention that their contributions be used outside the United States. This raises the "earmarking issue."

The question of earmarking arises in situations where the terms and conditions of a donor's gift (i.e., a requirement that that the gift be used for a specific beneficiary or be regranted to a specific organization) may prevent the recipient organization from controlling the gift. Where a gift is earmarked for the ultimate benefit of another organization, the recipient organization is a mere conduit, and the true recipient of the gift is the ultimate beneficiary. In these cases, the tax implications of the gift must be determined as if the donor directly made the gift to such recipient.

Clearly, the earmarking risk can arise where a donor makes a gift to a U.S. exempt organization with the intention that the gift ultimately be used for a non-U.S. organization. It can also arise in determining whether contributions intended to be used for another recipient will constitute "public support" for purposes of determining an organization's public charity status.

b. Revenue Ruling 63-252

Revenue Ruling 63-252, 1963-2 CB 121, sets out the general rule that a donor's income tax deduction will be disallowed under Code section 170(c) if the donor's contribution to a U.S. charity is inevitably committed to a foreign organization and it comes to rest only momentarily in a qualifying U.S. organization. The key question is whether the U.S. organization is the real recipient of the gift because of its right to exercise control over the disposition of the gift. If this control does not exist, the secondary donee will be the ultimate beneficiary.

The IRS uses five examples to illustrate the general rule of Revenue Ruling 63-252. In the first three examples (below), the IRS rules that the U.S. recipients were agents of the foreign organizations or conduits, and therefore contributions were earmarked, the U.S. entity was not the recipient of the contribution, and the donors could not deduct their contributions.

> (1) In pursuance of a plan to solicit funds in [the United States,] a foreign organization caused a domestic organization to be formed. At the time of formation, it was proposed that the domestic organization would conduct a fundraising campaign, pay the administrative expenses from the collected fund and remit any balance to the foreign organization.

(2) Certain persons in [the United States,] desirous of furthering a foreign organization's work formed a charitable organization within the United States. The charter of the domestic organization provides that it will receive contributions and send them, at convenient intervals, to the foreign organization.

(3) A foreign organization entered into an agreement with a domestic organization which provides that the domestic organization will conduct a fund-raising campaign on behalf of the foreign organization. The domestic organization has previously received a ruling that contributions to it are deductible under section 170. In conducting the campaign, the domestic organization represents to prospective contributors that the raised funds will go to the foreign organization.

In the following two examples the IRS concluded that the U.S. organizations exercised control over their funds and therefore were the true recipients of the contributions and not mere conduits.

(4) A domestic organization conducts a variety of charitable activities in a foreign country. Where its purposes can be furthered by granting funds to charitable groups organized in the foreign country, the domestic organization makes such grants for purposes which it has reviewed and approved. The grants are paid from its general funds, and although the organization solicits from the public, no special fund is raised by a solicitation on behalf of particular foreign organizations.

(5) A domestic organization, which does charitable work in a foreign country, formed a subsidiary in that country to facilitate its operations there. The foreign organization was formed for purposes of administrative convenience, and the domestic organization controls every facet of its operations. In the past the domestic organization solicited contributions for the specific purpose of carrying out its charitable activities in the foreign country, and it will continue to do so in the future. However, following the formation of the foreign subsidiary, the domestic organization will transmit funds it receives for its foreign charitable activities directly to that organization.

Revenue Ruling 63-252 was amplified by Revenue Ruling 66-79, 1966-1 C.B. 48, which held that "Contributions to a domestic charity described in section 170(c)(2) of the Internal Revenue Code of 1954 which are solicited for a specific project of a foreign charitable organization are deductible under section 170 of the Code where

the domestic charity has reviewed and approved the project as being in furtherance of its own exempt purposes and has control and discretion as to the use of the contributions."

c. Revenue Ruling 63-252 and "Friends-of" Organizations

"Friends-of" organizations are U.S. organizations formed to solicit and receive contributions from United States donors and to spend the funds on behalf of a foreign charitable organization outside the United States. An example of a friends-of organization is Americans for Oxford. This organization is a U.S. section 501(c)(3) public charity that raises funds in the United States intended to benefit Oxford University in the United Kingdom. So long as certain requirements are met, U.S. donors to this organization may obtain a U.S. income tax deduction for their contribution, even though the funds are intended to benefit a non-U.S. organization. Americans for Oxford's website states that its board of directors retains control and discretion concerning grants to Oxford.

In Revenue Ruling 66-79, contributions to a friends-of-organization were recognized as made to the U.S. organization (and not the foreign entity) and were therefore deductible under section 170 of the Code, when the U.S. organization's bylaws provided that:

> (1) The making of grants and contributions and otherwise rendering financial assistance for the purposes expressed in the charter of the organization shall be within the exclusive power of the board of directors; (2) in furtherance of the organization's purposes, the board of directors shall have power to make grants to any organization organized and operated exclusively for charitable, scientific or educational purposes within the meaning of section 501(c)(3) of the Code; (3) the board of directors shall review all requests for funds from other organizations, shall require that such requests specify the use to which the funds will be put, and, if the board of directors approves the request, shall authorize payment of such funds to the approved grantee; (4) the board of directors shall require that the grantees furnish a periodic accounting to show that the funds were expended for the purposes which were approved by the board of directors; and (5) the board of directors may, in its absolute discretion, refuse to make any grants or contributions or otherwise render financial assistance to or for any or all the purposes for which funds are requested.

The bylaws further provided that the organization could solicit funds for grants to a specific project or purpose that the board of directors had previously approved; provided, however, that the board of directors must have the right to withdraw approval of the grant and use the funds for other exempt purposes. The organization's board of directors communicated to donors that it could withdraw its approval of a particular grant at any time. And finally, the organization refused to accept earmarked contributions to a particular foreign organization.

Commentators have suggested that organizations seeking to qualify as a domestic friends-of organization (1) include the bylaw provisions described above, (2) establish grant application review and approval procedures, (3) adopt the appropriate resolutions for fundraising proposals for each grant and each disbursement, and (4) require grant accountability. Furthermore, the organization's solicitation materials should ensure that donors understand that they are not giving to the foreign organization and that the domestic organization retains discretion over the use of the gift.

d. Private Foundations and Earmarking Concerns

Private foundations often elect to forego direct contributions to foreign organizations in lieu of making grants to "friends-of" organizations because by making a grant to a U.S. public charity, they avoid the expenditure responsibility requirements of I.R.C. section 4945(h) and are assured that the grant is a qualifying distribution under I.R.C. section 4942. (The expenditure responsibility and qualifying distribution requirements are discussed in further detail in CHAPTER 38.) The earmarking concerns discussed above apply to grants by private foundations in this type of situation. *See* Treas. Reg. section 53.4945-5(6). To obtain the benefits of making a grant to a U.S. public charity, the private foundation's grant must be viewed as made to and received by the U.S. public charity. If the U.S. charity is merely a conduit or an agent for the foreign organization, the private foundation will be considered to have made the gift directly to the foreign organization, and all the complex rules discussed in this chapter will apply to the grant.

CHAPTER 43. Grants by U.S. Public Charities to Non-U.S. Organizations

As discussed above, a U.S. public charity may fulfill its qualified exempt purposes by expending funds outside the United States, either by directly carrying on its exempt activities outside the United States or by making grants to individuals or organizations outside the United States that will advance the U.S. organization's exempt purpose.

If the foreign organization has obtained a favorable determination letter from the IRS regarding its section 501(c)(3) tax-exempt status, the U.S. public charity can presume that the recipient will use the contribution for a proper exempt purpose. However, if the foreign organization does not hold a favorable determination letter, the U.S. public charity must establish that the grant was made for an exempt activity, and was in fact, actually used for such purpose, all in furtherance of the grantor's exempt purpose. Although the detailed procedural requirements imposed on private foundations by the Code and Regulations do not apply to a public charity, the public charity must be able to demonstrate that is has complied with the requirements of section 501(c)(3). A U.S. public charity cannot make grants to a foreign organization without exercising sufficient supervision and control to demonstrate compliance with section 501(c)(3).

Public charities typically employ written grant agreements to assure that recipient organizations comply with the requirements described above and that grantees use the grant funds for proper purposes. The grantor often establishes an internal procedure that demonstrates the charity's evaluation of the proposed foreign grant and the manner in which it advances the charity's exempt purposes, establishing controls in the grant arrangement to assure proper use of the funds, and creating reporting obligations from the grantee on its use of the funds. A U.S. charity will need to include provisions in the grant agreement that prevent violation of the requirements of section 501(c)(3), such as appropriate restrictions on lobbying and political campaigning activities and that empower the donor to reacquire the funds if used for an improper purpose. Generally, it may be easier to comply with the requirements of section 501(c)(3) if the grant is for a specific project, rather than a general support grant.

CHAPTER 44. Grants by U.S. Private Foundations to Non-U.S. Organizations

a. Special Rules Applicable to Private Foundations

The Code imposes additional rules on private foundations making grants outside the U.S. These rules include the "expenditure responsibility" provisions of section 4945(h) of the Code and the "qualifying distributions" requirements of section 4942(g) of the Code.

(i) Expenditure Responsibility.

A private foundation's grants to another organization will constitute a "taxable expenditure" under section 4945 of the Code unless the recipient is a public charity, an exempt operating foundation, or the foundation exercises "expenditure

responsibility" with respect to such grant. Treas. Reg. section 53.4945-5(a)(1). A foundation is considered to be exercising expenditure responsibility if it:

> ...exerts all reasonable efforts and establishes adequate procedures:
>
> (a) To see that the grant is spent solely for the purpose for which made,
>
> (b) To obtain full and complete reports from the grantee on how the funds are spent, and
>
> (c) To make full and detailed reports with respect to such expenditures to the Commissioner.

Treas. Reg. section 53.4945-5(b)(1).

The granting organization must first perform a pre-grant inquiry into the nature of the grantee, confirming that the grantee will properly use the grant funds. Treas. Reg. section 53.4945-5(b)(2). The grantor and grantee must then enter into a written grant agreement outlining a variety of restrictions on the use of the grant, including a requirement that the grantee submit annual reports to the grantor and a prohibition on use of the grant funds or commercial, political or lobbying activities. Finally, the private foundation itself must satisfy certain recordkeeping requirements with respect to its expenditure responsibility grants and disclose them to the IRS on Form 990-PF. *See* Treas. Reg. section 53.4945-5(d).

(ii) Qualifying Distributions.

A private foundation (other than a private operating foundation) is required to make "qualifying distributions" essentially equal to 5% of its net investment assets. The private foundation will incur an excise tax under section 4942 of the Code, if it fails to make the required distribution.

A qualifying distribution is an amount paid to accomplish one or more of the purposes described in section 170(c)(1) or (c)(2)(B) of the Code, other than a contribution to (1) an organization controlled by the private foundation or a disqualified person with respect to the private foundation; (2) a non-operating private foundation; or (3) an organization described in section 4942(g)(4)(A)(i) or (ii) of the Code, if paid by a private foundation that is not an operating foundation. The term qualifying distribution also includes an amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c) (1) or (2)(B)." *See* Treas. Reg. section 53.4942(a)-3(a)(2).

A U.S. private foundation's grant to a foreign organization will generally only constitute a qualifying distribution if the recipient has received a favorable determination from the IRS as to its public charity or private foundation status, or the grantor makes a good-faith determination that the foreign organization is the equivalent of a public charity or a private operating foundation (as discussed below). Treas. Reg. section 53.4945-5(a)(5).

If the donor private foundation has determined that the foreign recipient is equivalent to a 501(c)(3) organization but cannot determine that it is equivalent to a public charity or private operating foundation, the grant will only constitute a qualifying distribution if it satisfies the "out of corpus" requirements of section 4942(g)(3) of the Code, i.e., the recipient organization must redistribute the grant by the close of the first taxable year after the year of receipt and must provide evidence to the grantor private foundation that a qualifying distribution has been made that is treated under section 4942(h) of the Code as "out of corpus."

(iii) Exceptions.

In certain circumstances an organization will be treated as a public charity for purposes of the expenditure responsibility rules and the qualified distribution rules even though the recipient organization does not possess a determination letter from the IRS finding that it is a public charity. These circumstances are discussed below.

First, a grant to a foreign government or any agency or instrumentality of a foreign government, or an international organization designated as such by Executive Order under 22 U.S.C. section 288 (even if not described in section 501(c)(3) of the Code) that agrees to use the grant exclusively for charitable purposes will constitute a qualifying distribution and will not require expenditure responsibility. *See* Treas. Reg. section 53.4945-5(a)(4)(iii). A college or university that is an agency or instrumentality of a foreign government or of any political subdivision of a foreign government and that agrees to use the grant exclusively for charitable purposes also comes within this exception. *See* Treas. Reg. section 53.4945-5(a)(4)(ii). In these situations, it is important that the contributing private foundation make a determination that the recipient organization is a government agency. Private foundations may want to obtain an opinion of counsel or an affidavit of the grantee to confirm that the recipient is a government agency under local law.

Second, a grant to a foreign organization that does not have a determination letter from the IRS but that is "equivalent" to a U.S. public charity will constitute a qualifying distribution under Code Section 4942 and will not require expenditure

responsibility to avoid the excise tax imposed under Code Section 4945. *See* Treas. Reg. sections 53.4942(a)-3(a)(6), 53.4945-5(a)(5), 53.4945-6(c)(2)(ii); Rev. Proc. 2017-53. To come within this exception, the donor private foundation must make a good faith determination (referred to as an "equivalency determination") that the grantee organization is a qualifying public charity.

The "good faith determination" test is generally satisfied if the determination is based on current written advice from a qualified tax practitioner and the donor organization reasonably relied in good faith on such advice. Treas. Reg. section 53.4945-5(a)(5)(i). The written advice must contain sufficient information for the IRS to determine that the grantee organization would likely qualify as a qualifying public charity. *Id*.

Written advice is "current" if "as of the date of the grant payment, the relevant law on which the advice is based has not changed since the date of the written advice and the factual information on which the advice is based is from the grantee's current or prior taxable year [or annual accounting period]." *Id.* A "qualified tax practitioner" is a lawyer, CPA, or an enrolled agent. *Id.*

Revenue Procedure 2017-53 addresses the factors and procedures for making an equivalency determination and provides guidelines that qualified tax practitioners may use in preparing written advice on which donor foundations may rely.

b. Grantor's Duty to Inquire as to section 501(c)(3) Status of Foreign Organization Lacking Determination Letter

A private foundation that wishes to make a grant to a foreign organization can choose to make an equivalency determination or exercise expenditure responsibility over the foreign grantee. Based on a letter from the IRS to the Council on Foundations dated June 18 2001, it is clear that a private foundation does not need to establish that a foreign charitable organization is equivalent to either a public charity or a private foundation; rather, the foundation may simply treat the foreign organization as a noncharitable entity to which it makes grants for charitable uses and exercise expenditure responsibility with respect to the grant. It must also require the recipient to hold the grant funds in a segregated account dedicated to the exempt purpose of the grant. If the private foundation takes these steps, the grant will constitute a qualifying distribution under section 4942 of the Code and will not be a taxable expenditure under Treasury Regulation section 53.4945-6(c). This approach contrasts with a situation in which the donor private foundation finds that the foreign charitable organization is equivalent to a 501(c)(3) organization but that

it is NOT equivalent to a public charity. Here, the grantor would still have to exercise expenditure responsibility and the grant would avoid taxable expenditure status under Code section 4945. However, the grant will not constitute a qualifying distribution under Code section 4942 unless the recipient satisfied the "out of corpus" rules discussed above.

CHAPTER 45. Special Treatment Accorded Canadian and Mexican Organizations

There may be exceptions to the general rules regarding recognition of exemption of foreign charities if an income tax treaty exists between the United States and another country, as set forth below.

a. Canada

The 1980 United States-Canada Income Tax Convention (the "Convention") provides for reciprocal recognition of exemption for religious, scientific, literary, educational or charitable organizations under certain circumstances. Article XXI of the Convention governs inter alia, exemption of a Canadian or U.S. charity from income tax in the other country and it allows a limited charitable contribution deduction for gifts by U.S. citizens or residents to Canadian charities and by Canadian residents to U.S. charities.

Notice 99-47, dated September 7, 1999, states that recognized religious, scientific, literary, educational or charitable entities that are organized under the laws of either the United States or Canada will automatically receive recognition of exemption without application in the other country. Thus, U.S. organizations must be recognized as exempt under section 501(c)(3) to come within the requirements of the treaty, and Revenue Canada must recognize Canadian organizations as Canadian registered charities in order to come within the requirements of the treaty. Every Canadian registered charity is automatically treated as a 501(c)(3) organization, regardless of whether the entity has filed a Form 1023 with the IRS. The Canadian entity's 501(c)(3) status will continue until Canada withdraws its registration or the IRS determines that the organization fails to satisfy the requirements for exempt status.

It is important to note that under the Convention there is a presumption that all registered Canadian charities are private foundations for U.S. tax purposes unless they demonstrate otherwise. This presumption can create qualifying distribution issues for U.S. private foundations that make grants to Canadian registered charities

if the private foundation cannot determine that the recipient is equivalent to a public charity.

b. Mexico

The 1992 United States-Mexico Income Tax Treaty (the "Treaty") also provides for reciprocal recognition of exemption and reciprocal deduction of charitable contributions, subject to limitations to the income arising in the other country. Article 22(1) of the Treaty provides that if an organization is tax-exempt in one country and the income received by such organization would be exempt in the other country if the organization were organized under the laws of the latter country, then the organization shall be exempt from tax in both countries.

A U.S. or Mexican contributor making a cross-border contribution to a charity in the other country may deduct the contribution in the state of residence because in Article 17(b) of the 1992 protocol, the two countries agreed that Article 70-B of the Mexican Income Tax Law and sections 509(a)(1) and 509(a)(2) of the Code (other than churches or a convention or association of churches as described in section 170(b)(1)(A)(i) of the Code) provide essentially equivalent standards as contemplated by Articles 22(2) and 22(3) of the Treaty. Entities qualifying under Mexican law will be treated as public charities for U.S. purposes, and unlike the U.S.-Canada treaty, there is no need for an entity-by-entity determination of public charity status for U.S. purposes.

In Information Letter 2003-0158, the IRS concluded "[i]f the Mexican authorities have granted special authorization to a Mexican charity as an organization described in Article 70–B, a U.S. private foundation or other grant-maker may treat the Mexican charity as equivalent to a section 501(c)(3) organization classified as a public charity described in section 509(a)(1) or (2)." *Id*.

CHAPTER 46. Consequences to Foreign Recipients of Grants (Withholding Issues for Grantor)

The Code imposes federal income tax on certain U.S. sources of income. Sections 871(a)(1) and 881(a) of the Code impose a 30% tax on several types of U.S.-source nonbusiness income of nonresident aliens and foreign corporations. Section 1441(a) of the Code generally provides that the person making a payment that constitutes gross income from sources within the United States to a nonresident alien must withhold tax at a rate of 30% at the time the payment is made. However, in the case of scholarship or fellowship payments made to individuals in the United States on an F, J, M or Q immigration status, the withholding rate may be reduced

to 14%. Code section 1441(b); Rev. Proc. 88-24, 1988-1 CB 800. In addition, the withholding rate may be reduced or eliminated by treaty.

Under the withholding rules discussed above, U.S. grantors are generally required to withhold U.S. tax on the nonexempt portion of scholarship and fellowship grants to foreign students for study in the United States. Code section 117 excludes from the recipient's income scholarships or fellowship grants used for "qualified tuition and related expenses (i.e., tuition, fees, books, etc.). However, grants used for other purposes, such as room and board, are not excluded from income. Likewise, amounts received for services performed for the grantee (teaching or research activities) are taxable, even though these services may be required to obtain a degree or the scholarship.

In general, scholarships and fellowship grants (as defined in Code section 117), grants (as defined in Code section 4945(g)), and prizes and awards (as defined in Code section 74) made by a U.S. citizen or resident or private or governmental entity for study in the United States are treated as income from sources within the United States. Treas. Reg. section 1.863-1(d)(2)(i). Conversely, scholarships, fellowship grants, targeted grants and achievement awards made by a foreign government, international organization, or person other than a U.S. citizen is treated as sourced outside the United States and is not subject to U.S. tax. Treas. Reg. section 1.863-1(d)(2)(ii). And scholarships, fellowship grants, targeted grants, and achievement awards received by a person other than a U.S. person from activities conducted outside the U.S. are treated as U.S. sourced income. Treas. Reg. section 1.863-1(d)(2)(iii). Amounts paid as salaries or compensation are governed by the sourcing rules applicable to personal services under Treasury Regulation section 1.861-4.

In January 2001, the IRS issued Treasury Regulations under section 1441 of the Code that broadly defined the type of income subject to 30% withholding. The IRS has indicated that reimbursement for travel and living expenses of independent contractors is included in the type of gross income (as emoluments or remunerations) subject to withholding under Code section 1441(a). These facts have created uncertainty with respect to withholding by U.S. charities on grants solely for travel expenses of a grantee doing research, attending conferences or otherwise performing activities in the United States. The Council on Foundations has requested that the IRS provide guidance on the final regulations under section 1441 with respect to grants solely for travel expenses of a grantee who is doing research, attending conferences, or otherwise performing activities in the United States. The June 14, 2002 letter to the IRS requesting this guidance, and a supporting detailed

memorandum are published in 37 Exempt Org. Tax Rev. 370 (2002). As of the present time, the IRS has not provided guidance on this point.

CHAPTER 47. Compliance With Antiterrorist Provisions

a. Executive Order 13224

In response to the terrorist attacks on the United States of September 11, 2001, President Bush signed Executive Order 13224 (the "Order"), aimed at cutting off resources to terrorists and terrorist organizations. The Order prohibits transactions with individuals and organizations deemed to be associated with terrorism and blocks any assets controlled by or in the possession of such entities and those supporting them. While the Executive Order is not a law, it has the force of law.

The Order prohibits donations or contributions to certain persons and organizations ("Listed Persons"). Listed Persons include individuals and organizations identified by the Executive Order, the Secretary of State, and by the Secretary of the Treasury to have committed, or to pose a significant risk of committing, acts of terrorism. Exec. Order No. 13,224 section 1(a); (b); (c). Listed Persons can also include other parties who assist, sponsor or support acts of terrorism by Listed Persons or are otherwise associated with Listed Persons. Exec. Order No. 13,224 section 1(d).

Several U.S. government agencies, the United Nations, and the European Union, have created lists of known or suspected terrorists. The Treasury Department's Office of Foreign Assets Control ("OFAC") maintains the most comprehensive U.S. list. OFAC operates a listserv that provides an electronic notice whenever the list is altered. Links to the list and listserv and other information can be found here: https://home.treasury.gov/policy-issues/office-of-foreign-assets-control-sanctions-programs-and-information.

Other lists include the U.S. Government's Terrorist Exclusion List maintained by the Department of Justice and the European Union's Terrorist List **Error! Hyperlink reference not valid.**. Note that the Order can extend to persons that are not actually included in the published lists due to a person's relationship with one who is on a published list.

The Order has neither a knowledge nor an intent requirement, and thus an organization can violate the Order (and have its assets frozen) even if it does not know that it is supporting a Listed Person and does not intend to support a Listed

Person. In contrast, the USA Patriot Act (discussed below) does have a knowledge and intent requirement.

The reach of persons, entities and property subject to the Order is quite broad. It applies to all U.S. persons and entities, regardless of their location, and foreign organizations with a presence in the United States. Exec. Order No. 13,224 section 3(d). It also applies to property located within the United States or that subsequently comes within the United States, or property in the possession of a United States-based person or entity. Exec. Order No. 13,224 section 1. The Order also prohibits a variety of transactions, including financial, in-kind, material, and technical assistance, as well as humanitarian donations. Exec. Order No. 13,224 section 1(d); section 4.

b. USA Patriot Act

The USA Patriot Act of 2001 (the "USA Patriot Act") includes a variety of anti-terrorism provisions, including expanded penalties for providing material or financial support for terrorism. The USA Patriot Act imposes civil and criminal penalties on individuals or organizations that provide "material support" or resources with the intent or knowledge that such resources be used to fund terrorist acts or by terrorist organizations. It is clear that the potential penalties under the USA Patriot Act apply to nonprofits, and commentators anticipate that investigation and enforcement activities may focus on exempt organizations involved in international grantmaking or that directly carry out international programs.

(i) Material Support for Terrorism.

"Material support" means any property or service, including "currency or monetary instruments or financial securities, financial services, lodging, training, expert advice or assistance, safe houses, false documentation or identification, communications, equipment, facilities, weapons, lethal substances, explosives, personnel transportation, and other physical assets, except medicine or religious materials." 18 U.S.C. section 2339A(b). Penalties for providing material support for terrorism include imprisonment for up to fifteen years or imprisonment for support of terrorism that results in death. 18 U.S.C. section 2339A(a); section 2339B(a)(1).

(ii) Financing Terrorism.

As of June 2002, financing terrorism is a federal crime. Terrorist Bombings Convention Implementation Act of 2002 section 202(a); 18 U.S.C. section 2339C. An individual or organization that directly or indirectly "willfully provides or collects

funds with the intention that such funds be used, or with the knowledge that such funds are to be used" to carry out terrorist activities or "any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing any act," is subject to imprisonment of up to twenty years 18 U.S.C. section 2339C(a)(1); (d)(1).

(iii) Potential Civil Penalties.

The USA Patriot Act also provides for civil penalties against those who materially support terrorism. 18 U.S.C. 2333. Plaintiffs in a civil action may be entitled to damages, court costs and attorneys' fees. 18 U.S.C. section 2333(a). A criminal indictment or conviction is not a prerequisite to commencing a civil action. 18 U.S.C. section 2333(b); (c).

c. Voluntary Treasury Guidelines

On September 29, 2006, the Treasury Department issued an updated version of the U.S. Department of the Treasury Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities (the "Voluntary Treasury Guidelines"). The Voluntary Treasury Guidelines do not have the force of law, and an exempt organization is not obligated to comply with these guidelines. Furthermore, the Voluntary Treasury Guidelines do not create a "safe harbor." The Treasury Department suggests that an exempt organization following these guidelines will reduce the chance that it will unwittingly make problematic expenditures or that it will be found liable if it does make problematic expenditures.

The Voluntary Treasury Guidelines address five topics. The first four address (1) fundamental principles of good charitable practice, (2) governance accountability and transparency, (3) financial accountability and transparency, and (4) programmatic verification. The suggestions in these first four topics are typically practiced by most well-run nonprofits.

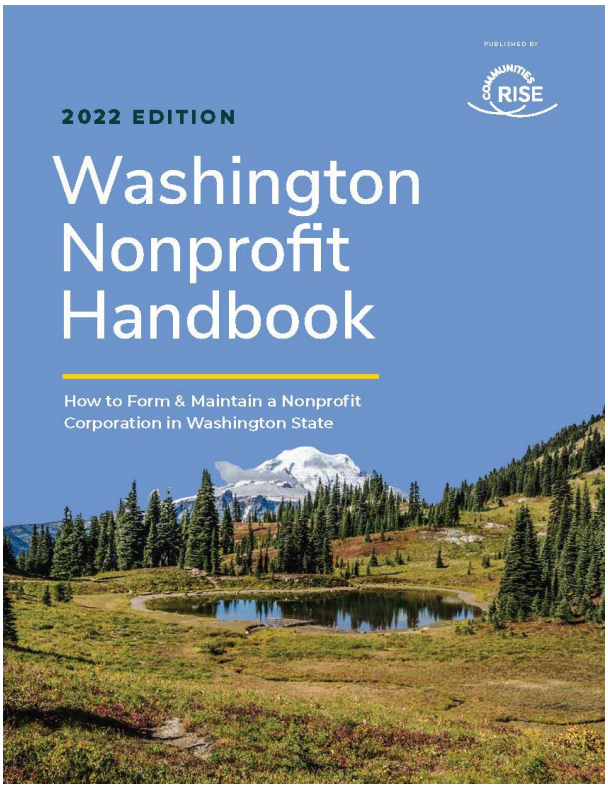
The fifth topic of the revised Voluntary Treasury Guidelines speaks to anti-terrorist financing best practices and has generated more controversy. In drafting the revised guidelines, the Treasury Department responded to various criticisms received regarding the initial draft of the Voluntary Treasury Guidelines. For example, the Council on Foundations stated that the initial version of the Voluntary Treasury Guidelines (1) were not tailored to the reality of international grantmaking by U.S. charitable organizations, (2) did not take into account either the legal

requirements governing international grants or the extensive experience of U.S. grant-makers in administering foreign grant funds, and (3) included provisions that were unworkable in many respects, were wholly unrelated to achieving the intended objectives, and had a compliance cost so high as to deter many charitable organizations from making international grants. However, the Treasury Department rejected many of the suggestions included in the comments.

The suggested anti-terrorist procedures require collecting extensive information about the potential recipient, and demonstrating that the grantor has (1) collected certain basic information about a grantee; (2) conducted basic vetting of grantees, including a reasonable search of publicly available information to determine whether the foreign recipient organization is or has been suspected of activity relating to terrorism, including terrorist financing or other support, and to determine that the grantee and its key staff are not on the OFAC list or subject to OFAC sanctions, and (3) conducted basic vetting of its own key employees, including a reasonable search of publicly available sources to determine whether they are suspected of activities relating to terrorism or are subject to OFAC sanctions. Furthermore, if a charity's vetting practice leads to a finding that any of its own key employees, any of its grantees, or any of the key employees of grantees is suspected of terrorism activities, the Voluntary Treasury Guidelines direct the charity to take certain actions.

CHAPTER 48. Best Practices

At the present time, grant-makers do not possess any "official" guidance from the Treasury Department to aid in developing compliance plans and procedures that will satisfy the requirements of Executive Order 13224, the USA Patriot Act, and other laws. As discussed above, the Voluntary Treasury Guidelines are simply that: voluntary. Moreover, these guidelines can generate significant burdens on grant-makers, especially smaller organizations, and are expensive to carry out. Finally, there is no assurance that a grant-maker complying with the Voluntary Treasury Guidelines will avoid violating the law.



PART 7 FUNDRAISING: THE OBVIOUS AND NOT-SO-OBVIOUS PITFALLS

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PART 7. FUNDRAISING: THE OBVIOUS AND NOT-SO-OBVIOUS PITFALLS

CHAPTER 49. Charitable Solicitation in Washington

a. Overview

Washington, like other states, regulates persons and entities requesting contributions to support a charitable purpose. Charitable solicitation in Washington is governed by the Charitable Solicitations Act ("CSA"), RCW 19.09, and the Consumer Protection Act ("CPA"), RCW 19.86. The CSA regulates the activities of persons and entities that make almost any type of charitable appeal to the public. This includes persons and entities requesting or collecting funds for a charitable organization or purpose, or who say they do this, and businesses that say they are contributing to a charitable organization based on purchases of goods or services. The CPA is a statute that protects consumers from unfair or deceptive acts or practices in trade or commerce, which includes unfair or deceptive acts or practices in the context of charitable solicitations. Violations of the CSA are *per se* (intrinsically) violations of the CPA. A person or entity that violates the CSA may face a civil action alleging violations of both statutes.

b. Regulation of Charitable Organizations Under the CSA

The CSA regulates charitable organizations, providing the public with information about charitable organizations that engage in fundraising in order to prevent deceptive and dishonest practices and the improper use of contributions that are intended for charitable purposes. The CSA requires charitable organizations to (1) register and file annual reports with the Charities Program of the Secretary of State, and (2) make certain disclosures when soliciting for charitable contributions.

(i) Definition of "Charitable Organization"

A "charitable organization" under the CSA is an entity that solicits or collects contributions from the general public, where the contribution is, or is purported to be, used to support a "charitable purpose". A charitable organization does not include commercial fundraisers, commercial co-venturers, or fundraising counsel. RCW 19.09.020(2). Churches, their integrated auxiliaries, and political organizations are not charitable organizations, but they must comply with RCW 19.09.100(15) through (18). *See* RCW 19.09.020(2). These statutory provisions bar deceptive solicitations, govern how and when solicitations and collections occur, and forbid any form of harassment of donors and potential donors. Religious organizations that are not churches or their integrated auxiliaries are charitable organizations.

RCW 19.09.020(16). The CSA's definition of "charitable purpose" includes, but is not limited to, the generally accepted meaning of assisting the poor, distressed, or underprivileged; erecting or maintaining public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency. It also includes religious, scientific, literary, educational, environmental, humanitarian, patriotic, and civic purposes. *See* RCW 19.09.020(3).

Here are examples of what constitutes a charitable organization and what does not, according to the CSA:

- Any person or entity that solicits charitable contributions from the public is a charitable organization. This includes an individual, organization, group, association (including a loose association of people), partnership, corporation, agency or unit of state government, or any combination thereof. For example, firefighters' unions that ask members of the public to purchase tickets to an event to benefit their members are charitable organizations.

- Entities with a physical presence inside or outside Washington that maintain websites or send email messages that solicit or accept charitable contributions from Washington residents are charitable organizations.

- Entities that raise money for charitable causes and donate all of the money to those causes are not charitable organizations if they do not solicit or collect charitable contributions from the public.

- An entity that solicits contributions only from its members is not a charitable organization if membership in the entity is determined by the payment of dues, fees, or other assessments that confer bona fide rights, privileges, professional standing, or other direct benefits, in addition to the right to vote, hold office, or elect officers. "Membership" does not include those who become members of the entity upon making a contribution because of a solicitation.

(ii) Definition of "Solicitation"

The CSA defines "solicitation" as any written or oral request for a contribution in which (1) any appeal is made for a charitable purpose, (2) the name of any charitable organization is used as an inducement for making a sale; or (3) any

statement is made that implies that all or part of sales proceeds will benefit a charitable purpose or be donated to any charitable organization. *See* RCW 19.09.020(19).

Here are examples of what constitutes a charitable solicitation and what does not:

- A telephone call in which the caller asks the recipient to buy a ticket to a concert to benefit disadvantaged youths is a charitable solicitation.
- A letter that asks for a contribution to a named charity is a charitable solicitation.
- A website that describes a program to help people experiencing houselessness find work and explains how to make a donation is a charitable solicitation.
- A postcard asking for donations of used clothing and household items to benefit disabled people is a charitable solicitation.
- Grant applications or requests submitted to any foundation, corporation, governmental agency, or similar entity that has an established process for reviewing such requests are not charitable solicitations. *See* WAC 434-120-025(9)(c)(i).
- Bingo, raffles, and amusement games regulated by the Gambling Commission are not charitable solicitations. *See* RCW 19.09.020(19)(c).
- Attempts to sell goods or services that constitute the basis for the charitable organization's activities for which federal tax exemption status was granted are not charitable solicitations. *See* WAC 434-120-025(9)(c)(ii).

(iii) Registration and Reporting Requirements

All charitable organizations must register with the Secretary of State unless they are exempt from the CSA. *See* RCW 19.09.065; WAC 434-120-105. Exempt charitable organizations include (1) charitable organizations that raise less than $50,000 in any accounting year if the organization's activities (including all fundraising activities) are conducted exclusively by volunteers and none of the organization's officers, directors, members, or trustees receive compensation or assets from the organization; and (2) persons or entities that appeal for funds on behalf of specific individuals named in the solicitation, if all of the proceeds of the

solicitation are given to or expended for the direct benefit of the named individual. *See* RCW 19.09.081; WAC 434-120-100(2). To further evaluate whether or not a charitable organization is exempt from registering with the Charities Program of the Secretary of State, and other information on charity registration, Secretary of State Charity Forms website https://www.sos.wa.gov/charities/allforms.aspx#charity.

Marijuana and donations: It is important to remember that although use and sale of recreational marijuana is legal under Washington State law, it is illegal under federal law. Nonprofits with 501(c)(3) tax-exemption should be careful not to be in violation of any federal laws, this includes being a part of any marijuana transactions including, but not limited to, marijuana donations or receiving money from a marijuana business, recognizing that certain donations or money received from hemp transactions and businesses may be legal under federal law pursuant to the 2018 Farm Bill. Nonprofit organizations may receive financial donations from a retailer or producer (grower) of marijuana if there is no advertisement associated with the donation. Because marijuana is illegal at the federal level, proceed with caution if the donation is significant enough to be claimed on your organization's IRS Form 990.

Charitable organizations must provide the information requested by the Secretary of State on an annual basis, through an annual filing with the Charities Program of the Secretary of State.

TIP:
Make sure you allow adequate time for your charitable solicitations registration to arrive by the due date. Charitable Solicitations registration filings are done by post mail and must be received by the annual due date. There is a late fee for registrations that are received late. There are no exceptions.

Among other things, nonprofits must provide the contact information for officers accepting responsibility for the charitable organization, and the names of the three highest compensated officers or employees. Additionally, nonprofits must provide financial information, including revenue and the total amount applied to charitable purposes, expenses, and solicitation information. *See* RCW 19.09.075; WAC 434-120-105. In addition to the standard financial reporting required pursuant to RCW 19.09.075, the following requirements apply to charitable organizations with more than one million dollars in annual gross revenue averaged over the three previously completed accounting years:

- If annual gross revenue is one million dollars to three million dollars averaged over the three previously completed accounting years, the

organization must make available to the public upon request (or make it accessible to the public on the internet) the organization's federal financial reporting form (e.g., IRS Form 990, 990PF, 990T) prepared by a professional in the business of preparing such forms or an audited financial statement prepared by an independent certified public accounting for the preceding accounting year.

- If annual gross revenue is more than three million dollars averaged over the three previously completed accounting years, the organization must make available in paper form to the public upon request (or make it accessible to the public on the internet) the organization's independent, third-party audit of its financial records for the preceding accounting year. *See* RCW 19.09.541.

If a charitable organization has existed for less than three years, the calculation of gross revenue is based on the number of years of existence. *See* WAC 434-120-107(1). The requirement to obtain an audited financial statement prepared by an independent certified public accountant may be waived by the Charities Program of the Secretary of State if the organization receives $500,000 or less in cash averaged over the prior three accounting years and complies with the reporting requirements for organizations with less annual gross revenue, or if the organization can demonstrate that it reached the three-year average of more than three million dollars in gross revenue because of unusual or nonrecurring revenue received in a single year. *See* WAC 434-120-107(2).

All charitable organizations must register before conducting solicitations. Charitable organizations must renew their registrations and file reports annually. Conducting solicitations without current registration is a violation of the CSA and may result in legal action. *See* RCW 19.09.065.

c. Regulation of Commercial Fundraisers Under the CSA

A "commercial fundraiser" under the CSA is a person or entity that (1) solicits or receives contributions for or on behalf of any charitable organization or charitable purpose in exchange for compensation or other consideration; or (2) is in the business of conducting charitable solicitations or receiving contributions on behalf of others (or who say they do this) in exchange for compensation or other consideration. *See* RCW 19.09.020(5).

"Fundraising counsel," "consultants," and "commercial co-venturers" are not commercial fundraisers. "Fundraising counsel" and "consultants" are retained by

charitable organizations under written agreement to provide services such as advice and counseling regarding charitable solicitation activities, and do not engage in any fundraising activities on behalf of others. *See* RCW 19.09.020(10). "Commercial co-venturers" are persons or entities in the business of selling goods or services to the public for profit, and they make representations to potential buyers that the purchase of their goods or services will benefit a charitable organization. *See* RCW 19.09.020(4). Commercial co-venturers are not in the business of making solicitations or otherwise raising funds for charitable organizations and they do not ask purchasers to make checks (or other forms of payment) payable directly to a charitable organization or other third party. *See* RCW 19.09.020(4).

Commercial fundraisers must register and file reports annually with the Secretary of State using the required forms prior to conducting any charitable solicitations. *See* RCW 19.09.065; WAC 434-120-200. Commercial fundraisers must file information pertaining to the charitable organizations with which they contract, financial information regarding the total value of the contributions received and disbursed, and solicitation information. *See* RCW 19.09.079; WAC 434-120-215.

If the commercial fundraiser meets one of the four following criteria, it must post a surety bond of at least $25,000 and file a copy of the bond with the Secretary of State: (1) the commercial fundraiser directly or indirectly receives contributions from the public on behalf of a charitable organization; (2) the commercial fundraiser is compensated based on the amount of funds raised or the amount to be raised, on the number of solicitations made or to be made, or on a similar method; (3) the commercial fundraiser incurs, or is authorized to incur, expenses on behalf of a charitable organization; or (4) the commercial fundraiser had not been registered with the Secretary of State in the last accounting year. *See* RCW /819.09.191; WAC 434-120-260.

d. Contracts Between Charitable Organizations and Commercial Fundraisers

The CSA requires written contracts between charitable organizations and commercial fundraisers. *See* RCW 19.09.097. The contract must be filed with the Secretary of State before the commercial fundraiser commences solicitation activities on behalf of the charitable organization. The contract must contain the following provisions:

- A requirement that both parties must comply with the law

- A provision that allows the officers of the charitable organization reasonable access to the commercial fundraiser's (1) financial records pertaining to the charitable organization, (2) operations, including the ability to be present during telephone solicitations, and (3) the names of all of the commercial fundraiser's employees or staff who are conducting the solicitations

- A statement of the amount of funds that the charitable organization will receive or the method of computing the amount, the commercial fundraiser's compensation or the method of computing that amount, and whether the compensation is fixed or contingent

e. Solicitation Requirements

The CSA applies broadly to appeals for support of charitable organizations or charitable purposes; there are a few specific exceptions, discussed below. "Solicitation" in this context refers to any form of request for a contribution or donation, including most invitations to become a "member" or "supporter" of an organization or cause. Therefore, anyone making a solicitation (including formally organized groups and ad hoc efforts) must comply with the solicitations rules regardless of whether they must register with the Secretary of State. There are several provisions of the CSA that do not apply to churches and their affiliate auxiliaries; however, they must comply with RCW 19.09.100(15) through (18) (see below).

When making a solicitation, the solicitor must disclose the following:

- The name of the individual who is making the solicitation;

- The name of the charitable organization and the city of its principal place of business; and

- If requested by the solicited person, the Secretary of State's published telephone number (1-800-332-4483). If the solicitation takes place by telephone, the disclosures must be made during the solicitation but before asking for a commitment of a contribution, and also in writing to any solicited person that makes a pledge, within five business days of the pledge. *See* RCW 19.09.100(3).

Commercial fund-raisers making a solicitation must disclose the following:

- The name of the individual making the solicitation

- The full name of the commercial fund-raiser;
- The name of the charitable organization and the city of its principal place of business; and
- If requested by the solicited person, the Secretary of State's published telephone number (1-800-332-4483) and website (https://www.sos.wa.gov/charities/), if requested by the solicited person.

Solicitations by advertisement or mass distribution (e.g., posters, brochures, publications, audio or visual broadcasts, automatic dialing devices) are required to disclose if:

- The solicitation is conducted by a named commercial fundraiser;
- The required CSA registration is on file with the Secretary of State (if the person or entity is required to file under the CSA); and
- Additional financial and other information can be obtained by calling the Secretary of State's published telephone number (1-800-332-4483) or visiting the Secretary of State online (https://www.sos.wa.gov/charities/). RCW 19.09.100(4).

Anyone using a vending machine or container to solicit must make these disclosures:

- The name of the charitable organization for which the funds are solicited;
- The name, business address, and telephone number of the individual and commercial fund-raiser responsible for collecting the funds in the containers or vending machines; and
- This statement: "This organization is currently registered with the secretary's office under the charitable solicitations act — call 1-800-332-4483" with the registration number (if the person or entity is required to file under the CSA). *See* RCW 19.09.100(5).

Persons or entities soliciting for charitable organizations whose names are similar to government entities are required to make these additional disclosures:

- Whether the charitable organization is or is not part of any government unit; and

- The true nature of its relationship with that government unit. *See* RCW 19.09.100(8).

Persons or entities soliciting contributions may not, and may not attempt to, collect contributions in person or by courier unless:

- Contributions are noncash items such as clothing or other tangible personal property; or

- Solicitations are made in person and the collections, or attempts to collect, are made at the time of the solicitations; or

- The contributor has agreed to purchase items in connection with the solicitation and the collection or attempt to collect is made at the time of delivery of the items. *See* RCW 19.09.100(18).

f. Prohibited Representations

The CSA prohibits the following representations:

- That a solicited contribution is tax deductible, unless the charitable organization has received-tax exempt status from the IRS. *See* RCW 19.09.100(7).

- That the person conducting the solicitation is a volunteer or words of similar meaning or effect that create the impression that the person soliciting is not a paid solicitor, unless that person is not paid for their services. *See* RCW 19.09.100(7).

- That the person conducting the solicitation is a member, staff member, helper, or employee of the charitable organization or words of similar effect that create the impression that the person is not a paid solicitor, if the person is employed, connected, or paid by a commercial fundraiser. *See* RCW 19.09.100(7).

- Any statement that is false, misleading, or deceptive. All solicitations, advertising material, and promotional plans must fully and fairly disclose the identity of the entity on whose behalf the solicitation is made. *See* RCW 19.09.100(15).

- That tickets to any fundraising event will be donated for use by another person unless all of the following requirements are met:

- The person or entity conducting the solicitation has a written commitment from people stating that they will accept the donated tickets and the number of tickets they will accept;

- The written commitments are kept on file by the person or entity for three years and makes them available to the Secretary of State, Attorney General, or county prosecutor on demand;

- The contributions solicited for donated tickets do not exceed the amount representing the number of ticket commitments on file; and

- The commercial fundraiser gives all of the tickets to the people who made the written commitments to receive them no later than seven calendar days prior to the ticketed event. *See* RCW 19.09.100(6).

g. Prohibited Conduct

The CSA also prohibits the following conduct as part of charitable solicitation:

- Using the words "police," "sheriff," "firefighters," or similar words in a solicitation unless properly authorized by the police, sheriff, or firefighter department, or unless an organization has authorized that use in a writing signed by two authorized officials of the department or organization. *See* RCW 19.09.100(9).

- Using the name of a nationally known or federally chartered military veterans' service organization in a solicitation unless the highest ranking official of that organization in Washington State has authorized that use in writing. *See* RCW 19.09.100(10).

- Leading the public to believe that registration with the Secretary of State constitutes state endorsement or approval of the charitable organization or the solicitation activities. *See* RCW 19.09.100(14).

- Harassing, intimidating, or tormenting conduct during a telephone solicitation. *See* RCW 19.09.100(17).

- Making a telephone solicitation before 8:00 a.m. or after 9:00 p.m. Pacific time. *See* RCW 19.09.100(16).

- Failing to comply with RCW 19.09 or local regulations regarding charitable solicitation. *See* RCW 19.09.100(11)-(12).

- Solicitations by a charitable organization or commercial fundraiser that has been, or whose officers, directors, or principals have been, convicted of a crime involving charitable solicitations in the United States or any other country within the past ten years, or has been subject to a permanent injunction, administrative order, or judgment pursuant to RCW 19.86.080 or RCW 19.86.090 involving a violation of RCW 19.86.020 within the past ten years. *See* RCW 19.09.100(13).

h. Record Keeping

The CSA requires that all charitable organizations and commercial fundraisers maintain accurate and current books and records at their business location. Books and records must include, at a minimum, documentation supporting the information contained in solicitation reports and authorizations required under the CSA. *See* RCW 19.09.200(1). The records must be readily available and retained for three years after the period for which they relate expires. Contracts between charitable organizations and commercial fundraisers must be maintained for three years after the period to which they relate expires. *See* RCW 19.09.200(2).

Charitable organizations, or commercial fundraisers who solicit on their behalf, must keep records of the following contributors for three years following the contributions:

- Each contributing entity that collects individual contributions from an employee, member group, or business, and turns them over to a charitable organization as a single sum.

- Each corporation that contributed.

- Each individual who contributed more than $25. *See* WAC 434-120-135.

All records, contracts, and contributor lists must be made available to the Attorney General or the county prosecutor upon demand.

Commercial fundraisers must submit financial statements to the Secretary of State, Attorney General, or county prosecutor upon demand. The statements shall include, without limitation:

- The gross amount of the contributions pledged and the gross amount collected.

- The amount retained and the amount given or to be given to charitable organizations and the details of distribution.
- The aggregate amount paid and to be paid for solicitation expenses.
- The amounts paid and to be paid to charitable organizations.
- Copies of annual or periodic reports. *See* WAC 434-120-255.

i. The Consumer Protection Act

CPA prohibits unfair and deceptive acts and practices. *See* RCW 19.86.020. The CPA applies to fundraising activity if the activity is in trade or commerce, regardless of whether the activity is covered by the CSA. Violations of the CSA are per se violations of the CPA. *See* RCW 19.09.340.

Under the CPA, the Attorney General may bring an action to enjoin unfair or deceptive acts or practices, including acts prohibited by the CSA. The court may award civil penalties of up to $7,500 per violation. *See* RCW 19.86.140. An enhanced penalty of $5,000 shall apply for unlawful acts or practices that target or impact specific individuals or communities based on demographic characteristics including, but not limited to, age, race, national origin, citizenship or immigration status, sex, sexual orientation, presence of any sensory, mental, or physical disability, religion, veteran status, or status as a member of the armed forces, as that term is defined in 10 U.S.C. Sec. 101. *See* RCW 19.86.140. The court may award attorneys' fees to the prevailing party. *See* RCW 19.86.080. A private litigant may also bring an action under the CPA to enjoin unfair or deceptive acts or practices and, in addition, the court may award treble damages. The court may award attorneys' fees to the prevailing party. *See* RCW 19.86.090.

CHAPTER 50. Charitable Solicitations in Other States

Most states require nonprofits which are asking for donations in their state to register under the charitable solicitations law of that state. The rules of each state are different. If a nonprofit organization is soliciting the public in a state outside of Washington, the nonprofit should check the rules for the states in which they are asking for donations. Soliciting contributions in a state will trigger the state's charitable solicitation laws and require registration unless a specific exemption applies. The solicitation may be through mail, email, internet, in-person, at fundraisers, or through other fundraising methods.

As discussed in the previous chapter, Washington has a Charitable Solicitations Act, RCW 19.09, that requires registration for nonprofits which solicit contributions in Washington State. The Charitable Solicitations Act also has exemptions to those requirements for different types and sizes of nonprofit organizations. Please *see* CHAPTER 45 for more information about Washington State rules.

Most other states have similar charitable solicitation rules to Washington, including registration requirements and exemptions (exceptions) to those requirements. *See* the IRS website (https://www.irs.gov/charities-non-profits/state-links) for links to other state requirements. State agencies may take action against persons or entities that fail to properly register or otherwise comply with solicitation requirements.

Nonprofits that solicit for donations nationally will likely have to register in every state. There are service providers that offer state registration services.

If a nonprofit has not solicited in another state, but receives a donation from an individual in that state, industry standards do not require registration in that state, under the "Charleston Principles" outlined below.

If the nonprofit engages in fundraising that could be construed as soliciting nationwide, via the internet or otherwise, it is a safe option for a charity to decide to register nationwide. There is no single portal for registering in every state, although one is being considered by the National Association of State Charity Officials (https://www.nasconet.org/) and there are services that can assist with registrations.

It is important to note that registration may bring to light other compliance obligations. For example, a registration may require a person or entity to pay annual filing fees, submit copies of fundraising contracts or summary of the terms of contracts, provide audited financial statements, make certain solicitation disclosures, qualify to do business, obtain a registered agent, or otherwise comply with the state's solicitation laws. In particular, many states have regulations that affect solicitation conduct, such as limits on the time of day when individuals may be approached with a request for a contribution. The person or entity who will benefit from any contribution is generally considered responsible for ensuring compliance with such rules, whether or not it conducts other charitable activities in the state. Even if a person or entity is not required to register with a state, states retain the right to enforce their consumer protection and charitable solicitation laws against deceptive

charitable solicitations such as fraud or misuse of charitable contributions to the extent that there is an impact to persons or entities in their state.

a. Internet Solicitations

Internet solicitations are trickier. There is limited regulatory guidance with respect to charitable solicitation compliance if a person or entity is soliciting in a state solely through the internet. In an attempt to provide clarity, the National Association of State Charity Officials published internet registration guidelines known as the "Charleston Principles" which outline when registration in a foreign state is required:

- If the person or entity solicits through the internet and specifically targets (e.g., email, telephone, or direct mail) persons or entities physically located in the state;

- If the person or entity solicits through the internet and receives contributions on a repeated and ongoing basis (the number of contributions may vary, but some states would say that 25 or more contributions per year is considered repeated and ongoing) from persons or entities physically located in the foreign state; or

- If the person or entity solicits through the internet and receives substantial contributions (this amount may vary, but some states would say $25,000 or 1% of total contributions per year in the aggregate constitutes substantial contributions) from persons or entities physically located in the state.

However, many states advise that a person or entity soliciting contributions on the internet proactively register and comply with every state's charitable solicitations laws, particularly if the solicitations are broadcast widely and are likely to receive responses in many states.

Registering nationwide is not required so long as the following elements are met:

- The only connection with the state is a small number of donations;

- There is no plan to actively target residents of that state, and

- The person's or entity's role is passive (e.g., there is simply a "donate here" button with no further outreach to encourage residents in that state to donate).

If the organization merely has a "donate here" button on its website, its work is solely in Washington and only solicits donations in Washington, it is commonly accepted that the organization does not have to register in states outside of Washington.

CHAPTER 51. Nonprofit Bulk Mailing Permits

Many nonprofit organizations qualify for discounted rates when sending U.S. Postal Service marketing mail (also known as "bulk mail"). To qualify for special nonprofit rates, the organization must complete PS Form 3624, Application to Mail at Nonprofit USPS Marketing Mail Prices and wait for the Post Office to approve its request.

The cost of mailing at nonprofit marketing rates is lower than ordinary first-class mail but determining the actual rate depends on many factors including the size and weight of the mail, how it is addressed and sorted, and whether automated processing is possible. A rate chart is available online and should be consulted before mailing.

Also, under United States Postal Service rules, not only must the organization qualify to use these preferential rates but it must also maintain its eligibility by making at least one qualifying mailing during a two-year period.

a. How to Apply for Nonprofit Rates

As mentioned above, the first step is to fill out Postal Service Form 3624, which is available online. Once authorization is granted, arrangements will need to be made to pay the postage for mailings. There are several options: special stamps, postage metering, or use of a PostalOne account from which the Postal Service will deduct the postage charges for each mailing as it occurs.

Many organizations may be recognized as tax-exempt by the IRS under section 501(c)(3), but such recognition is not, in and of itself, sufficient to assure eligibility under the Postal Service regulations. Generally, organizations are eligible if their primary purpose is religious, educational, scientific, philanthropic (charitable), agricultural, labor, veterans, or fraternal. The Postal Service's understanding of these terms is explained in some detail at https://pe.usps.com/text/dmm300/703.htm#ep1114977.

Organizations that may be recognized as tax-exempt under other sections of the Internal Revenue Code, such as auto clubs, business leagues, chambers of

commerce, civic improvement associations, service clubs, social and hobby clubs, and trade associations generally will not be granted the nonprofit mailing rate. Political groups and voting registration offices are specifically authorized to use nonprofit standard mail.

b. Nonprofit Mail Content

In addition to the overall eligibility as describe above, organizations must ensure that the content of its mail, if at nonprofit rates, does not violate any restrictions including the following:

- The authorization for mailing at nonprofit rates applies to a single organization and cannot be shared with or delegated to another. Contents must refer to the affairs and operations of the authorized organization itself.

- If several organizations are cooperating to produce and distribute a single mailing, all of the organizations must be authorized to mail at nonprofit rates at the same Post Office — the one where the mail is being deposited for delivery.

- The mailing cannot advertise any product or service that is not substantially related to the organization's purpose, and, specifically, cannot promote a credit or debit card, an insurance policy (unless it is primarily for the members of the organization and not commercially available otherwise), or travel arrangements that do not contribute substantially to achieving the organization's purpose.

When a mailing is presented at a Business Mail Entry office for delivery, it may be inspected before it is accepted. If the inspection suggests that any of these restrictions has been violated, the mailing may be rejected, or payment of regular first-class postage may be applied. If a mailing is subsequently identified as having been accidentally accepted, the mailer may be required to pay the difference between the postage paid at the time of mailing and regular first-class rates. These determinations can be appealed to the Postmaster of the office where the additional postage was paid.

c. How to Complete a Nonprofit Mailing

Nonprofit standard mailings must be delivered to a Business Mail Entry office.

The minimum size of a mailing is 200 pieces or 50 pounds. The pieces to be mailed must be sorted and bundled following very specific procedures. When the mailing is delivered to the Business Mail Entry office, it must be accompanied by a completed PS Form 3601-N; a PDF version of this form can be downloaded at https://about.usps.com/forms/ps3602n.pdf. The postage rate that will be applied to the mailing will depend on the kind of sorting that is reported by the mailer. For example, lower rates are available for mailings when the pieces are "automation ready" with postal service bar codes imprinted near the addresses from an address file that has been screened as the Postal Service requires. Several Postal Service "Quick Service Guides" outline these requirements; they can be obtained online. (The "Quick Service Guides" are updated frequently, so an online search for "USPS quick service guide" to find the most recent edition is advised. Specifics for Nonprofit Marketing Mail are described in each of the sections under Marketing Mail.)

Current rates for various mailings are shown on PS Form 3602 N for occasional mailings and 3541 N for periodicals—these two forms are known as Postage Statements and are used to calculate the postage due at the time of mailing.

When nonprofit standard mail is presented for mailing at the Bulk Mail facility, a Postal Service employee reviews the Postage Statement, examines the items to be mailed, and checks to see if the postage charge is proper. The mailing will be rejected if the Post Office's requirements are not met. Errors on the Postage Statement can usually be corrected immediately. If the review of the items to be mailed suggests that they are not eligible to be mailed at nonprofit rates, it is possible to agree to pay the higher rate in order to have the mailing go out immediately and appeal the extra charges later through an administrative process. If the mail is marked with a Nonprofit Mailing Permit number (called "nonprofit indicia" by the Postal Service) and the deposit account balance is insufficient to cover the mailing, the facility may agree to hold it while a deposit is made.

d. Mailing Services

Many nonprofit organizations rely on mailing services to prepare nonprofit marketing mail to these specifications. Their services range from simply sorting, bundling and delivering to the Business Mail Entry office to comprehensive consultation about the design and strategy of a continuing mailing program. Many firms that provide these services can be located online by searching for "Mailing Services."

e. Troubleshooting

Common mistakes or missteps that disqualify a nonprofit's mail from the special rate include:

- Items that are not identical. It is best to check in advance with the post office when there will be any variation from piece to piece.
- Use of an organization's permit to attempt a mailing for another organization that has not received authorization.
- Problems with "cooperative mailings" where more than one organization is sharing costs, risks, or benefits. Such an arrangement is only possible when all the cooperating organizations are authorized to mail at nonprofit rates and (unless special arrangements have been made) at the same Post Office.
- The mailing includes words such as "sponsored by" that suggest that some organization other than the authorized nonprofit mailer will benefit directly from the mail's distribution.
- The mailing contains promotional mention of travel, credit card, insurance or certain other goods or services.

There are different requirements for periodical mailings (which generally may contain advertising without loss of nonprofit eligibility). Considerations are discussed in useful detail in Publication 417.

The practice of using postage-paid reply envelopes or cards is covered by a separate set of regulations and standards. There are no special provisions for nonprofit organizations using business-reply mail.

The Postal Service will review the content of planned mailings while in the preparation stage. When difficulties can be foreseen in the preparation of a mailing, a Business Mail Entry office can provide advice and assistance. If there are any areas of concern that remain, the results of the prescreening may be requested in the form of a letter.

The Postal Service sends announcements and other information to authorized nonprofit organizations from time to time. It also conducts occasional training and information sessions and participates in meetings for mailers and other interested

parties. Once an organization has been authorized to mail at nonprofit rates, these informational mailings and invitations are sent automatically.

Resources:

- *Nonprofit USPS Marketing Mail Eligibility* FAQ) has detailed instructions on applying for authorization to mail at nonprofit rates and the types of mail that can be sent.

- Application for Nonprofit post rate. A blank Postal Service Form 3624 is available at https://about.usps.com/forms/ps3624.pdf.

CHAPTER 52. Requirements for Deducting Contributions

A charitable contribution is deductible by the donor only if the donor and the donee organization (the nonprofit receiving the donation) follow certain verification procedures. While the majority of the burden to "substantiate" a charitable contribution falls on the donor, the donee organization has certain responsibilities of its own under the substantiation rules. This Chapter addresses the following topics: (a) the confirmation that the donee organization is qualified to receive deductible contributions; (b) the substantiation requirements for donors; (c) the "contemporaneous acknowledgment" requirement for donee organizations; (d) the "quid pro quo contribution" disclosure requirement for donee organizations; (e) the information return filing requirement for donee organizations selling contributed property within three years of receipt; and (f) gifts of property, including vehicles.

a. Donee Organization Must Be Qualified

To be deductible, a contribution must be made to, or for the use of, a qualified organization and not set aside for use by a specific person. A taxpayer claiming a charitable deduction has the burden of establishing that the donee organization is qualified to receive deductible contributions. Rather than compel donors to rely on the organization's statements or to prove independently that it is a qualified recipient, the IRS issues a Cumulative List of Exempt Organizations (IRS Publication 78).

The IRS has an online search tool at https://www.irs.gov/charities-non-profits/tax-exempt-organization-search that allows users to search for certain information about an exempt organization's federal tax status. It allows users to check whether an organization:

- Is eligible to receive tax-deductible charitable contributions

- Has filed a Form 990-N (e-Postcard) annual electronic notice
- Has had its tax-exempt status automatically revoked because it has not filed its required Form 990-series return for three consecutive years

The list of organizations eligible to receive tax-deductible charitable contributions is updated monthly.

Contributors and grantors may rely on either the Tax Exempt Organization Search or the Exempt Organizations Business Master File Extract (EO BMF). Both are updated monthly, although not necessarily on the same day. To assist with searches, the IRS publishes the date the information was posted. More information is found in Search Tips and Revenue Procedure 2011-33, Updated Reliance Rules for Practitioners.

If an organization has not received an IRS ruling confirming its tax-exempt status, the deductibility of contributions to the organization depends on when the donee was organized. If it was organized before October 10, 1969, the donor may establish that the organization satisfies the requirements of section 170(c) of the Code, a showing that can call for detailed analysis of the organization's charter, bylaws, and activities. *See* S. Rep. No. 552, 91st Cong., 2d Sess., *reprinted in* 1969-3 C.B. 459. If the donee was organized after October 9, 1969:

- The organization is not a 501(c)(3) organization unless it gives notice to the IRS of its application for recognition of exempt status (*see* section 508(a)(1) of the Code);
- If notice is not given within 27 months after incorporation, exempt status is not recognized for any period before the notice is given (*see* section 508(a)(2) of the Code); and
- No deduction is allowed for gifts or bequests made while the organization is not exempt (*see* section 508(d)(2)(B) of the Code).

In contrast, if timely notice is given and the organization is qualified, contributions are deductible, even if the contribution is made before the application for tax exemption is filed.

The foregoing rule requires would-be exempt organizations organized after October 9, 1969, to give notice to the IRS of their existence and to the status they claim by applying for tax exemption. The effect of the notice is procedural rather than substantive, and the action taken by the IRS on the application is not conclusive.

Nevertheless, a favorable determination letter from the IRS is of great practical importance because it reassures potential donors and, unless revoked, relieves them of the need to prove independently that the organization is qualified to receive deductible contributions.

The requirement to apply for tax exemption does not apply to:

- Churches and certain related organizations;
- Organizations, other than private foundations, that do not normally have gross receipts in excess of $5,000 per taxable year; and
- Subordinate organizations, other than private foundations, covered by a group exemption letter.

b. Requirements for Donors

(i) Gifts of Property

An individual, partnership, or corporation is allowed no deduction for a charitable gift of property claimed to exceed $500 unless (i) the donor's return for the year during which the gift was made includes a description of the property and such other information as the IRS may require, or (ii) the donor shows that the failure to include this statement was "due to reasonable cause and not to willful neglect." *See* Code sections 170(f)(11)(A)(i), 170(f)(11)(A)(ii)(II), 170(f)(11)(B). For purposes of the dollar threshold, all similar items of property donated to one or more organizations are treated as one property. *See* Code § 170(f)(11)(F).

This requirement applies to a C corporation only if it is either a personal service corporation or a closely held C corporation. *See* Code sections 170(f)(11)(A)(i), 170(f)(11)(B). With respect to a gift by a partnership or S corporation, the partnership or corporation must include a statement with its return, but if the statement is not so included, the deduction is denied at the partner or shareholder level. *See* Code section 170(f)(11)(G).

Contributions of certain property are subject to special rules under federal tax law. These include contributions of:

- Clothing or household items;
- A car, boat, or airplane;

- Taxidermy property;
- Property subject to a debt;
- A partial interest in property;
- A fractional interest in tangible personal property.

This chapter will provide general information regarding gifts of property and some information regarding gifts of vehicles. IRS Publication 526 contains information regarding the special rules for gifts of the other types of property listed above.

(ii) Appraisal Requirement

An individual, partnership, or corporation is allowed a deduction for a charitable contribution greater than $5,000 if the donor obtains a qualified appraisal of the property and the donor's return for the taxable year the contribution was made includes information regarding the property and the appraisal, as the IRS may require. *See* Code section 170(f)(11)(C). If the claimed deduction exceeds $500,000, the donor's return must include a copy of the qualified appraisal. *See* Code section 170(f)(11)(D). These requirements apply to a C corporation whether or not it is a personal service corporation or closely held corporation. They do not, however, apply to gifts of cash, inventory property, and publicly traded securities or to gifts of vehicles, which are governed by different rules described below. *See* Code section 170(f)(11)(A)(ii)(I). Also, a taxpayer failing to meet the requirements may salvage the deduction by showing that the failure is due to reasonable cause and not to willful neglect. *See* Code section 170(f)(11)(A)(ii)(II).

For purposes of the appraisal requirements, including the $5,000 and $500,000 thresholds, all similar items of property donated to one or more organizations shall be treated as one property. *See* Code section 170(f)(11)(F). With respect to a gift by a partnership or S corporation, the requirements apply at the entity level, but if they are not satisfied, the deduction is denied at the partner or shareholder level.

A qualified appraisal is an appraisal satisfying requirements established by the Treasury or IRS. *See* Code section 170(f)(11)(E). An appraisal is qualified if it meets four requirements. *See* Treas. Reg. section 1.170A-13(c)(3)(i).

- First, it must be made not earlier than 60 days before the gift or later than the due date (with extensions) of the return on which the deduction is claimed.

- Second, it must be made by a "qualified appraiser," who must sign and date the appraisal report. To be qualified, an appraiser must declare in the report that he or she:

    - Performs appraisals regularly or holds himself or herself out to the public as an appraiser;

    - Is qualified to appraise property of the type involved;

    - Is not the donor, the donee, the person from whom the donor acquired the property, or a person employed by or related to any of the foregoing; and

    - Understands that an intentionally false or fraudulent appraisal subjects him or her to penalties.

- Third, a qualified appraisal must be embodied in a report that contains several items of information. *See* Treas. Reg. section 1.170A-13(c)(3)(ii).

    - The report must describe the property sufficiently so that a person other than an expert can tell that the property appraised is the donated property.

    - If the property is tangible, the report must describe its physical condition.

    - Any agreement or understanding limiting the donee's use of the property must be described.

    - The report must state the appraiser's name, address, and taxpayer identification number, describe the appraiser's qualifications, and note the date of the appraisal and the date (or expected date) of the taxpayer's gift.

    - The report must state the property's fair market value on the date of the gift and describe the valuation method or methods used in determining that value and the facts used in applying that method.

- Fourth, an appraisal is not qualified if the appraiser receives a fee calculated as a percentage of the donated property's value or a fee that may vary with the amount allowed as a charitable deduction. *See* Treas. Reg. section 1.170A-13(c)(6).

Generally, a separate qualified appraisal is required for each item of property. *See* Treas. Reg. section 1.170A-13(c)(3)(iv)(A). However, if a taxpayer makes two or more gifts of similar items of property to one or more organizations within a taxable year, one appraisal may cover all of these gifts. A donor must obtain an appraisal not later than the due date (with extensions) of the return on which the deduction for the gift is claimed. *See* Treas. Reg. section 1.170A-13(c)(3)(iv)(B). A taxpayer must retain an appraisal for so long as it may be relevant in the administration of any internal revenue law. *See* Treas. Reg. section 1.170A-13(c)(3)(iv)(C).

(iii) IRS Form 8283

Donors must report noncash gifts in excess of $500 on Form 8283, which is attached to donor's tax return. The donor must provide information on the type and amount of the gift, including a description of property, the date of gift, the date the property was acquired by the donor, how the property was acquired, the donor's cost or other tax basis, and the fair market value of the property and how it was determined. Schedule B to the form is an appraisal summary of the qualified appraisal required for donated property of $5,000 or more (except for publicly traded securities).

c. Acknowledgment Requirement for Donee Organizations

A contribution of $250 or more is not deductible unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee organization. *See* Code section 170(f)(8)(A). If the taxpayer gives $250 or more to an organization more than once during a particular year, the deduction for gifts may be substantiated by one acknowledgment covering all of the gifts or by a separate acknowledgment for each gift. *See* Treas. Reg. section 1.170A-13(f)(1). The $250 threshold applies separately to separate gifts, and no contemporaneous acknowledgment is required for separate contributions of less than $250 each, even if the sum of the taxpayer's contributions to the donee organization during the taxable year equals $250 or more. *See id.*

If the donor's payment is distributed to another charity, the initial payee is usually treated as the donee for this purpose, even if the ultimate recipient of the funds is designated by the taxpayer. *See* Treas. Reg. section 1.170A-13(f)(12).

However, if the ultimate recipient provides goods or services to the taxpayer and the payment is put through the intermediate charity in an attempt to avoid a reduction of the taxpayer's deduction for the value of the goods or services, the gift is deemed made to the ultimate recipient, not the intermediate charity.

The contemporaneous acknowledgment must state the amount of a cash contribution and provide a description, but not a valuation, of donated property other than cash. *See* Code section 170(f)(8)(B). It must also state whether the donee organization provided any goods or services in consideration for the contribution and, if so, it must include a description and good faith estimate of the value of these goods or services. However, no contemporaneous acknowledgment is required if, after subtracting the value of the goods and services, the charitable gift is less than $250. *See* Treas. Reg. section 1.170A-13(f)(1).

If the donee organization provides any intangible religious benefits, the acknowledgment must contain a statement to that effect. *See* Code section 170(f)(8)(B)(iii). An "intangible religious benefit" is a benefit provided by an organization organized exclusively for religious purposes that generally is not sold in a commercial transaction outside the donative context. *See* Code section 170(f)(8)(B). An example is admission to a religious ceremony. *See* H.R. Rep. No. 213, 103d Cong., 1st Sess. 566. Tuition for education leading to a recognized degree, travel services, and consumer goods are not intangible religious benefits unless they are *de minimis* and incidental to a religious ceremony (e.g., communion wine). *See id.* at n.34.

The acknowledgment need not contain the donor's taxpayer identification number. *See* H.R. Rep. No. 213, 103d Cong., 1st Sess. 565 n.30. No particular form is required, and the acknowledgment may consist, for example, of a letter, postcard, or computer-generated form. *See id.* at n.32. An acknowledgment is contemporaneous if the taxpayer obtains it no later than the date on which the taxpayer's return for the year is filed or, if earlier, the filing due date, taking extensions into account. *See* Code section 170(f)(8)(C).

For a taxpayer performing gratuitous services for charity, unreimbursed expenses incident to these services are considered adequately substantiated if the taxpayer's records adequately substantiate the amount of the expenses and the charity provides a written statement:

- Describing the taxpayer's services;

- Stating whether the organization provided any goods or services in consideration for the unreimbursed expenses and, if so, providing a good faith estimate of the value of the goods or services; and

- Stating whether the organization provided any intangible religious benefits for the taxpayer. *See* Treas. Reg. section 1.170A-13(f)(10).

If payments to charity are made by withholding from the taxpayer's salary or wages, the amount withheld from each payment of wages is a separate contribution for purposes of the $250 threshold. *See* Treas. Reg. section 1.170A-13(f)(11). If the amount withheld for any pay period is $250 or more, the gift is adequately substantiated by a pay stub or Form W-2 from the employer stating the amount withheld and the recipient of the withheld amount, and a pledge card or other document prepared by or at the direction of the donee organization stating that the organization provides no goods or services in consideration for contributions made by payroll deduction.

A contribution by a partnership or S corporation is treated as made by the entity, not its partners or shareholders, who are allowed the deduction for the gift. *See* Treas. Reg. section 1.170A-13(f)(15). The entity must therefore obtain contemporaneous acknowledgment for a gift of $250 or more, even if no partner's or shareholder's share of the gift is as much as $250, and a partner or shareholder whose share of the gift is $250 or more is not required to substantiate the gift further.

The contemporaneous acknowledgment requirement is waived if the donee organization files a return including the information required to be given by the acknowledgment. *See* Code section 170(f)(8)(D). Also, the Treasury, by regulations, may waive some or all of the requirements of the acknowledgment rule in appropriate cases. *See* Code section 170(f)(8)(E).

d. Quid Pro Quo Contribution Requirement for Donee Organizations

The recipient of a quid pro quo contribution in excess of $75 must provide a written statement to the donor in connection with the solicitation or receipt of the contribution. *See* Code section 6115(a). The term "quid pro quo contribution" generally includes any payment made partly as a contribution and partly in consideration for goods or services provided to the donor by the donee organization. *See* Code section 6115(b). However, a contribution to a religious organization is not quid pro quo if the donor receives solely an intangible religious benefit that generally is not sold in a commercial transaction outside the donative context. Also, no statement is required for a gift to the federal government or a state or local

government if the gift is exclusively for public purposes. *See* Code section 6115(a). Moreover, transactions that have no donative element (e.g., sales of goods by a museum gift shop that are not, in part, donations) are not quid pro quo contributions. *See* H.R. Rep. 213, 103d Cong., 1st Sess. 566. The $75 threshold is applied separately to each contribution. *See id.* at n.36.

The statement required must inform the donor that the federal income tax deduction for the contribution is limited to the amount of the contribution (the sum of the money and the fair market value of any contributed property), less the value of the goods or services provided by the organization. *See* Code section 6115(a)(1). The organization must also provide a good faith estimate of the value of such goods or services. *See* Code section 6115(a)(2).

The organization may estimate fair market value by any reasonable method, so long as the method is applied in good faith. *See* Treas. Reg. section 1.6115-1(a)(1). If the goods or services are not generally available in a commercial transaction, their value may be estimated by reference to the fair market value of similar or comparable goods or services, even if those goods or services do not have the unique qualities of the goods or services that are being valued. *See* Treas. Reg. section 1.6115-1(a)(2).

Various goods and services, including many items of smaller value and most benefits allowed to members who pay annual membership contributions of $75 or less, may be disregarded in determining whether a contribution is quid pro quo and, if so, in valuing goods or services. *See* Treas. Reg. section 1.6115-1(b). These items are also disregarded if they are provided to employees or partners of a corporate or partnership donor. *See* Treas. Reg. section 1.6115-1(d)(1).

The statement need not be in any particular form, but the disclosure must be made in a manner that is reasonably likely to come to the attention of the donor. *See* H.R. Rep. No. 213, 103d Cong., 1st Sess. 566 n.35. A disclosure of the required information in small print set forth within a larger document might not meet the requirement.

A penalty of $10 is usually imposed for each quid pro quo contribution for which the required written statement is not provided. *See* Code section 6714(a). The penalties will apply if an organization either fails to make any disclosure in connection with a quid pro quo contribution or makes a disclosure that is incomplete or inaccurate. *See* H.R. Rep. No. 213, 103d Cong., 1st Sess. 566. However, the aggregate penalty for a particular fundraising event or mailing may not exceed

$5,000, and the penalty is excused for a contribution if the failure to provide the statement is due to reasonable cause. *See* Code section 6714(a), (b).

A donor receiving a quid pro quo contribution can generally rely on a written acknowledgment provided by the charity in valuing the charitable gift, but a donor must disregard the charity's valuation if the donor knows, or has reason to know, that such treatment is unreasonable. *See* Treas. Reg. section 1.170A-1(h)(4).

e. Information Return Requirement for Donee Organizations Selling Contributed Property Within Three Years of Receipt

If a recipient of charitable deduction property sells, exchanges, or otherwise disposes of the property within two years after receiving it, it must file a Form 8282, which is an information return showing:

- The donor's name, address, and taxpayer identification number;
- A description of the property;
- The date of the contribution;
- The amount received on the disposition;
- The date of such disposition;
- A description of the donee's use of the property; and
- A statement indicating whether the use of the property was related to the purpose or function constituting the basis for the donee's exemption under Code section 501. *See* Code section 6050L(a)(1).

"Charitable deduction property" is property other than money for which a donor claimed a charitable deduction based on a claimed value that, when added to the claimed value of all similar items of property donated by the donor to one or more donees, exceeds $5,000. *See* Code section 6050L(a)(2)(A). Publicly traded securities for which market quotations were readily available on an established securities market when the contribution was made are not charitable deduction property and are disregarded in applying the $5,000 threshold. *See* Code section 6050L(a)(2)(B). The donee must furnish a copy of the return to the donor. *See* Code section 6050L(c).

If the original donee transfers the property to another charitable organization within three years, the original donee should provide a copy of its report on the transfer to the successor donee, and the successor donee should also report any disposition it makes within three years after the original gift. *See* Treas. Reg. section 1.6050L-1(c). The return is due 125 days after a disposition triggering the obligation to file. *See* Treas. Reg. section 1.6050L-1(f). The information return is excused in three situations:

- First, it need not be filed if the gift is of money or publicly traded securities or if, for some other reason, the donee is not required to sign an appraisal summary under the donor substantiation rules described above. *See* Treas. Reg. section 1.6050L-1(e).

- Second, no return is required to report the sale of an item if the donor attests in the appraisal summary that the item's appraised value does not exceed $500. *See* Treas. Reg. section 1.6050L-1(a)(2).

- Third, the return need not be filed if the property is consumed by the donee in the pursuit of its charitable purposes. *See* Treas. Reg. section 1.6050L-1(a)(3).

f. Gifts of Vehicles

If the claimed value of a charitable gift of a qualified vehicle exceeds $500, no deduction is allowed for the gift unless the donor substantiates it with a contemporaneous written acknowledgment from the donee organization and includes the acknowledgment with the return on which the deduction is claimed. Even if so substantiated, the deduction may not exceed the donee's gross proceeds on selling the vehicle unless the donee uses the vehicle in its charitable activities or materially improves it. *See* Code section 170(f)(12).

(i) Qualified Vehicles

A "qualified vehicle" is a motor vehicle manufactured primarily for use on public streets, roads, and highways, a boat, or an airplane. *See* Code section 170(f)(12)(E). While the rules apply to donations of new as well as used vehicles, they do not apply to a donor that held a donated vehicle as inventory or for sale to customers in the ordinary course of business.

(ii) Vehicles Sold Without Significant Intervening Use or Material Improvement

If a donee organization receiving a charitable gift of a qualified vehicle sells it without making any significant intervening use or material improvement of the vehicle and realizes gross sales proceeds exceeding $500, the donor's deduction for the gift is the lesser of the gross proceeds or the vehicle's fair market value at the time of the gift, provided all other requirements of Code section 170 are satisfied. *See* Code section 170(f)(12)(A)(ii). If the gross sales proceeds are $500 or less, the donor's deduction is the lesser of the vehicle's fair market value when contributed or $500. *See* Notice 2005-44, 2005-25 I.R.B. 1287, section 4.02.

(iii) Vehicles Significantly Used or Materially Improved

The rule limiting the deduction for a charitable gift of a qualified vehicle to the gross proceeds on the donee organization's sale does not apply if the donee significantly uses or materially improves the vehicle before selling it. *See* Code section 170(f)(12)(A)(ii). If properly substantiated, the deduction for such a contribution equals the vehicle's fair market value when donated.

To meet the significant use test, an organization must actually use the vehicle to substantially further the organization's regularly conducted activities, and the use must be significant. A donee organization will not be considered to significantly use a qualified vehicle if the use is incidental or not intended at the time of the contribution. Whether a use is significant also depends on the frequency and duration of use. *See* Notice 2005-44, 2005-25 I.R.B. 1287, section 7.01(1).

Material improvements include major repairs to a vehicle, or other improvements to the vehicle that improve the condition of the vehicle in a manner that significantly increases the vehicle's value, but not cleaning, minor repairs, or routine maintenance. *See id.* section 7.01(2). Services not qualifying as material improvements include painting, waxing, rustproofing, applications of other finishes, removal of dents and scratches, repair of upholstery, and installation of theft deterrent devices. *See id.* Moreover, an improvement funded by an additional payment to the donee organization from the donor of the qualified vehicle cannot be a material improvement, regardless of its nature.

(iv) Vehicles Transferred to Needy Individuals

The rule limiting the deduction to the gross proceeds on a donee organization's sale without significant use or material improvement does not apply

if the donee sells a qualified vehicle to a needy individual at a price significantly below fair market value or makes a gift of the vehicle to such an individual in direct furtherance of a charitable purpose of the donee organization of relieving the poor and distressed or the underprivileged who are in need of a means of transportation. *See id.* section 3.02(3). The charitable purpose must be served by making vehicles available to the sellers or transferees; it is not sufficient that the charity uses the proceeds of sales to help needy individuals for charitable purposes. *See id.*

(v) Fair Market Value

The fair market value of a qualified vehicle, like that of any other property, is the price at which the property would change hands between a willing buyer and a willing seller, neither being under a compulsion to buy or sell and each having reasonable knowledge of relevant facts. *See* Treas. Reg. section 1.170A-1(c)(2). An established used vehicle pricing guide establishes a particular vehicle's value only if it lists a sales price for a vehicle that is the same make, model, and year, sold in the same area, in the same condition, with the same or substantially similar options or accessories, and with the same or substantially similar warranties or guarantees, as the vehicle in question. *See* Notice 2005-44, 2005-25 I.R.B. 1287, section 5. A donor of a qualified vehicle must obtain a qualified appraisal if his or her deduction is not limited to the gross proceeds of the donee organization's sale of the vehicle and is claimed to exceed $5,000. *See id.* section 6.

(vi) Acknowledgments

For a gift of a vehicle with a claimed value exceeding $500, the donee organization's acknowledgment must include the donor's name and taxpayer identification number, the vehicle identification number of the donated vehicle, and the date of the contribution. *See* Code section 170(f)(12)(B). If the donee sells the vehicle without a significant intervening use or material improvement, the acknowledgment must also certify that the vehicle was sold in an arm's length transaction between unrelated parties, indicate the date and gross proceeds of the sale, and state that the donor's deduction may not exceed the gross sale proceeds. *See* Code section 170(f)(12)(B)(iii). If the donee intends to use or improve the vehicle, the acknowledgment must include a certification and detailed description of the intended use or improvement, the intended duration of such a use, and a certification that the vehicle will not be sold before the use or improvement is completed. *See* Code section 170(f)(12)(B)(iv). If the donee intends to sell or give the vehicle to a needy person at a price significantly below fair market value in direct furtherance of a charitable purpose, the acknowledgment must also certify that the

donee will make such a sale or gift and that the sale or gift will directly further the organization's charitable purpose of relieving poor and distressed or underprivileged persons in need of means of transportation. *See* Notice 2005-44, 2005-25 I.R.B. 1287, section 3.03(4).

An acknowledgment must be "contemporaneous." A donee organization satisfies this requirement by providing an acknowledgment within 30 days after its sells a vehicle at fair market value or, if the acknowledgment certifies an intended use, improvement, or sale or gift to a needy person, within 30 days after the contribution is made. *See* Code section 170(f)(12)(C). A donee organization must provide the information contained in an acknowledgment to the IRS. *See* Code section 170(f)(12)(D). An organization may provide an acknowledgment in any reasonable manner. *See* Notice 2005-44, 2005-25 I.R.B. 1287, section 8.03. A donee must report contributions of qualified vehicles to the IRS on Form 1098-C and may use copies of this form as contemporaneous written acknowledgments to donors.

(vii) Penalties for False or Fraudulent Acknowledgments

The IRS may impose a penalty on a donee organization required to furnish a contemporaneous written acknowledgment to a donor of a qualified vehicle if the organization knowingly furnishes a false or fraudulent acknowledgment or knowingly fails to furnish such acknowledgment in the manner, at the time, and showing the information required by the foregoing rules. *See* Code section 6720. For each vehicle that the donee organization sells without significant intervening use or material improvement, the penalty for a false or fraudulent acknowledgment, no acknowledgment, or a noncompliant acknowledgment is the greater of the gross sale proceeds or 35% of the sales price stated in the acknowledgment. *See* Code section 6720(1). If a donee organization does not so sell a vehicle, the penalty for a false or fraudulent acknowledgment is the greater of 35% of the claimed value of the vehicle or $5,000. *See* Code section 6720(2).

CHAPTER 53. Fundraising Involving Gambling

a. Introduction

All gambling in Washington State, with the exception of the state lottery and horseracing, is subject to regulation by the Washington State Gambling Commission (and in certain circumstances, controlled by tribal governments). Qualified nonprofit organizations may hold gambling activities to raise funds. While some gambling activities are allowed without a gambling license, other activities require licensure from the Gambling Commission.

Gambling is defined as an activity that has three elements: consideration, chance and prize. These terms are further defined as:

- Consideration: Payment
- Chance: Outcome not determined by skill
- Prize: Money or anything of value

All three elements must be met for the activity to constitute gambling.

b. Unlicensed Gambling Activities

The forms of gambling that can occur without a license are described, along with limitations or restrictions, in the Gambling Commission's pamphlet, "Unlicensed Gambling Activities for Charitable/Nonprofit Organizations." This pamphlet is available on the Gambling Commission's website, https://www.wsgc.wa.gov/. Permitted activities include bingo; raffles and amusement games; raffles for members only; turkey shoots; golfing sweepstakes; card and dice games and limited social card games. In most cases, the total receipts from such activities cannot exceed $5,000 per year, and participation is often restricted to members of the organization or members and their guests.

Only certain authorized charitable and nonprofit organizations are permitted to host or organize these forms of unlicensed gambling activities. An authorized organization is one that has been in operation for at least 12 months prior to the gambling event or activity, and it must be able to show that it has made "significant progress toward achieving [its] stated purposes" during the preceding 12 months.

c. Gambling Licensing

All other gambling activities require a license. RCW 9.46.010 states gambling activities must be for "the raising of funds for the promotion of bona fide charitable or nonprofit organizations is in the public interest" when conducted as authorized by the law. Accordingly, charitable and nonprofit organizations may apply for a license to engage in various sorts of gambling for fundraising purposes. In addition to the requirements for unlicensed activities, organizations seeking a license for gambling activities must have at least 15 members with authority to elect board members, and there are many other requirements to consider before proceeding.

Generally, a nonprofit needs a gambling license for gambling activities if either (1) the total annual receipts from such activities is more than $5,000 or (2) the

nonprofit holds more than 2 gambling events (raffles, bingo or amusements games) in a year. In addition, there are different licensing requirements for public and private (member only) activities. If your activity is open to the public, a license may be required. Please review specific rules on the Gambling Commission's website, *see* the Liquor, Cannabis, Gambling…and Your Fundraising Event Toolkit or call the Gambling Commission directly.

d. Record Keeping

The Gambling Commission requires organizations to keep records, of certain gambling activities, such as licensed raffles. Example records can be found on the Gambling Commission website. The Gambling Commission also requires that all funds collected from gambling be accounted for with an audit trail showing the funds raised from gambling were used to further the organization's stated purpose. Some activities even require organizations to maintain a separate gambling receipts bank account.

e. Reporting Theft

The Gambling Commission is a limited jurisdiction law enforcement agency. Their agents are trained in conducting investigations. If you suspect a theft of gambling funds, contact them for help. Their agents will also help answer questions regarding gambling.

f. Tax Considerations

Lastly, there are federal tax considerations that require attention before an exempt organization engages in a gambling activity. A useful summary is in IRS Publication 3079, which can be found at http://www.irs.gov/pub/irs-pdf/p3079.pdf.

CHAPTER 54. Liquor and Cannabis at Nonprofit Events

Liquor and Cannabis in Washington is regulated by the Washington State Liquor and Cannabis Board ("WSLCB" – http://www.lcb.wa.gov). Before hosting an event where liquor is served, sold, or offered as a raffle prize, nonprofits should review current Liquor and Cannabis Board rules. The Liquor, Cannabis, Gambling…and Your Fundraising Event toolkit breaks down and charts the complex rules for liquor, cannabis and gambling at fundraising events.

Serving liquor at an event can expose an organization to a wide variety of risks. Before planning a party or any other activity involving liquor, consider consulting with a knowledgeable insurance agent to review the coverages in place, or needed.

Venues where alcoholic beverages are served may also require insurance and impose other conditions.

Banquet Permits: Nonprofit organizations that serve alcohol at events will need to obtain a banquet permit from the WSLCB before serving liquor at an event. Once the permit is issued, a WSLCB inspector or law-enforcement agent may visit the venue during the event to determine that all requirements have been met including the following:

- The event is by invitation only; it cannot be advertised or open to the public.
- The liquor must be bought at full retail price from a Washington liquor dealer or brought by the participants. Donated liquor may not be served.
- While there may be a charge for attending the event, there cannot be any separate charge for liquor; scrip or drink tickets may be provided to attendees so that all participants share equally.
- Liquor may not be served between the hours of 2am and 6 am or to anyone under 21 years old.
- If the location or venue requires any other permits for the event, those permits must also be obtained.
- To raffle liquor at an unadvertised, members-only event requires a raffle permit from the WSLCB and a raffle license from the Washington State Gambling Commission (WSGC). Information for how to apply for these and other licenses from the WSGC is available online at https://www.wsgc.wa.gov/sites/default/files/public/forms/apps/4-028-f-nonprofit-org.pdf.
- Liquor cannot be raffled at any event that is open to the public.

If a nonprofit organization is helping to put on an event, or will benefit from it in some way, a banquet permit is necessary even if the invitations come from individuals (from board members or key fundraising volunteers, for example).

To apply for a banquet permit go to https://lcb.wa.gov/licensing/online-banquet-permit; an email address is required to receive a printable copy of the permit and a debit or credit card is necessary for payment of the $10 (per day) fee. Further information about banquet permits is available on the WSLCB website at https://lcb.wa.gov/licensing/banquet-permits.

Special Occasion Licenses: A Special Occasion License allows a nonprofit organization to sell liquor at a specified date and place and is required when alcohol will be sold to participants during events like fundraising dinners, galas, auctions, and wine tastings. The application can be found online at https://lcb.wa.gov/publications/licensing/forms/LIQ-285-App-for-Special-Occasion-License-for-NP.docx and must be filed by mail at least 45 days in advance of the event.

All proceeds from liquor sales must be retained by the nonprofit organization; no other person or entity may receive a share or percentage. The liquor may be purchased at wholesale or retail from any vendor licensed to sell liquor in Washington; organizations recognized by the IRS as 501(c)(3)s or 501(c)(6)s may also receive donated liquor from producers or distributors.

The fee for a special occasion license is $60 per day, per location. Special occasion licenses are limited to 12 single-day events per calendar year. WSLCB will notify the mayor or county executive of the location where the event will be held; that official will have an opportunity to comment on whether or not the license should be granted.

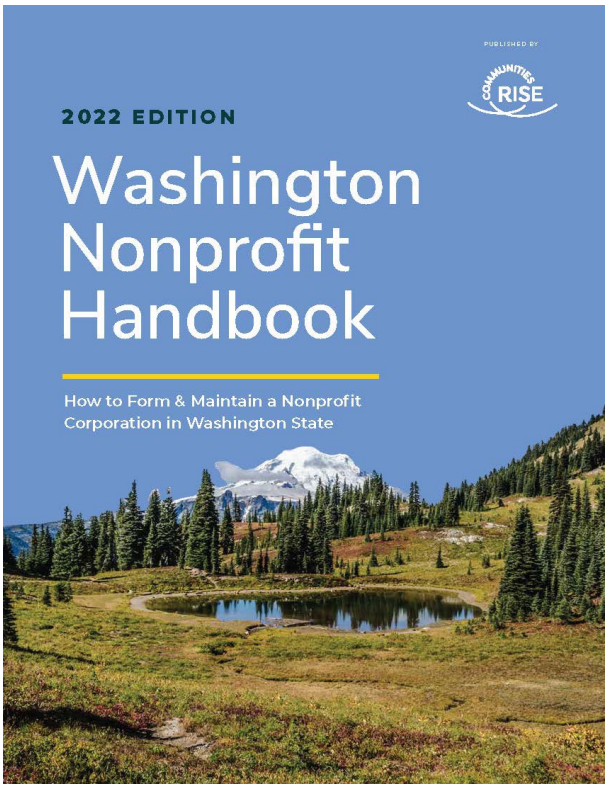
There are many specific requirements and restrictions that apply to Special Occasion Licenses. The best way to review these requirements is to examine the application forms or review the Liquor, Cannabis, Gambling...and Your Fundraising Event toolkit. If underage attendees are present, an addendum must also be filed. This application (with addendum) is due 60 days before the event. The address for filing is on the WSLCB information page at https://lcb.wa.gov/licensing/special-occasion-licenses.

WSLCB recommends that anyone who is unfamiliar with the requirements or the application process for Special Occasion Licenses contact customer services staff by calling 360-664-1600. Also, frequently asked questions about Special Occasion Licenses may be found at https://lcb.wa.gov/licensing/special-occasion-licenses/faq.

Other Licenses for Nonprofits: There are several other kinds of alcoholic beverage licenses that may be of interest to arts organizations, private clubs, and in some cases to other types of nonprofit organizations. The application process usually involves consultation with WSLCB staff because identifying the right license can be difficult, and the consequences of starting down the wrong path can be frustrating especially if fees have been paid, expensive. The telephone number for the WSLCB is 360-664-1600.

Resources on Liquor and Cannabis:

- Washington State Liquor and Cannabis Board at https://lcb.wa.gov/
- The Liquor, Cannabis, Gambling...and Your Fundraising Event toolkit (2018)



PART 8 WASHINGTON STATE TAXES AND NONPROFIT CORPORATIONS

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PART 8. WASHINGTON STATE TAXES AND NONPROFIT CORPORATIONS

CHAPTER 55. Nonprofit Organizations Are Subject to State Taxes

In Washington State, nonprofit organizations are presumed taxable in the same manner as for-profit organizations. Therefore, if no statutory exemption or deduction exists, a nonprofit organization must pay each of the following taxes: (1) state and local business taxes, (2) state and local retail sales taxes, (3) state and local use taxes, and (4) real and personal property taxes.

The general presumption in favor of taxation is that while a nonprofit organization should assume that all its business activities are taxable, it should also determine whether an exemption or deduction applies to the specific activity ors transaction. A nonprofit organization claiming any exemption or deduction has the burden of proof of establishing that it qualifies for that benefit or deduction.

CHAPTER 56. The State Business and Occupation Tax

a. Defined

Washington imposes the Business and Occupation tax ("B&O tax") on the gross receipts of every person engaged in business activities in the State. Nonprofit organizations must pay the B&O tax based on the value of its products, the gross proceeds of its sales, or the gross income of its services, as appropriate. Typically, nonprofit organizations pay tax under at least two general classifications of the B&O tax. These classifications are: (i) retailing and (ii) service and other activities. *See* RCW 82.04 for the statute governing Business & Occupation Tax, and the Department of Revenue website on business & occupations tax online at https://dor.wa.gov/find-taxes-rates/business-occupation-tax.

(i) Retailing

Retailing includes every sale of tangible personal property to consumers (e.g., sales of publications, periodicals, books, and tapes). Retailing also includes certain services such as repair or improvement of property and certain personal services. Nonprofit organizations must pay a tax, currently at a rate of 0.471% of the organization's gross sales proceeds on these activities. Because the state retail sales tax — separate from the B&O tax — uses this same definition as a starting point, sales of property or services in this classification are also subject to the retail sales tax.

(ii) Service and Other Activities

The Service and Other Activities classification includes all other sources of income that do not fall into the "retailing" classification of the B&O tax. Nonprofit organizations must pay either 1.5% or 1.75% of the gross income the organization receives from services, taxable rents, fees, advertising income, dues, reimbursements, agency fees, and commissions in taxes. Unlike retailing, items in this classification are not subject to the retail sales tax.

b. Exemptions for Low Gross Receipts and the Small Business Tax Credit

(i) Low Gross Receipts

Nonprofit organizations are not required to register with the Washington State Department of Revenue or pay the B&O tax if their gross annual receipts are $12,000 or less. Additionally, the organization is not required to pay any other state tax such as the sales or use tax.

(ii) The Small Business B&O Tax Credit

If a nonprofit organization has a gross annual receipt of greater than $12,000 but less than $56,00, the Small Business B&O Tax Credit may offset all or a portion of the B&O tax. This credit, however, applies only to the B&O tax due from the organization and does not apply to any retail sales and use taxes due.

c. Exemptions and Deductions for Artistic and Cultural Organizations

Washington exempts certain nonprofit organizations from liability for the B&O tax.

Artistic and cultural organizations may deduct all their income from business activities from their B&O tax liability. Artistic or cultural organizations include nonprofit corporations that are organized and operated exclusively for the purpose of providing "artistic or cultural exhibitions, presentations, performances, or cultural or art education programs" for viewing or attendance by the general public. The term "artistic or cultural exhibitions, presentations, or performances or cultural or art education programs" includes and is limited to:

- An exhibition or presentation of works of art or objects of cultural or historical significance, such as those commonly displayed in art or history museums;

- A musical or dramatic performance or series of performances; or

- An educational seminar or program, or series of such programs, offered by the organization to the general public on an artistic, cultural, or historical subject.

To qualify for the permitted deduction, a nonprofit corporation must meet the following requirements (*see* RCW 82.04.4328):

- The organization must be either be (i) a nonprofit corporation organized and managed by a governing board of not less than eight individuals, none of whom is a paid employee of the corporation or (ii) a corporation sole as defined under RCW 24.12.010 (church and religious societies);

- No part of the corporation's income may be paid directly or indirectly to its members, stockholders, officers, directors or trustees, except in the form of services rendered by the corporation in accordance with its purposes and bylaws;

- Salary or compensation paid to the corporation's officers and executives must be only for actual services rendered, and at levels comparable to the salary or compensation of like positions within the state;

- Assets of the corporation must be irrevocably dedicated to the activities for which the exemption is granted and, upon liquidation, dissolution, or abandonment by the corporation, may not inure directly or indirectly to the benefit of any member or individual, except a nonprofit organization, association, or corporation which would also be entitled to the exemption;

- The corporation must be duly licensed or certified when licensing or certification is required by law or regulation;

- The amounts received that qualify for exemption must be used for the activities for which the exemption is granted;

- Services must be available regardless of race, color, national origin, or ancestry; and

- The Department of Revenue must have access to the corporation's books to determine whether the corporation should be exempt.

Requirements Concerning Boards

To qualify for this exemption there are two requirements. The first requirement is that the organizations must have at least eight board members, none of whom is a paid employee. This means no member of the board of directors may be a paid employee, regardless of the total number of directors. For example, an organization with 39 board members, five of whom are paid employees, would not qualify for the deduction. Similarly, if the executive director, a paid employee, is directly involved in the decision making or management by the board of directors, no deduction is applicable. However, if the executive director serves the board in an advisory capacity, without voting rights, a deduction is allowed. Cautious nonprofit organizations that qualify for this deduction may want to ensure that the organization's articles call for at least eight directors and provide that the executive director can only act in an advisory capacity to the board of directors, without voting rights.

Articles or bylaws that call for a minimum of eight board members are also valuable for boards with only eight members in the instance of a board resignation, which leaves the board temporarily with only seven members. As long as the governing documents call for eight and the board can demonstrate it is actively searching for the eighth member, a deduction is still allowed.

The second requirement is that no part of the corporation's income may be paid directly or indirectly to its members, stockholders, officers, directors, or trustees, except in the form of services rendered by the corporation in accordance with its purposes and bylaws. This requirement is intended to limit the ability of others to profit indirectly from the operations of the nonprofit. This does not limit the ability of the organization to reasonably compensate officers who are not board members, to pay board stipends, or to provide services to board members who are also constituents served by the nonprofit.

Artistic and cultural organizations are also exempt from paying the retail sales or use tax on certain objects used for the purposes of exhibition or presentation to the general public. These objects include both objects of artistic or cultural value and objects to be used in displaying art or presenting artistic or cultural exhibitions or performances.

d. Exemptions for Other Specified Organizations

- **Blood, Bone, and Tissue Banks:** Blood, bone, and tissue banks are exempt from the B&O tax to the extent amounts received are exempt from federal income tax. *See* RCW 82.04.324.

- **Adult Family Homes:** Adult family homes are exempt from the B&O tax. *See* RCW 82.04.327.

- **The Red Cross:** State law specifically exempts this organization from the B&O tax. *See* WAC 458-20-190.

- **Sheltered Workshops:** Sheltered workshops are exempt from the B&O tax. The operation of sheltered workshops means performance of business activities of any kind, on or off the premises of a nonprofit organization, which are performed for the primary purpose of either (1) providing gainful employment or rehabilitation services to persons with disabilities as an interim step in the rehabilitation process for persons with disabilities who cannot be readily absorbed in the competitive labor market or during such time as employment opportunities for persons with disabilities in the competitive labor market do not exist; or (2) providing evaluation and work adjustment services for persons with disabilities. *See* RCW 82.04.385.

- **Comprehensive Cancer Centers:** Comprehensive cancer centers are exempt from the B&O tax to the extent amounts received are exempt from federal income tax. *See* 82.04.4265.

- **Organ Procurement Organizations:** Organ procurement organizations are exempt from the B&O tax to the extent amounts received are exempt from federal income tax. *See* 82.04.326.

- **The State, the Federal Government, and Housing Authorities:** These organizations are exempt from B&O tax.

- **Nonprofits providing legal services to low-income persons:** Nonprofit legal services organizations serving low-income individuals that do not charge or services are exempt from State B&O taxes. *See* RCW 82.04.635 & 82.04.431.

e. Exemptions and Deductions for Fundraising Activities

(i) General

Washington allows certain nonprofit organizations, as defined below, to deduct income received from a qualifying fundraising activity under the B&O tax. *See*

RCW 82.04.3651. In addition, the nonprofit is not required to collect the retail sales tax on sales made as part of the fundraising activity.

"Fundraising activity" means activities involving both the direct solicitation of money or other property and the anticipated exchange of goods or services for money between the soliciting organization and the organization or person solicited, for the purpose of furthering the goals of the nonprofit organization.

A fundraising activity does not include the operation of a regular place of business in which sales are made during regular hours such as a bookstore, thrift shop, restaurant, or similar business. It also does not include the operation of a regular place of business from which services are provided, such as retail, personal, or professional services.

"Nonprofit organization," for the purpose of the fundraising activity exemption, means one of the following:

- An organization exempt from tax under section 501(c)(3), (4), or (10) of the Code;
- A nonprofit organization that would qualify for the exemption except that it is not organized as a nonprofit corporation; or
- A nonprofit organization that meets all of the following criteria: (1) the members, stockholders, officers, directors, or trustees of the organization do not receive any part of the organization's gross income, except as payment for services rendered; (2) the compensation received by any person for services rendered to the organization does not exceed an amount reasonable under the circumstances; and (3) the activities of the organization do not include a substantial amount of political activity, including, but not limited to, influencing legislation and participation in any campaign on behalf of any candidate for political office.

(a) Retail Sales Tax Exemption for Items Purchased for Fundraising Activities

Organizations that purchase items to be resold as part of a qualifying fundraising activity may either purchase the items to be resold without payment of the retail sales tax if the organization has a reseller's permit or pay tax at the point of sale and take the credit for tax paid at the source. For example, a qualifying nonprofit has an annual auction at which it serves a meal. If the attendees pay a fee

to the nonprofit to come to the event, the nonprofit is reselling the meal to the attendees. Therefore, the nonprofit gives the caterer or hotel a reseller's permit for the meals and does not pay retail sales tax on the purchase of the meals because of the resale exemption. The nonprofit also does not collect retail sales tax on the fee received from attendees due to the fundraising exemption discussed earlier.

(b) Other State Tax Consequences of Fundraising Activities

Nonprofit organizations must still pay the retail sales tax on consumable items incorporated into fundraising activities. For example, if as part of an auction, an organization rents a hotel ballroom, buys decorations, or pays the caterer, the organization must pay sales tax or use tax on the purchases because those purchases are consumable items.

A limited-use tax exemption of $12,000 exists for buyers of tangible personal property for purchases of applicable items at any fundraiser. Effective January 1, 2021, this amount is inflation adjusted annually.

(*See* discussion on the use tax in CHAPTER 55.)

Nonprofit organizations exempt from real or personal property taxes are allowed to use their exempt property for fundraising purposes for limited time periods without impairing their property tax exemptions. The use of exempt property for fundraising activities sponsored by an exempt organization does not subject the property to taxation if the fundraising activities are consistent with the purposes for which the exemption was granted. For property tax exemption purposes, the term "fundraising" means: any revenue-raising activity, limited to less than five days in length, that disburses 51% or more of the profits realized from the activity to the exempt nonprofit organization conducting the fundraising activity.

(c) Trade Shows, Conventions, and Seminars

Nonprofit organizations may deduct attendance and space charges, such as conference registration fees and booth rentals, received in connection with trade shows, conventions, and seminars from the B&O tax if the following conditions are satisfied:

- The sponsoring organization must be exempt under section 501 of the Code;

- The sponsoring organization must either be a "trade organization" or a "professional organization." A "professional organization" is an entity whose members are engaged in a particular lawful vocation, occupation or field of activity of a specialized nature. A "trade organization" is an entity whose members are engaged "in trade" (i.e., in one or more lawful commercial trades, businesses, crafts, industries or distinct productive enterprises); and

- The event must not be open to the general public. This means that (1) attendance is limited to members of the sponsoring organization and to specific invited guests of the sponsoring organization; or (2) if attendance is not limited to members and specifically invited guests, all proceeds from the trade show, convention or seminar are subject to B&O tax.

(d) Exemptions and Deductions for Specific Revenue Streams

- **Rents:** Rents received from long-term leases of real property are exempt from the B&O tax. Otherwise, rental income is likely subject to the B&O tax. For example, short-term rentals by those who hold themselves out to the public as hotels and motels are subject to the Retailing B&O tax. In addition, the organization must collect the retail sales tax and remit it to the state. Short-term rentals or other types of real property are subject to the Service and Other Activities B&O tax. Rentals of personal property are subject to the Retailing B&O tax, and the organization must collect and remit the retail sales tax to the state.

- **Advancements and Reimbursements:** Advancements and reimbursements received by nonprofit organizations are excludable if the organization receiving the reimbursement had no liability other than as an agent when the original payment was made. Nonprofit organizations should be aware, however, that this possible deduction poses a significant audit trap, especially for affiliates or subsidiaries of the organization and any cost-sharing relationships. Reimbursement arrangements must be carefully structured to avoid being treated as taxable gross receipts.

- **Income Exempt Under the U.S. Constitution:** The federal constitution prohibits Washington from taxing revenue derived from interstate sales, imports and exports, Indians and Indian tribes, or sales made by the

federal government. Nonprofit organizations that sell to the federal government are generally subject to the B&O tax. *See* WAC 458-20-190.

- **Investment Income:** Investment income is deductible. Investment income includes amounts derived from one of three sources: (1) investments, (2) dividends or distributions from a capital account, or (3) interest on loans between a subsidiary entity and its parent, but only if the total investment and loan income of the parent is less than 5% of total annual gross receipts. *See* RCW 82.04.4281.

  This deduction does not apply to amounts received by a banking, lending, or security business. In addition, no deduction is allowed for any organization for loans or the extension of credit to another, revolving credit arrangements, installment sales, and the acceptance of payment over time for goods or services.

- **Bona Fide Dues:** A nonprofit organization may deduct the bona fide dues of its members. Bona fide dues are defined as those amounts paid periodically by members solely for the purpose of entitling those persons to continued membership in the club or similar organization. *See* RCW 82.04.4282.

  However, a nonprofit organization may not be eligible for this deduction if, in consideration of the dues, the members receive significant goods or services, or if dues are graduated based on the level of services provided.

  The Department of Revenue has ruled that a nonprofit organization may provide the following significant goods and services without losing eligibility for bona fide due deduction: (1) the provision of newsletters of a general informational nature to members; (2) the conduct of regulatory and legislative liaison or lobbying activities of a nonspecific nature on the behalf of its members; (3) the conduct of conventions and shows for its members; (4) the conduct of meetings and seminars of general and varied interest to its members; and (5) member discounts for goods and services, which will not cause a portion of dues to be taxable if those members are separately charged for the goods and services and the charges are, after discounts, for at least the full cost of the goods and services.

- **Bona Fide Contributions and Donations:** Gifts, contributions, and donations received by a nonprofit organization are not subject to the B&O tax. If the income received is part sale and part gift, the measure of the

B&O tax is the lesser of the selling price or the fair market value of the item sold. The excess of the selling price over the fair market value is a nontaxable donation. *See* RCW 82.04.4282.

- **Initiation Fees:** Initiation fees are deductible. "Initiation fees" means those amounts paid solely to initially admit a person as a member to a club or organization. These fees are only those one-time amounts paid that genuinely represent the value of membership in a club or similar organization. An initiation fee does not include any amount paid for or attributable to the privilege of receiving any goods or services other than mere nominal membership. *See* RCW 82.04.4282.

- **Tuition Fees:** Tuition fees are deductible. "Tuition fees" includes library, laboratory, health service and other special fees, and amounts charged for room and board by an educational institution when the property or service for which such charges are made is furnished exclusively to the students or faculty of such institution. "Educational institution" means only those institutions created or generally accredited as such by the state. An "educational institution" offers to its students an educational program of a general academic nature. *See* RCW 82.04.4282.

- **Daycare:** Charges for the operation of privately operated kindergartens are deductible. The Department of Revenue interprets this deduction to include income received by nursery schools, preschools, day care providers, and privately operated kindergartens for the care or education of children who are under eight years of age and are not enrolled in or above the first grade. A special B&O tax rate of 0.484% exists for those who provide day care services or care of children eight years or older or at the first-grade level or above. *See* RCW 82.04.4282 & 82.04.431.

- **Endowment Funds:** Income from endowment funds is deductible. *See* RCW 82.04.4282.

- **Grants:** Grants received by nonprofit organizations may be deductible from the B&O tax under the bona fide contribution and donation deduction. However, if the grants received are in exchange for significant goods or services, the bona fide contribution and donation deduction does not apply. To qualify a grant for this exemption, the grantee may have to establish that the grantor had a "gratuitous intent" when making the grant.

A grant is presumed nontaxable if three conditions are met: (1) the grantor must receive no significant goods, services or benefits in return for making the grant; (2) the grantee is a nonprofit or governmental organization; and (3) the grant must be used to promote, advance, or fulfill charitable purposes, including related administrative expenses, within the meaning of section 501(c)(3) of the Code.

A safe-harbor provision exists for certain restrictions imposed by the grantor regarding grantee accountability. This provision permits a grantor to place restrictions on the use of the grant for specific charitable purposes and provides that a grantee may submit accountability reports to the grantor regarding the use of the funds or describing the general nature of the project.

Sponsorship or public acknowledgement alone that the grantor provides a grant does not trigger B&O tax liability for the grantee.

Several statutory provisions permit nonprofit research institutions to reduce their potential tax liability. A special B&O tax classification exists for nonprofit organizations that engage in research and development within Washington. The current tax rate is 0.484%. In addition, if a grant is otherwise taxable but services are performed both inside and outside of Washington, a nonprofit can apportion its gross income and pay tax on only the portion attributable to the services performed within the state.

Grants by the federal government to municipal corporations or political subdivisions of the state may be deducted from B&O tax liability.

(e) Health or Social Welfare Organizations

"Health or social welfare organizations" are allowed to deduct grants or fees received from government sources for providing certain "qualifying services."

First, the organization must qualify as a "health or social welfare organization," which requires that the organization meet all of the following requirements (*see* RCW 82.04.431):

- The organization must be either (A) a nonprofit corporation managed by a governing board of not less than eight individuals, none of whom is a paid employee of the organization, or (B) a corporation sole (*See* box above on Requirements Concerning Boards for further discussion.);

- No part of the corporation's income may be paid directly or indirectly to its members, stockholders, officers, directors, or trustees, except in the form of services rendered by the corporation in accordance with its purposes and bylaws;

- Salary or compensation paid to the corporation's officers and executives must be only for actual services rendered, and at levels comparable to the salary or compensation of like positions within the public service of the state;

- Assets of the corporation must be irrevocably dedicated to the activities for which the exemption is granted and, upon liquidation, dissolution, or abandonment by the corporation, may not be dispensed directly or indirectly to the benefit of any member or individual, except a nonprofit organization, association or corporation which would also be entitled to the exemption;

- The corporation must be duly licensed or certified where licensing or certification is required by law or regulation;

- The amounts received qualifying for exemption must be used for the activities for which the exemption is granted;

- Services must be available regardless of race, color, national origin, or ancestry; and

- The Department of Revenue must have access to the corporation's books in order to determine whether the corporation should be exempt.

Second, "qualifying services" are limited to: mental health, drug, or alcoholism counseling; family counseling; health care services; therapeutic, diagnostic, rehabilitative, or restorative services for the care of the sick, the aged, or certain disabled individuals; activities for the prevention of juvenile delinquency or child abuse; care of orphans or foster children; day care of children; employment development, training, and placement; legal services for low-income individuals; low-income weatherization or home repairs; low-income heating assistance; community services to low-income families and groups designed to reduce poverty in a measurable way; or temporary medical housing.

Third, this deduction applies only to amounts the corporation received as compensation for, or to support, health or social welfare services from any of the

following sources: The United States or any instrumentality thereof, or from the State of Washington or any municipal corporation or political subdivision thereof.

Several issues frequently arise surrounding the health or social welfare deduction. If a fee or grant is received from a nongovernmental organization, such as a for-profit organization, a charitable foundation, or another nonprofit organization, this deduction does not apply. The nonprofit corporation must analyze its B&O tax liability under the general rule that permits taxation of grants if those grants are exchanged for services. Any compensation for services from a nongovernmental payer is taxable.

The same analysis applies if a qualifying nonprofit corporation receives a government grant to provide services other than services meeting the definition of "qualified services" described above.

Two recent exceptions were created allowing gross income received through a non-governmental entity — but originating from the state of Washington — to qualify for this deduction: mental health or chemical dependency services under a government funded program; and child welfare services.

Salary or compensation paid to officers and executives must be at levels comparable to the salary or compensation of like positions within the public service of the state. The Department of Revenue has attempted to disqualify an organization from this deduction by showing that the organization's executives were not paid salaries comparable to salaries paid at like positions in the public service.

(f) Deductions for Public and Nonprofit Hospitals and for Community Health Centers

A public hospital district, a nonprofit hospital, a nonprofit community health center, or a network of nonprofit community health centers that qualifies as a health and social welfare organization is allowed to deduct amounts received as compensation for health care services covered under Medicare, Medicaid, Children's Health, and the State of Washington Basic Health Plan. The deduction does not apply to amounts received from patient copayments or patient deductibles.

(g) Deductions for Camps and Conference Centers

The B&O tax does not apply to amounts received by a nonprofit organization from the sale or furnishing of certain items conducted at a camp or conference center conducted on property exempt from property tax. Exempt revenues are

those for lodging, conference and meeting rooms, camping facilities, parking, and similar licenses to use real property; food and meals; and books, tapes, and other products that are available exclusively to the participants at the camp, conference, or meeting and are not available to the public at large. *See* 82.04.363.

(h) Deductions for Childcare Resources and Referral Services

The B&O tax does not apply to nonprofit organizations in respect to amounts derived from the provision of childcare resources and referral services. *See* RCW 82.04.3395.

(i) Deductions for Credit and Debt Services

The B&O tax does not apply to nonprofit organizations in respect to amounts derived from provision of certain credit and debt services. Exempt services include presenting individual and community credit education programs, including credit and debt counseling; obtaining creditor cooperation allowing a debtor to repay debt in an orderly manner; establishing and administering negotiated repayment programs for debtors; or providing advice or assistance to a debtor with regard to the above-noted services. *See* RCW 82.04.368.

(j) Deductions for Group Training Homes

The B&O tax does not apply to income received from the Department of Social and Health Services for the cost of care, maintenance, support, and training of persons with developmental disabilities at nonprofit group training homes. "Group training home" means a facility equipped, supervised, managed, and operated on a full-time basis for the full-time care, treatment, training, and maintenance of persons with developmental disabilities.

(k) Deductions for Student Loan Programs

B&O tax does not apply to gross income received by nonprofit organizations that are guarantee agencies under the federal guaranteed student loan program, that issue debt to provide or acquire student loans, or that provide guarantees for student loans made through programs other than the federal guaranteed student loan program. Qualifying organizations are nonprofit organizations exempt from federal income tax under section 501(c)(3) of Code. *See* RCW 82.04.367.

(l) Deductions for Nonprofit Boarding Homes

The B&O tax does not apply to amounts received by a nonprofit boarding home for providing room and domiciliary care to residents of the boarding home. "Domiciliary care" means assistance with activities of daily living, health support services, or intermittent nursing services, any of which may be provided by the boarding home either directly or indirectly. "Nonprofit boarding home" means a boarding home that is operated as a religious or charitable organization, is exempt from federal income tax under section 501(c)(3) of the Code, is incorporated under RCW 24.03, is operated as part of a nonprofit hospital, or is operated as part of a public hospital district.

CHAPTER 57. Local Licensing and Local B&O Taxes

State law permits cities to impose a local business and occupation tax. Fifty Washington cities assess such a tax, including Seattle, Tacoma, Bellevue, Bellingham, Everett, and Olympia. Each city administers its business and occupation tax independently.

Most cities imposing a local B&O tax follow the state-level definitions of activities such as manufacturing, wholesaling, retailing, and services. However, cities offer far fewer exemptions and deductions to their local B&O tax than Washington State does. Moreover, unlike the state-level tax, local B&O taxes are true "gross receipts" taxes and are essentially taxes on the "privilege" of doing business within the city rather than taxes on the actual business activity conducted within the city. Consequently, cities often impose a B&O tax on activities with only minimal connection to specific business activities conducted within the taxing city.

Most cities with a local B&O tax typically exempt the activity of nonprofits, with the exception of retailing activity, which is subject to tax. The City of Seattle is a notable exception to this rule and subjects more nonprofit activities within its borders to different tax classifications. Because cities have broad freedom to define their local B&O taxes differently from the state, and thus offer different exemptions and deductions, it is advisable to review the local tax code for any city in which an organization has activity.

Even if an organization has otherwise taxable activity, many cities have established an annual minimum gross receipt threshold that must be reached before any tax is due.

Many Washington cities impose other requirements, such as the need for a business license, or impose other purely local taxes, such as the admissions tax, which is a local sales tax on tickets. Nonprofits should contact the finance office of any cities in which they have activities to verify the specific local licensing and tax requirements.

CHAPTER 58. Retail Sales Tax Issues for Nonprofit Organizations

Washington imposes a tax upon the sale of any article of tangible personal property to consumers and certain services performed for consumers. *See* RCW 82.08. This is the retail sales tax, which is imposed upon the same activities subject to the Retailing B&O tax. Therefore, unless an exemption applies, nonprofit organizations should collect the retail sales tax on all sales of tangible personal property and any services that fall within the definition of retailing.

a. Exemptions (*See* RCW 82.08.0203-82.08.036, WAC 458-20-190 for Exemptions.)

The following sales are exempt from the retail sales tax:

- Sales to the Red Cross
- Sales of food products for human consumption; this exemption applies only to certain food products that are not sold for immediate consumption on the premises
- Sales to artistic or cultural organizations of certain objects acquired for exhibition or presentation, including objects of art and objects to be used in presenting cultural exhibitions or performances
- Certain fundraising activities
- Dues or membership fees paid to nonprofits that do not operate a health or fitness facility, such as an aquatic facility for swimming, gun clubs or gun ranges, or skating facility
- Sales of medical supplies, chemicals, or materials to a blood, bone, or tissue bank, comprehensive cancer center, or organ procurement organization
- Sales of lodging, meals, and books at a nonprofit camp or conference center

- Sales of drugs for human use pursuant to a prescription
- Sales of certain medical items such as prosthetic devices, medically prescribed oxygen, osmotic items, and disposable devices used to deliver drugs for human use
- Sales of meals provided to senior citizens, disabled persons, or low-income persons by a nonprofit organization
- Sales of emergency lodging for the homeless
- Purchases of items for resale, including items resold as part of fundraising events

b. Collection of Sales Tax

The seller acts as the collection agent for the state in collecting the retail sales tax. A seller commits a misdemeanor if it fails to pay collected retail sales taxes to the state by the due date. If a seller fails to collect the required tax on a taxable transaction, the tax remains a debt owed by the buyer to the seller and the seller becomes personally liable for the uncollected tax to the state.

c. Rates

On the Washington State Combined Excise tax return, filers must use four-digit location codes to source local sales or use taxes to the correct jurisdiction. The Department of Revenue quarterly publishes the Local Sales and Use Tax Flyer that contains the codes, rates, and reports of recent changes. The flyer appears on the Department of Revenue website.

CHAPTER 59. Use Tax Issues for Nonprofit Organizations

Washington imposes a tax on the user of any article of tangible personal property or certain services acquired by purchase or gift where the user or donor has not paid the retail sales tax.

a. Rates and Reporting

The use tax rates are the same as the combined state and local portions of the retail sales tax.

Nonprofits are required to accrue and remit their use tax obligations on the Combined Excise Tax Return, the same form used to pay the B&O tax and remit

collected sales tax. Smaller organizations that are not required to be registered with the Department of Revenue can remit their use tax obligations on the Consumer Use Tax Return, which is available from the Department of Revenue.

b. Liability When No Sales Tax Is Collected

Most nonprofit organizations, like most other consumers and businesses, have contingent use tax liabilities (taxes owed) for small items purchased from sellers who do not collect the sales tax, such as:

- Computer equipment, computer parts, software licenses, and software purchased from out-of-state sources
- Purchases from small in-state unregistered service providers such as contractors, landscapers, and information technology service providers
- Any mail-order catalog items
- Items purchased over the internet
- Fixed assets shipped into Washington from a seller outside of Washington who does not collect the retail sales tax
- Magazine and periodical subscriptions
- Office supplies, if purchased from out-of-state sources

c. Donations of Property

The use tax does not apply to any item of tangible personal property that has been donated to the nonprofit charitable organization or state or local governmental entity, when used by that nonprofit charitable organization or state or local governmental entity. *See* RCW 82.12.02595.

The use tax does not apply to the donation of tangible personal property without intervening use to a nonprofit charitable organization, or to the incorporation of tangible personal property without intervening use into real or personal property of or for a nonprofit charitable organization in the course of installing, repairing, cleaning, altering, imprinting, improving, constructing, or decorating the real or personal property for no charge. For example, a lumber yard can buy lumber exempt from sales tax as a retailer for resale of lumber, and then donate lumber to Habitat for Humanity and this exemption would apply, resulting in

Habitat for Humanity not having to pay a use tax. If a consumer bought lumber from the lumber yard, paid the sales tax on the lumber, and then donated it to the nonprofit, there would be an intervening use. In this situation, there would also be no use tax because the consumer paid a sales tax on the lumber when they purchased the lumber, therefore the exemption is not necessary to avoid the use tax.

d. Donations of Retailing Services

The use tax does not apply to labor and services rendered in respect to installing, repairing, cleaning, altering, imprinting, or improving personal property provided to the charitable organization at no charge, or to the donation of such services. *See* RCW 82.12.02595.

The use tax does not apply to the donation of amusement and recreation services without intervening use to a nonprofit organization or state or local governmental entity, or to the subsequent use of the services by a person to whom the services are donated in furtherance of the purpose for which the services were originally donated.

e. Real Estate Excise Tax Issues

Washington imposes a transfer tax on the sale of real property including leasehold improvements, and certain transfers of 50% or more of the ownership interest in entities that own the real property.

Nonprofit organizations, even if exempt from real or personal property taxes, are nevertheless subject to the real estate excise tax unless the transaction is otherwise specifically exempt.

There are numerous exceptions to the real estate excise tax, including:

- Gifts of real property
- Transfers of real property that consist of a mere change in the identity or form of ownership
- Transfers of real property that, for federal income tax purposes, do not involve the recognition of gain or loss for the purposes of entity formation, dissolution, or reorganization

CHAPTER 60. Property Tax Issues

Washington exempts qualifying nonprofit organizations from the payment of (*see* RCW 84.36):

- Real property taxes
- Personal property taxes
- Leasehold excise taxes: The leasehold excise tax is a 12.84% tax on leasehold interests in publicly owned real or personal property. The tax base is measured by the amount paid for the use of the property. If a nonprofit organization receives the use of donated property, the tax base is the fair market value of the rent on similar property.

a. Exemptions Limited to Certain Nonprofit Activities

Not all nonprofit organizations qualify for exemption from payment of property taxes. *See* RCW 84.36. Exemptions are only allowed for specific types of activities. Qualifying activities include those involving:

- Public property
- Cemeteries, churches, parsonages, convents, and religious grounds
- Property used for character-building, benevolent, protective, or rehabilitative social services, camp facilities, veteran or relief organization-owned property, and property of nonprofit organizations that issue debt for student loans or that are guarantee agencies
- Administrative offices of nonprofit religious organizations
- Nonprofit organizations engaged in procuring, processing, etc., blood, plasma or blood products
- Nonprofit organizations' property connected with operation of public assembly halls or meeting places
- Nonprofit day care centers, libraries, orphanages, homes or hospitals for the sick or infirm, and outpatient dialysis facilities
- Nonprofit homes for the aging

- Nonprofit organizations' property used in providing emergency or transitional housing for persons with developmental disabilities
- Nonprofit organizations' property used in providing emergency or transitional housing to low-income homeless persons or victims of domestic violence
- Nonprofit organizations' property available without charge for medical research or training of medical personnel
- Nonprofit cancer clinics or centers
- Nonprofit organizations' property used for transmission or reception of radio or television signals originally broadcast by governmental agencies
- Nonprofit homeownership development organizations
- Schools and colleges
- Artistic, scientific, and historical collections and property used to maintain such collections; property of associations engaged in the production and performance of music, dance, art, etc.
- Property to be used for an exempt purpose in the future
- Fire engines, implements, and buildings of cities, towns, or fire companies
- Property owned by humane societies
- Water distribution property owned by nonprofit corporations or cooperative associations
- Property owned or used for sheltered workshops for disabled people

b. Application for Exemption

A nonprofit organization must apply in advance of receiving an exemption for property taxes and renew its exemption with the Department of Revenue by March 31 of each year. *See* Department of Revenue website on property tax exemption for nonprofit organizations.

Once exempt, the property must be exclusively used for its exempt purpose. As a general rule, the loan or rental of all or a portion of the exempt property does not subject the property to property taxes if:

- The rents or donations received for the use of the property are reasonable and do not exceed the maintenance and operation expenses attributable to the portion of the property loaned or rented; and

- The property would be exempt from tax if owned by the organization to which it is loaned or rented.

If exempt property is loaned or rented, the tax-exempt status of the property will not be affected if:

- The property is loaned or rented for a period of 15 consecutive days or less;

- The property is loaned or rented to another nonprofit organization, association, or corporation that would qualify for exemption if it owned the loaned or rented property; and

- All income received from the rental is devoted exclusively to the exempt purpose of the nonprofit organization that receives the tax exemption.

If the property is loaned or rented and the lessor or lessee intends to produce revenue from the loan or rental, the property loses its exemption. Property loaned or rented, and intended to produce revenue, must be segregated and taxed whether or not the revenue is devoted to exempt purposes.

Over the last few years, a standardized exception was created for nonprofit organizations if they want to rent or loan their property to the public. Nonprofits can now loan or rent their exempt property to individuals and organizations for non-exempt purposes up to 50 days in a year, as long as the rent or donation received for the use does not exceed the maintenance and operations costs attributable to the property. Of the 50 days, a maximum of 15 days can be spent for profit or to promote business purposes, with no limitation on the amount of rent or donation received. Days that immediately precede or follow an event do not count towards the 50 or 15 day allowances, if only used for set-up or take down activities. (Rental income may be subject to Business and Occupation Tax as discussed in CHAPTER 57)

The use of exempt property for "fundraising" activities sponsored by an exempt nonprofit organization does not subject the property to taxation if the fundraising activities are consistent with the purposes for which the exemption was

granted. "Fundraising" means any revenue-raising activity, limited to less than five days in length, that disburses 51% or more of the profits realized from the activity to the exempt nonprofit organization conducting the fundraising.

CHAPTER 61. Further Information

More information on Washington taxes may be obtained by contacting the Department of Revenue, as follows:

State of Washington
Department of Revenue
Taxpayer Information and Education
Telephone: 1-800-647-7706

The Department of Revenue also maintains an internet site with access to laws, rules, forms, and the Department's topical publications and notices. The address is https://dor.wa.gov/doing-business/business-types/industry-guides/nonprofit-organizations.

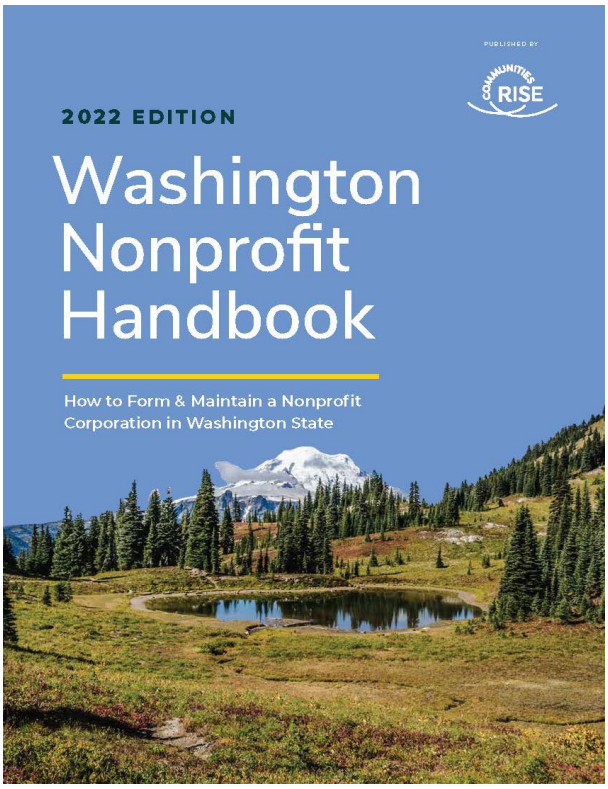
More information on local business and occupation taxes and licensing issues may be obtained by contacting the finance office of the city in question.

The following resources are available online at the listed sites:

- **Revised Code of Washington (RCW):** The best and most readily searchable Revised Code of Washington is available through the website for the Washington State Legislature. The RCW on excise taxes is located at http://app.leg.wa.gov/rcw/default.aspx?cite=82.

- **Washington Administrative Code:** The best and most readily searchable Washington Administrative Code is available through the website for the Washington State Legislature. It is located at https://app.leg.wa.gov/wac/.

- **Taxpedia:** Taxpedia is the free state tax research service from the Department of Revenue. It provides access to laws, rules, advisory bulletins, precedents from the Department's Appeals Division, the Board of Tax Appeals, and the courts. It is located at http://taxpedia.dor.wa.gov.



PART 9 FISCAL SPONSORSHIPS, JOINT VENTURES AND OTHER COLLABORATIONS

Chapter 62 Working With Others
Chapter 63 Fiscal Sponsorships
Chapter 64 Joint Ventures And Other Contractual Collaborations

PART 9. FISCAL SPONSORSHIPS, JOINT VENTURES AND OTHER COLLABORATIONS

CHAPTER 62. Working With Others

It is often advantageous, for financial or programmatic reasons, to work with other organizations to further your own organization's objectives. A successful collaboration can result in cost savings and improved efficiency for your organization and can provide access to needed skills and resources. In arranging these relationships, however, you must take care not to jeopardize your organization's tax-exempt status by ceding too much control to others or by unwittingly furthering noncharitable purposes. The following chapters outline two common ways in which organizations work with others: through fiscal sponsorships and contractual collaboration (including joint ventures). For a discussion of nonprofit mergers and consolidations, *see* CHAPTER 83.

CHAPTER 63. Fiscal Sponsorships

Sometimes, when one or more individuals begin conducting charitable activities, start up a new organization or conduct a one-time or short-term project, they find that they need tax-exempt status to receive donations and grants to continue the work. Fiscal sponsorship is a way for that new project or organization to have the advantages of tax exemption without having to apply to the IRS for its own 501(c)(3) tax-exemption status. In a fiscal sponsorship, a 501(c)(3) organization ("Sponsor" or "sponsoring organization") enters into an agreement with another organization or group that does not have tax-exemption ("Sponsored organization"), in which the Sponsored Organization can be covered by the Sponsor's tax-exemption. This gives a Sponsored Organization the opportunity to take advantage of the benefits of having 501(c)(3) tax-exemption before it has its own tax-exemption. For example, organizations who haven't applied for their own tax-exemption yet, or are in the process of applying, may be fiscally sponsored so that they can carry out charitable activities and have the benefits of being covered under the sponsoring organization's tax-exempt status. Sometimes this arrangement is referred to as a "fiscal agency." However, this term should not be used to describe this type of relationship, because it implies control by the sponsored organization over the sponsoring organization and is disfavored by the IRS.

There are two main reasons that nonprofit organizations seek 501(c)(3) status. First, many donors give money to tax-exempt organizations with the expectation of taking a charitable deduction for their donations on their federal income taxes.

Some organizers of projects cannot attract these donors because their projects have not been qualified as tax-exempt (and may never be). Second, usually grant-making entities, such as foundations and government entities, have policies or legal constrictions that require that grants be made only to 501(c)(3) tax-exempt organizations that are public charities. To gain access to those revenue sources, organizers of a particular project can establish a fiscal sponsorship with a 501(c)(3) organization.

The Sponsor in a fiscal sponsorship agrees to receive and disburse funds for the project on behalf of the sponsored organization. Donations are made directly to the sponsoring organization, which runs the funds through its books and includes the funds as part of its income on its reports to the IRS. Subsequent disbursements are then made to, or on behalf of, the sponsored organization. An administrative fee is usually paid to the sponsor by the sponsored organization.

In Revenue Ruling 68-489, 1968-2 C.B. 210, the IRS set forth the following three guidelines for fiscal sponsorship arrangements to ensure that such arrangements are not used to circumvent laws governing charitable giving:

(1) The sponsored project must further one or more of the charitable purposes of the sponsor. The sponsor should determine not only that the project will further a specific charitable purpose of the sponsor, but also that the sponsored project, or the legal entity or organization accepting funds for the sponsored project, will not engage in any other activities that might jeopardize the sponsor's tax-exempt status. For example, the fiscal sponsorship agreement should prohibit political activities and restrict lobbying activities during the term of the fiscal sponsorship.

(2) The sponsoring organization must maintain records establishing that the funds were actually used for such charitable purpose. The sponsor should establish procedures in the agreement for ongoing oversight of the sponsored organization. For example, the sponsoring organization may require periodic reports regarding the use of funds disbursed for the sponsored project. The level of oversight and control can vary from regular reporting obligations for the sponsored organization to the direct submission and payment of invoices for the sponsored project by the sponsor.

(3) The sponsor must retain control and discretion (described as "complete discretion and control" in related IRS rulings) over the use of the funds. In other words, the sponsor must make disbursements for the sponsored project as if the

sponsor is undertaking the project as part of its own operations and is solely legally and financially responsible.

These guidelines reflect the IRS prohibition of a "conduit" transaction. A donor could not make a deductible donation directly to the sponsored organization, since it does not have tax-exempt status. Thus, if a donation is made to the sponsor with a requirement that it be disbursed for the sponsored project (i.e., the donation is "earmarked"), the IRS deems that the donation has been made to the non-exempt sponsored project and no deduction is allowed. This is a conduit transaction. To avoid this "pass through" characterization, the sponsor must have discretion to refuse to disburse funds if the sponsored project engages in any activities that would be prohibited for the sponsor as a tax-exempt organization or uses the funds for purposes other than to implement the agreed-upon sponsored project.

All parties should realize that in a fiscal sponsorship there are actually two levels of granting. In the first level, the donor agrees to make a grant to the sponsor, usually provided certain conditions are satisfied. In the second level, the sponsor agrees to support the sponsored project, again provided certain conditions are satisfied. Thus, the sponsor is responsible for satisfying any requirements of the original donor, and the sponsored project is responsible for satisfying the requirements of the sponsoring organization. This means that the sponsoring organization must agree to the fiscal sponsorship of the sponsored project that gives the sponsor complete discretion and control over any funds prior to accepting any funds for the sponsored project

What should be in a Fiscal Sponsorship Agreement?

The agreement between the sponsoring organization and the sponsored organization should be in writing and should set forth:

- A description of the project and the charitable purpose(s) of the sponsoring organization it furthers;
- Any performance requirements for the project;
- Prohibited and restricted activities of the sponsored organization and project;
- When and how donations will be solicited and whether there will be any restrictions on solicitations (to avoid situations where multiple requests are made to the same source);

- A description of how the sponsor will account for the funds to be made available to the sponsored project;

- When and how donations will be remitted to the sponsoring organization, and how the funds will be held and disbursed to the sponsored project;

- Responsibility for providing acknowledgments and receipts to donors;

- The extent to which the sponsoring organization, the sponsored organization, and the project will be identified in promotional materials;

- Clarification of employment and/or supervisory relationships for any personnel involved in the project;

- Timing and nature of financial reports from the sponsoring organization to the sponsored organization;

- Timing and nature of project reports from the sponsored organization to the sponsoring organization;

- The amount of any administrative or other fees charged by the sponsoring organization (either as a fixed fee or a percentage of funds received) and how such fees will be paid;

- The duration of the fiscal sponsorship;

- Indemnification and insurance provisions; and

- Events of and remedies for default, including specifically the ability of the sponsoring organization to cease making disbursements, demand return of funds, or terminate the fiscal sponsorship arrangement if the fiscal sponsorship conditions are not satisfied or if the sponsoring organization's tax-exempt status is in any way jeopardized by the relationship with the sponsored organization.

For a discussion on whether to seek fiscal sponsorship for your organization, *see* CHAPTER 3.

CHAPTER 64. Joint Ventures and Other Collaborations

Sometimes a donor may not want to just make a grant of funds to a nonprofit organization, but nonetheless wants to collaborate with the organization in furthering its charitable purpose. Or there may be an instance where organizations

with compatible missions desire to collaborate to further a charitable purpose. One organization may be seeking financing or resources for an exempt-related project and looking for different ways to attract private partners. There are two basic models of collaboration: project-specific, where the two organizations partner to fulfill a specific project or goal; and comprehensive, where organizations partner to fulfill a comprehensive set of shared goals. In either of these cases, there may be risks to the organization's tax exemption.

In order for an organization to qualify for tax exemption under Code section 501(c)(3), it must be organized and operated exclusively (generally interpreted to mean "substantially") for charitable purposes. Where a collaboration is with a for-profit entity, the concern is that the participation of a private partner in a venture with a tax-exempt entity significantly increases the likelihood that the venture will undertake activities that are outside of the organization's charitable purpose (and that the tax-exempt organization may lack sufficient control over the venture to prevent such activities). It is also critical to section 501(c)(3) qualification that no part of the tax-exempt organization's earnings inure to the benefit of a private individual and that such organization serve a public interest rather than a private interest, which is more difficult to do when operations and economics become interrelated in a joint venture or other collaboration. When forming a collaboration with a private partner, it is important to guard against unrelated business income and illegal shelters of taxable income. For more information, *see* Part 4 Maintaining Federal Tax Exemption of your 501(c)(3) Organization.

Regardless of the form of the collaboration, the two organizations should, as in any partnership, enter into a written agreement that sets forth their respective rights and obligations. Some of the more important details to consider in forming any type of partnership, which should be included in a written agreement between the two organizations, include (in no specific order):

a. Vision/Goals

Both parties should share the same vision, expectations, and goals with respect to their participation in the partnership, which need to be clearly defined from the outset. Why does each of the parties want to participate in this partnership? Does the partner organization have a primary interest in furthering your organization's purposes? Does it have other interests, such as attracting positive public recognition? Does the partner organization have any goals that conflict with those of your organization? Any private partner with your tax-exempt organization should understand that the written agreement between the parties will specify that

making sure the venture operates in furtherance of the tax-exempt organization's purposes must override the desire to produce profit. Can either organization pursue other goals without the partner organization? Will either organization object to having its name associated with the other organization in areas in which the two organizations are not collaborating?

b. Control and Decision Making

After establishing a shared vision and goals, the issue of control is probably the most important factor. If an organization aspires to be a tax-exempt entity, all decisions must be made in furtherance of charitable purposes. If the organization yields too much decision-making control to a partner organization, even another nonprofit, there is a risk that some decisions will not further charitable purposes and this can jeopardize tax-exempt status.

At a minimum, the terms of the agreement should allow an organization to terminate or limit involvement in the partnership to protect its tax-exempt status at any time. Consider carefully which organization gets to make decisions over which issues, including, for example, program design and implementation and funding priorities.

It is also important to consider how decisions are made. The organization could, for example, dedicate a governing or advisory board seat to a representative from the other organization. Alternatively, it could agree that certain decisions will require the approval of both organizations or could establish an entirely new entity in which both organizations participate. Well-defined decision-making processes that require transparency, and a process for resolving inevitable disagreements is essential. The agreement should also state whether and how any additional parties may join as partners.

c. Capitalization and Distribution

If the partner organization is providing funding, the agreement needs to state clearly what this funding will cover. A project budget that specifies the sources and uses of all funds should be attached as an exhibit to the agreement, and the agreement should state whether and how the budget may be modified. The agreement should specify the extent to which funds are discretionary or restricted. It should also specify the extent to which additional fundraising or capitalization is required, how funds will be distributed or disbursed as between the two organizations, whether any costs are to be covered by others, and whether there are

in-kind contributions or previously dedicated funds that need to be calculated when determining the respective contributions of the partners.

In general, the ownership interest of the parties in the venture should be proportionate to the value contributed. When contracting with a donor, the agreement should state the purposes for which funds may be used, the circumstances or conditions under which funds will be disbursed (such as whether certain milestones must be accomplished) and whether there are any circumstances under which funds would have to be returned (for example, for breach of the agreement). Determine whether the organization's books and records will be subject to review and/or audit by the funding organization.

d. Implementation

Implementation issues include identification of each partner's respective roles and responsibilities. What are the strengths and expertise of each partner in areas such as fundraising, political savvy, public relations, and staff support? To what extent will each partner be involved in day-to-day operations? Will some responsibilities be shared and others carried out by only one of the organizations? What is the time frame for implementation? Can any responsibilities be assigned or subcontracted?

e. Communication

Who speaks for each organization and in what ways? How do the two organizations communicate between themselves? How do they communicate with third parties and the public?

f. Accountability

What standards will the organization utilize to measure respective responsibilities? How will it measure progress towards your collective goals? What specific targets or benchmarks are important to acknowledge? What reporting and monitoring standards and procedures will it utilize, for example, in areas of accounting, project implementation, audit and evaluation? How frequent will these reports be?

g. Intellectual Property Rights

Which entity will own materials created during the course of the collaboration? Can those materials be used by third parties? What will become of those materials upon termination of the partnership? Will the collaboration result in the use or

creation of any trade names or marks? Which entity organization is entitled to use those during and upon the termination of the partnership?

h. Taxes, Indemnification and Insurance

Which of the two organizations will be responsible for receiving funds and reporting the funds as income? Will either organization be responsible for employment taxes? Will any insurance requirements be imposed on either organization (liability, medical, travel, life, etc.)? Will either organization be required to secure additional insurance? Will one party indemnify the other?

i. Duration

How long will the partnership last? Under what circumstances can the partnership be terminated before the agreed-upon termination date (for example, loss of funding or breach of the agreement)? What are the consequences? Will either organization owe money to the other? Will the organization agree in advance to an alternative dispute resolution process, such as mediation or arbitration, in the case of litigation?

j. Recognition/Visibility

What type of recognition will each organization receive? Will the organization acknowledge each other in written materials or on their respective websites? Will press releases be sent out? What other type of public recognition will be required?

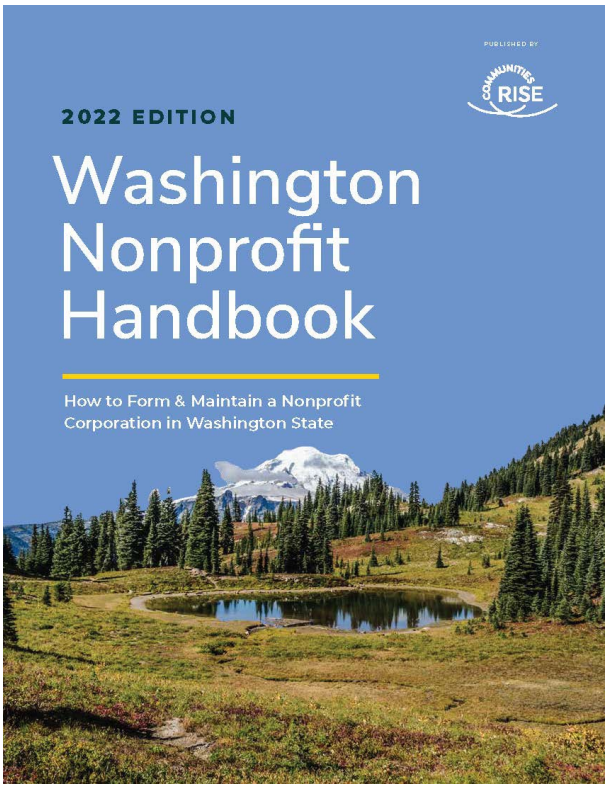
k. Shared Services, Facilities, and Personnel

Which organization's employees will be responsible for overseeing the project? How will they be paid and who will supervise them? Will either party have access to or use of the other's facilities or equipment? Any agreement to share services or facilities between a tax-exempt organization and a private partner must be at arm's-length and must justify the reason for the sharing arrangement, for example economies of scale.

As should be apparent from the foregoing list, there are many issues to be resolved in forming a partnership. Although the foregoing list is a good point of departure for discussing a potential collaboration, consider consulting with an attorney and/or accountant before embarking on any such enterprise to ensure that the organization's legal and financial interests are protected in writing.

Skilled advisors will also be able to tell you whether it makes sense to create a separate entity (usually a subsidiary of your organization) to enter into the agreement with a partner. The rules governing subsidiary organizations are complex, and a number of different types of subsidiary organizations can be created (for example, a corporation, partnership or limited liability company) depending on the specific circumstances of the organization and what it is hoping to accomplish. If properly formed and maintained, a subsidiary can be used to shield the organization from potential tax liability and from jeopardizing its tax-exempt status were the partnership to engage in activities that do not further the organization's charitable purpose, and it can also protect the organization from contractual and other types of liability by shielding the organization's other assets.

Communities Rise and Communities of Opportunity produced a Community Collaboration Toolkit (2022), which is a resource for community organizations who are partnering on a particular project. The toolkit includes a Community Collaboration Agreement Template that community organizations can edit and make their own, and addresses many of the issues listed above.



PART 10 EMPLOYMENT ISSUES

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PART 10. EMPLOYMENT ISSUES

CHAPTER 65. Application of Employment Law to Nonprofits

There is an increasingly complex labyrinth of common law and statutory requirements at the federal, state, and local levels, which governs the employer-employee relationship. As a general rule, nonprofit organizations are not exempt from these laws. The array of employment law compliance issues facing nonprofit employers is far too extensive and complex to cover in detail in these materials. This part, however, highlights areas of employment law with which every nonprofit employer should be familiar. For specific advice, consult an attorney.

Nonprofit employers may also want to consider retaining one of several organizations that provides human resources support. For a fee, such organizations can in effect serve as an external human resources department. Because they are knowledgeable of employment practices, they can help maintain proper personnel files, assist with tailoring of benefits and employer policies, and advise on any employee-relations matters that do not require legal advice.

CHAPTER 66. Classification of Workers

a. "Volunteer" Versus "Employee"

Because nonprofit organizations often rely on volunteers for responsibilities that might be performed by employees in a for-profit organization, it is extremely important that the nonprofit employer understands how "volunteers" differ from "employees" under the law. Generally speaking, a person is considered a volunteer if they perform services freely for an organization without any expectation of, or receipt of, compensation for their services.

The Washington Minimum Wage Act ("WMWA"), Chapter 49.46 RCW, expressly exempts from its coverage volunteer work for nonprofit organizations.[1]

The statute provides as follows:

> "Employee" includes any individual employed by an employer

[1] Nonprofit employers are also subject to the federal Fair Labor Standards Act ("FLSA") if they have at least two employees and an annual business volume of $500,000, or operate as hospitals, health care providers, schools, or preschools. The FLSA definition of "volunteer" is substantially similar to the definition under Washington law. Note that the guidance from the federal Wage and Hour Division also clarifies that individuals may not "volunteer" for any commercial activities run by a nonprofit organization, such as a gift shop.

but shall not include:

. . . .

(d) Any individual engaged in the activities of an educational, charitable, religious, state or local governmental body or agency, or nonprofit organization where the employer-employee relationship does not in fact exist or where the services are rendered to such organizations gratuitously.

See RCW 49.46.010(3) (emphasis added).

The Washington Department of Labor and Industries has issued an Administrative Policy Statement listing the criteria for whether workers are truly volunteers exempt from the WMWA:

- Individuals will be considered volunteers only where their services are offered freely and without pressure or coercion, direct or implied, from an employer.

- Individuals who volunteer or donate their services, usually on a part-time basis, for public service or for humanitarian objectives, not as employees and without contemplation of pay, are not considered employees of the entities that receive their services.

- [I]f [volunteers] are paid for their services beyond reimbursement for expenses, reasonable benefits, or a nominal fee, they are employees and not volunteers. Individuals do not lose their volunteer status if they receive a nominal fee or stipend.

- An individual will not be considered a volunteer if they are otherwise employed by the same agency or organization to perform similar or identical services as those for which the individual proposes to volunteer.

See Minimum Wage Act Applicability, Admin. Policy No. ES.A.1, at 3-4 (rev. ed. 2020), https://www.lni.wa.gov/workers-rights/_docs/esa1.pdf.

Under the WMWA, any individual providing services as a volunteer who then receives wages for the same type of services is no longer exempt and must be paid at least minimum wage, and overtime pay for hours worked in excess of 40 hours per workweek. In this case, an employee-employer relationship is deemed to exist, and unpaid employment is unlawful.

However, individuals do not lose their volunteer status if they receive a nominal fee or stipend. A nominal fee is not a substitute for wage compensation and must not be tied to productivity. An individual who volunteers to provide periodic services on a year-round basis may receive a nominal monthly or annual fee without losing volunteer status. An employer should make sure that any "volunteering" is truly voluntary.

Nonprofits often are tempted to allow employees to volunteer for the organization. Although non-exempt employees of a nonprofit may in narrow circumstances volunteer for the organization without violating wage-hour rules, this is a risky proposition. The nonprofit can be held liable for unpaid wages and penalties if the volunteer activity would be determined by the Department of Labor to be regular work. For that reason, a prudent practice for nonprofits is to bar non-exempt employees from volunteer activities and pay them for all time spent on tasks related to the organization. For example, a non-exempt program staff member may want to volunteer and help check in attendees at a fundraising event. If the employee has nothing to do with fundraising and is not required to attend the fundraiser as part of their job, it may be permissible to allow them to volunteer at the fundraiser if all of the requirements below are met. However, almost every employee of a nonprofit has a range of responsibilities that may not have clear boundaries. In this example, it would be safer to pay the employee for their time at the fundraiser.

Any nonprofit that permits non-exempt employees to volunteer for the organization must avoid any implication that volunteering is a requirement of the job. An employer whose non-exempt employees also volunteer should make sure that:

- The services are entirely voluntary (without contemplation of pay), there is no coercion to volunteer, and no penalty for not volunteering;
- The activities are predominately for the employee's benefit;
- The employee does not replace another employee while volunteering;
- The activity does not take place during the employee's regular working hours; and
- The volunteer time is insubstantial in relation to the employee's regular hours.

Whether using employee volunteers or non-employee volunteers, nonprofit employers should strongly consider drafting a short form that a volunteer must sign before they begin volunteering. The employee volunteer form should incorporate the first, second, and fourth points above, and the non-employee volunteer form should include point 1 above.

Many nonprofit organizations also hire unpaid interns. It is generally permissible for nonprofits to have unpaid interns so long as the individuals qualify as "volunteers" (i.e., are free from control and have no expectation of payment) or they meet all six criteria listed below to be exempt from minimum wage law:

- The internship, though it includes actual operation of the facilities of the employer, is similar to training that would be given in an educational environment;
- The internship experience is for the benefit of the intern;
- The intern does not displace regular employees but works under close supervision of existing staff;
- The employer that provides the training derives no immediate advantage from the activities of the intern, and on occasion its operations may actually be impeded;
- The intern is not necessarily entitled to a job at the conclusion of the internship and
- The employer and the intern understand that the intern is not entitled to wages for the time spent in the internship.

If, however, an intern is paid more than a nominal stipend or expense reimbursement, then he or she will be considered an employee who is entitled to wages and overtime pay in accordance with the WMWA. *See* Wash. State Dep't of Labor & Indus., Unpaid Internships 101, https://www.lni.wa.gov/forms-publications/F700-173-000.pdf (last visited Sept. 22, 2021); *see also* CHAPTER 77 for a discussion regarding ownership of intellectual property created by volunteers or interns.

b. Independent Contractor Versus Employee

A person who performs services for an organization with an expectation or understanding that they will be paid for services is in most circumstances deemed to

be an employee. This is virtually always the case if the individual is providing services that are part of the organization's regular business and mission. Independent contractor relationships are an exception to the general presumption of employment and arise when an organization retains the services of an outside person or business to perform some specific task at a designated price. An example would be a nonprofit organization's retention of a painter to refurbish its offices or a computer consultant to install new software.

Unfortunately, the distinction between employees and independent contractors is frequently misunderstood, with the consequence that organizations and workers believe they may choose whether the workers will be considered employees or independent contractors. This is not the case. Legal standards determine which classification applies to any given relationship. Because of an increasing focus on enforcement of legal standards and the costly consequences of misclassification (claims for wages, tax violations, etc.), the following information outlines the rigorous standards for establishing an independent contractor relationship and demonstrates why most individuals working for a nonprofit are employees.

The tests for determining an individual's status vary according to the applicable law. Under both federal and state law governing minimum wages and overtime, the Fair Labor Standards Act ("FLSA") and WMWA, respectively, courts use an "economic reality" test to determine whether the worker is an employee. For most other purposes, such as income tax withholding, courts apply the "right of control" test. While a person could be deemed an employee for purposes of the FLSA but not for other purposes, such cases are rare. Employers should carefully review these factors to ensure that its independent contractors are appropriately classified.

(i) "Economic Realities" Test

For purposes of the WMWA and the FLSA, the proper test for determining whether a worker is an employee or independent contractor is the "economic realities" test. The economic realities test asks "whether, as a matter of economic reality, the worker is economically dependent upon the alleged employer or was instead in business for himself." *See Anfinson v. FedEx Ground Package Sys. Inc.*, 174 Wn.2d 851, 871, 281 P.3d 289 (2012) (citation omitted). Although the facts may be applied differently in each case, in general, the following non-exhaustive list of factors are considered in determining the proper classification:

- The degree of the alleged employer's right to control the manner in which the work is to be performed

- The alleged employee's opportunity for profit or loss depending upon their managerial skill

- The alleged employee's investment in equipment or materials required for their task, or their employment of helpers

- Whether the service rendered requires a special skill

- The degree of permanence of the working relationship

- Whether the service rendered is an integral part of the alleged employer's business

(ii) "Right of Control" Test

The test for determining whether a worker is an employee for purposes of income tax withholding, social security tax contributions and ERISA coverage is whether the employer has "the right to control the manner and means by which the work is accomplished."

An individual is considered an employee when the person or entity for whom they perform services has the right to control and direct the services, the result to be accomplished, and the details and means by which that result is accomplished. It is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if the employer has the right to do so. However, if an individual is subject to the control or direction of another merely as to the result to be accomplished and not as to the means and methods for accomplishing the result, they are an independent contractor. To return to the example above, a nonprofit can decide what color to repaint its office, but because the painter has control of the means and methods to complete the task, they are considered an independent contractor.

A court will consider the following factors in determining whether the "right of control" test is met:

- **The Skill Required to Perform the Work**. Workers who perform highly skilled work or work that requires specific training or education are more likely to be considered independent contractors than workers who do not have specific or specialized training work.

- **Who Provides the Tools and Materials to Accomplish the Work**. If the hiring party provides the tools and materials, this favors a conclusion that the worker is an employee. If the worker provides their own tools and materials, this favors a conclusion that the worker is an independent contractor.

- **Whether the Work Is Performed at the Employer's Business**. If a worker must perform the work at the hiring party's place of business, this favors a conclusion that the worker is an employee.

- **The Duration of the Relationship Between the Parties**. The longer the duration of the parties' relationship, the more likely it is that the worker will be considered an employee.

- **Whether the Worker Has the Right to Hire and Pay Assistants**. If the worker cannot hire assistants, this may support a conclusion that the worker is an employee.

- **Whether the Hiring Party Has the Right to Assign Additional Work to the Worker**. If the hiring party has the right to assign extra work to the worker, this supports a conclusion that the worker is an employee, regardless of whether the hiring party actually exercises that right.

- **Method of Payment**. Payment by payroll check, payment on a salary basis, or payment for hourly work would tend to support a conclusion that the worker is an employee.

- **Whether the Work Is Part of the Regular Business of the Hiring Party**. If the work performed is part of the hiring party's regular business, the worker is more likely to be considered an employee.

- **The Extent of the Worker's Discretion Over When and How Long to Work**. The less discretion the worker has over when, how, and for how long the work takes place, the more likely it is that the worker will be considered an employee.

- **Whether the Hired Party Is in Business**. A worker hired as an independent contractor who does not have any indication of being in business (does not have a business license, tax ID number, etc.) is more likely to be considered an employee.

- **Whether the Worker Receives Employee Benefits**. If a worker receives benefits usually given to employees, the worker is more likely to be considered an employee.

- **How the Parties Treat the Worker for Tax Purposes**. How the parties themselves characterize their relationship is relevant, but not a controlling factor. If the facts otherwise indicate that the worker is an employee, an agreement between the parties to the contrary is not sufficient to alter the employee's status.

The "right of control" test requires all of these factors to be considered and weighed. No one factor is decisive, and there is no shorthand formula that can be applied to find the answer. After considering all these factors, if a person is not found to be an employee, they will be considered an independent contractor.

(iii) The City of Seattle Office of Labor Standards will be issuing new rules for independent contractor relationships on September 1, 2022. These rules have not yet been finalized at the time of the publishing of this July 2022 Edition. Please check with the City of Seattle Office of Labor Standards after September 1, 2022 for more information and the Communities Rise Resources webpage.

CHAPTER 67. Antidiscrimination Laws

a. Prohibitions

Under federal, state, and local law, a nonprofit employer may not refuse to hire an applicant, treat an employee, or fire an employee because of the race, color, religion, sex,[2] disabling condition, age, or national origin. The Washington Law Against Discrimination (the "WLAD"), Chapter 49.60 RCW, protects the same groups as does federal law, and also prohibits discrimination on the basis of marital status, sexual orientation, citizenship or immigration status, honorably discharged veteran or military status, or the presence of any sensory, mental, or physical disability or the use of a trained dog guide or service animal by a person with a disability. In addition to these categories, the Seattle Municipal Code prohibits employment discrimination on the basis of sexual orientation, gender identity, marital status and political

[2] Although Title VII's sex discrimination prohibition was historically considered not to include discrimination based on sexual orientation or identity, that changed in 2020 with the U.S. Supreme Court decision in *Bostock v. Clayton County*, 590 U.S. ___, 140 S.Ct. 1731 (2020). Under *Bostock*, discrimination based on sexual orientation or identity constitutes sex discrimination under Title VII.

ideology. Other localities may have their own requirements, so a nonprofit should be sure to check on the specific regulations applicable to its location.

In very rare circumstances, Title VII of the Civil Rights Act of 1964 ("Title VII") allows employers to consider the gender, national origin, or religion of an applicant as a bona fide occupational qualification ("BFOQ") for a specific position. The BFOQ standard is difficult to demonstrate and requires that all, or substantially all, persons in the excluded class would be unable to efficiently perform the duties and the essence of the operation would be undermined by hiring anyone in that excluded class. A nonprofit employer should consult an attorney before failing to hire an otherwise qualified individual on the basis of a BFOQ.

Another limited carve-out from the non-discrimination laws exists for religious organizations. In particular, under Title VII, religious organizations are permitted to give employment preference to members of their own religion but only if the organization's "purpose and character are primarily religious." Factors include:

- Whether the organization's articles of incorporation state a religious purpose
- Whether its day-to-day operations are religious (e.g., whether the services the entity performs, the product it produces, or the educational curriculum it provides directed toward propagation are of the religion)
- Whether it is nonprofit
- Whether it is affiliated with, or supported by, a church or other religious organization.

This exception is not limited to religious activities of the organization. The WLAD also has a provision exempting religious employers.

It should also be noted that, while non-discrimination generally requires equal treatment of applicants and employees, two specific categories of protection—religion and disability—may require different treatment in order to accommodate individual needs. Accommodation of religious practices may mean deviating from regular work schedules or requirements. The same is true in the case of disability, discussed separately below.

b. Coverage of Employers

Whether any or all of these laws will directly govern a particular nonprofit organization will depend on the size of the organization. Title VII applies to all employers engaged in an industry affecting commerce who have 15 or more employees, as does the federal Americans with Disabilities Act ("ADA"). The definition of "affecting commerce" has been construed broadly, and many nonprofit organizations have found themselves on the wrong side of a Title VII lawsuit. The federal Age Discrimination in Employment Act governs employers of 20 or more employees.

The WLAD applies to the employment practices of employers of eight or more employees[3] and the Seattle Municipal Code applies to employers with four or more employees. As a general rule, volunteers do not count toward any of these totals.

c. Assessing Job Qualifications

For practical business reasons, it is in an employer's best interests to hire the most qualified applicant for a position, regardless of the applicant's race, gender, national origin, age, sexual orientation, or other protected category. Similarly, an employer generally evaluates and rewards employees based on their ability to perform the job in question. If an applicant believes that they not been hired or an employee claims an adverse job action because of a discriminatory reason, the claimant bears the burden of proving that their membership in a protected class motivated the employer's decision or action.

Even so, the employer's motivation may be called into question if it appears that the claimant was not appropriately assessed against the skills and abilities required by the job. It is a good idea to develop a job description for each position within the organization, including essential functions of the position, required skills and capabilities, and any other traits deemed important for successful performance. As long as a nonprofit employer establishes such standards and uses them to evaluate applicants for employment and employee job performance, a claimant will have difficulty proving an unlawful motive for an adverse action. By the same token, an employer that ignores its standards for job success—or has none—may be more

[3] Even an employer too small to be covered directly by Title VII or the WLAD should be cautious in basing an employment decision on a characteristic otherwise protected by the statutes. Note that Washington courts have recognized a public policy tort claim by an employee fired because of age, even where the employer had fewer than eight employees.

easily found to have improperly acted based on the protected status of an applicant or employee.

d. Disability Discrimination

(i) Hiring Issues

Under the ADA, it is illegal to ask whether an applicant has any disabilities. An employer may describe particular skills required on the job and ask whether the applicant can perform those tasks with or without reasonable accommodation. An employer may also ask an applicant to demonstrate how they will perform job tasks.

> **TIP:**
>
> An employer may not ask an applicant whether they need reasonable accommodation to perform the task. That question requires the applicant to disclose their other disability and the need for reasonable accommodation.

Generally, an employer may not ask about the kinds of accommodation that may be required until after the applicant is hired. However, if an employer reasonably believes that an applicant will need reasonable accommodation to perform the job functions, the employer may ask that applicant certain limited questions. For example, if the applicant arrives at the interview in a wheelchair, the employer may have reasonable belief that the applicant is disabled and may need an accommodation. In such a situation, the employer may ask whether the applicant needs reasonable accommodation and what type of reasonable accommodation would be needed to perform the functions of the job. The employer may ask these questions if: (1) the employer reasonably believes the applicant will need reasonable accommodation because of a visible disability; (2) the employer reasonably believes the applicant will need reasonable accommodation because of a less-visible disability that the applicant has voluntarily disclosed to the employer; or (3) an applicant has voluntarily disclosed to the employer that they need reasonable accommodation to perform the job. For example, if an individual with diabetes applying for a receptionist position voluntarily discloses that they will need periodic breaks to take medication, the employer may ask the applicant questions about the reasonable accommodation, such as how often they will need breaks and how long the breaks must be. Of course, the employer may not ask any questions about the underlying physical condition. *See* Equal Emp't Opportunity Comm'n, Notice No. 915.002, Enforcement Guidance: Preemployment Disability-Related Questions and Medical Examinations (Oct. 10, 1995), http://www.eeoc.gov/policy/docs/preemp.html. An employer may make a contingent offer of employment to an applicant and then

determine whether providing a reasonable accommodation would cause undue hardship to the business.

(ii) Failure to Accommodate: Disabling Conditions

Both the ADA and the WLAD require employers to reasonably accommodate disabled employees. According to the Equal Employment Opportunity Commission's (the "EEOC") ADA guidelines, an accommodation is generally any change in the work environment or in the way things are customarily done that enables an individual with a disability to enjoy equal employment opportunities. The guidelines provide that there are three categories of reasonable accommodation:

- Accommodations that are required to ensure equal opportunity in the application process
- Accommodations that enable employees with disabilities to perform the essential functions of the positions held or desired
- Accommodations that enable employees with disabilities to enjoy benefits and privileges of employment equal to those enjoyed by employees without disabilities

The guidelines also provide a non-exhaustive list of common types of accommodation:

- Making existing facilities used by employees readily accessible to and usable by individuals with disabilities
- Job-restructuring; part-time or modified work schedules; reassignment to a vacant position; acquisitions or modifications of equipment or devices; appropriate adjustments or modifications of examinations, training materials, or policies; the provision of qualified readers or interpreters; and other similar accommodations for individuals with disabilities

(iii) Undue Hardship

According to the ADA and EEOC regulations amplifying the ADA:

A determination of undue hardship should be based on several factors, including:

- The nature and cost of the accommodation needed;

- The overall financial resources of the facility making the reasonable accommodation; the number of persons employed at the facility; the effect on expenses and resources of the facility;

- The overall financial resources, size, number of employees, and type and location of facilities of the employer (if the facility involved in the reasonable accommodation is part of a larger entity);

- The type of operation of the employer, including the structure and functions of the workforce, the geographic separateness, and the administrative or fiscal relationship of the facility involved in making the accommodation to the employer; and

- The impact of the accommodation on the operation of the facility.

See 42 U.S.C. section 12111(10)(B) (1994); 29 C.F.R. section 1630.2(p)(2) (1997). These factors are important in the nonprofit arena because of the often-limited resources of nonprofit employers.

Common mistakes in the accommodation process include:

- Failing to follow up whenever the employee makes known a condition that is affecting his or her ability to perform the job; there is no requirement that the employee use the term "disability" or make a formal request for "accommodation"

- Failing to ask the employee for medical confirmation of the condition

- Failing to maintain accurate job descriptions that describe all essential functions and other requirements of the job

- Failing to analyze job requirements

- Making snap judgments about an employee's condition and/or limitations; decisions on accommodation should be the result of dialogue with the employee and careful consideration of medical information

- Failing to ask the applicant or the employee (and their health care provider) for suggestions on reasonable accommodation; the reasonable accommodation process is intended to be an interactive process

- Failing to include a human resources staff person in the process (if the organization has such resources)

(iv) Medical Records and Sharing of Information

Employers that receive medical information on employees or applicants are required by the ADA to keep such information and records secure and separate from regular personnel files. All such information and records should be treated as confidential and shared only to the extent necessary for supervisors and managers to understand the extent of an employee's limitation and needed accommodations, for first aid and safety personnel who may need to provide emergency treatment of the employee's condition, and for government officials investigating compliance.

(v) WLAD "Disability" Definition

Nonprofit employers should note that the definition of "disability" is broader under the WLAD than it is under the ADA. In 2007, the Washington State Legislature amended the WLAD to define "disability" as "a sensory, mental, or physical impairment" that is "medically cognizable or diagnosable," "[e]xists as a record or history," or is "perceived to exist whether or not it exists in fact"; and "impairment" includes:

- Any physiological disorder, condition, cosmetic disfigurement, or anatomical loss affecting one or more of the following body systems: neurological, musculoskeletal, special sense organs, respiratory, including speech organs, cardiovascular, reproductive, digestive, genitor-urinary, hemic and lymphatic, skin, and endocrine

- Any mental, developmental, traumatic, or psychological disorder, including but not limited to cognitive limitation, organic brain syndrome, emotional or mental illness, and specific learning disabilities

See RCW 49.60.040(7).

The statute recognizes a disability in a broad range of circumstances. Under the law, "a disability exists whether it is temporary or permanent, common or uncommon, mitigated or unmitigated, or whether or not it limits the ability to work generally or work at a particular job or whether or not it limits any other activity within the scope of this chapter." RCW 49.60.040(7)(b).

e. Sexual Orientation Discrimination

A prohibition on sexual orientation discrimination was added to the WLAD in 2006. The statute defines "sexual orientation" broadly to include "heterosexuality, homosexuality, bisexuality, and gender expression or identity." The phrase "gender expression or identity" means "having or being perceived as having a gender identity, self-image, appearance, behavior, or expression, whether or not that gender identity, self-image, appearance, behavior, or expression is different from that traditionally associated with the sex assigned to that person at birth." *See* RCW 49.60.040(26).

f. Harassment

In 1980, the EEOC issued guidelines specifying sexual harassment as a form of sexual discrimination prohibited by Title VII. In 1985, the Washington State Supreme Court recognized for the first time that failure to correct a hostile work environment caused by sexual harassment constituted discrimination in violation of the WLAD. The following year the U.S. Supreme Court addressed a claim of sexual harassment brought pursuant to Title VII for the first time. The Court unanimously held that a claim of sexual harassment is actionable under Title VII where a hostile environment is created by such harassment, even though the harassment has no tangible economic impact on the plaintiff's employment.

The concept of unlawful harassment has since expanded far beyond gender-based claims. The Washington Supreme Court has confirmed that the WLAD provides employees with a cause of action for disability-based hostile work environment harassment. Federal courts have upheld hostile work environment harassment claims against employers based on same-sex sexual harassment and harassment based on religion, race and national origin, and claims arising out of harassment based on sexual orientation. Even so, harassment offenses are most commonly associated with conduct based on sex.

A prudent employer should have in place:

- A clear anti-harassment policy informing all employees that workplace harassment based on sex, race, religion, age, or any other protected classification will not be tolerated and will result in disciplinary action. The policy should provide a clear complaint procedure, including an alternative if necessary to permit the complaining employee to bypass the alleged harasser. It should also assure that employees who make claims of harassment will be protected from retaliation;

- Documented distribution of the employer's anti-harassment policy; many employers require employees to individually sign a statement to confirm receipt; and

- Training programs to ensure that both managers and employees understand what constitutes harassment, and how the employer's harassment complaint procedure operates.

g. Discharge in Violation of Antidiscrimination Statutes

Claims that a discharge violated an antidiscrimination statute generally follow a disparate treatment theory (e.g., "you fired me because I'm a woman"). The essence of a disparate treatment claim is that the employer treated an employee less favorably because of that individual's race, sex, national origin, religion, age, marital status, sexual orientation or disabling condition (or any other protected status).

Although the claimant has the ultimate burden of proving discrimination, an employer must be able to articulate a legitimate nondiscriminatory reason for discharging the employee. If the employer fails to do so, it risks losing the case. The claimant may also challenge the validity of the employer's explanation to demonstrate that discrimination must have influenced the decision.

Some courts have found that an employer's failure to follow its own established procedures is evidence that the employer's explanation for the discharge is just a pretext for discrimination. Giving inconsistent reasons for the discharge similarly raises questions. For these reasons, it is important to follow established procedures and to be honest and consistent in communicating the reasons for the action.

Warnings and Corrective Action
Nothing in the federal, state, or local antidiscrimination laws requires an employer to warn an employee that misconduct and lack of performance will lead to termination of employment. Likewise, nothing in the federal, state, or local antidiscrimination laws requires an employer to document past misconduct or lack of performance prior to firing an employee. Nonprofit employers, like for-profit employers, should, however, always be aware of the jury factor: jurors expect employers to "Be Fair." Jurors sometimes consider a failure to warn or a lack of documentation as evidence that the reasons advanced for discharging an employee are not the true reasons. If jurors do not believe the employer, they may conclude that the employer's "legitimate nondiscriminatory reason" is a pretext for unlawful discrimination. In addition to the jury factor, today many employers, including nonprofit employers, have personnel policies that provide varying shades of "progressive discipline." Progressive discipline plans generally provide that employees will receive verbal counseling or written reprimands for all but the most serious infractions prior to discharge. Employers that ignore an established progressive discipline scheme expose their organizations to liability because, as noted above, courts allow plaintiffs to introduce evidence of failure to follow established procedures as evidence that the employer's legitimate nondiscriminatory reason for an adverse employment action is pretextual in nature.

CHAPTER 68. Overtime Compensation

a. The Law

The FLSA (*see* CHAPTER 66) establishes minimum wage, overtime pay, recordkeeping, and child labor standards affecting full-time and part-time workers in the private sector and in federal, state, and local governments. As noted above, the FLSA covers employers that have at least two employees and earn an annual business volume of at least $500,000 per year, or that are hospitals or businesses providing medical or nursing care for residents, school and preschools, and government agencies. Even if these factors do not apply, there may be individual coverage of employees who individually are engaged in interstate commerce, produce goods for commerce, or work in activities closely related and directly essential to the production of goods for commerce. Based on the two definitions for FLSA coverage, many nonprofits are exempt from the FLSA's requirements. The WMWA, however, applies to all employers in the State of Washington. Even when there is no enterprise coverage, individual coverage applies where both the FLSA and the WMWA require, among other things, that employers pay non-exempt employees overtime for all hours worked over 40 in a workweek. The overtime rate is one-and-one-half times an employee's regular rate of pay. While the WMWA generally mirrors

the requirements of the FLSA, in some respects the WMWA is more protective of employees than the FLSA is. Employers covered by both statutes must comply with the law that is more generous to the employee. Note that for many years, the minimum wage set by the WMWA (and adjusted annually) has been higher than the federal minimum wage. Also keep in mind that some cities in Washington, including Seattle and Tacoma, have higher minimum wage rates than Washington State, and the municipal rate may vary based on the employer's size. For more information on the current minimum wage rate in Washington, *see* Wash. State Dep't of Labor & Indus., Minimum Wage, https://lni.wa.gov/workers-rights/wages/minimum-wage/ (last visited Sept. June 30, 2022). Also note that Seattle has a higher minimum wage than Washington state does, which also depends on employer size and contributions towards an employee's medical benefits. *See* Minimum Wage, Office of Labor Standards, http://www.seattle.gov/laborstandards/ordinances/minimum-wage (last visited Sept. June 30, 2022).

b. Classifying Employees

(i) Classification of Exempt and Nonexempt Employees

By and large the most common mistake that employers make in the administration of wage and hour laws is misclassifying employees as exempt from the requirements of the FLSA and the WMWA. This mistake can be costly as both recordkeeping and overtime requirements differ for exempt and nonexempt employees.

To avoid misclassification, employers should start with the assumption that every employee is covered by minimum wage and overtime requirements, and work from that starting point. The FLSA was enacted in 1938, during the height of this country's Great Depression. The overtime premium was designed to incentivize employers to hire additional employees rather than lengthening the hours of existing employees. Given this statutory mandate, FLSA exemptions were narrow from their inception, and, although now seen more as a protection for workers, continue to be narrowly tailored.

(ii) The Big Three "White Collar" Exemptions

The most common exemptions under the FLSA and the WMWA are the so-called "white-collar" exemptions. They are also the most misunderstood exemptions. Bona fide executive, administrative, and professional employees are exempt from the overtime requirements of both the FLSA and the WMWA, but that leaves open

the question of who is a bona fide executive, administrative, or professional employee.

The FLSA does not define "executive, administrative, or professional" for purposes of the exemptions, but the U.S. Department of Labor ("DOL") has made known the administrative regulations defining the scope of those exemptions. As the DOL acknowledged in a proposal to amend these regulations, the exemptions have long "engendered considerable confusion . . . regarding who is, and who is not, exempt."

The Washington Department of Labor & Industries ("L&I") changed the minimum amount employees must earn to be classified as exempt when updates to the state overtime rules took effect on July 1, 2020. *See* Changes to Overtime Rules, Washington State Dept. of Labor & Industries, https://lni.wa.gov/workers-rights/wages/overtime/changes-to-overtime-rules (last visited Sept. June 30, 2022). The salary thresholds are now based on a multiplier of the minimum wage, which is subject to annual adjustment. As of 2022, the threshold is an employee must earn a salary of at least 1.5 times the minimum wage, or $1,014.30 a week ($52,743.60) in order to be considered exempt from overtime wages. Note as of 2022, there is no distinction between small or large employers.

This same threshold applies to part-time employees; it is not prorated for employees who are less than full-time. This means, for example, that a 50% (half-time) employee, whose annualized salary is $90,000, would be overtime eligible because their actual, half-time salary would be $45,000, which is less than the new $49,836 threshold.

Because the new state thresholds are more favorable for employees than the federal threshold of $684/week ($35,568/year), Washington employers have had to adhere to the state thresholds since 2021.

A DOL fact sheet lists the tests which must be met to qualify for an employee exemption.[4] The following summarizes such tests for qualifying an executive employee, administrative employee, learned professional employee, creative professional employee. The following section addresses the requirements for computer employee exemptions.

[4] *See* Dep't of Labor, Wage & Hour Div., Fact Sheet #17A (rev. Sept. 2019), https://www.dol.gov/sites/dolgov/files/WHD/legacy/files/fs17a_overview.pdf. Effective January 1, 2020, the salary threshold for these three exemptions increased from $455 per week to $684 per week. *See* https://www.dol.gov/agencies/whd/fact-sheets/17g-overtime-salary.

To qualify for the **executive employee exemption**, all of the following tests must be met:

- The employee must be compensated on a salary basis (as defined in the regulations) at a rate of $684 or more per week,[5]
- The employee's primary duty must be managing the enterprise, or managing a customarily recognized department or subdivision of the enterprise;
- The employee must customarily and regularly direct the work of at least two or more other full-time employees or their equivalent; and
- The employee must have the authority to hire or fire other employees, or have particular weight given to their suggestions and recommendations as to the hiring, firing, advancement, promotion or any other change of status of other employees.

To qualify for the **administrative employee exemption**, all of the following tests must be met:

- The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate of $684[6] or more per week;
- The employee's primary duty must be the performance of office or non manual work directly related to the management or general business operations of the employer or the employer's customers; and
- The employee's primary duty must include the exercise of discretion and independent judgment with respect to matters of significance.

To qualify for the **learned professional employee exemption**, all of the following tests must be met:

- The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate of $684[7] or more per week;

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[5] Note that the Washington salary threshold exceeded the federal threshold as of January 1, 2021. For the salary threshold implementation schedule for Washington employers between July 1, 2020, to Jan. 1, 2028, *see* https://lni.wa.gov/forms-publications/F700-207-000.pdf (last visited June 30, 2022).

[6] *See* note above.

[7] *See* note above.

- The employee's primary duty must be the performance of work requiring advanced knowledge, defined as work that is predominantly intellectual in character and that includes work requiring the consistent exercise of discretion and judgment;

- The advanced knowledge must be in a field of science or learning; and

- The advanced knowledge must be customarily acquired by a prolonged course of specialized intellectual instruction.

> **TIP:**
>
> The learned professional exemption does not cover an employee who holds a professional degree but who performs a job that is not professional in nature or to which the degree they holds is not applicable.

To qualify for the **creative professional employee exemption**, all of the following tests must be met:

- The employee must be compensated on a salary or fee basis (as defined in the regulations) at a rate of $684[8] or more per week; and

- The employee's primary duty must be the performance of work requiring invention, imagination, originality, or talent in a recognized field of artistic or creative endeavor.

(iii) Computer Employee Exemption

An addition to the three white-collar exemptions is the exemption for highly paid computer system analysts and programmers.

To qualify for the **computer employee exemption** under federal law, the following tests must be met:

- The employee must be compensated either on (a) a salary or fee basis (as defined in the regulations) at a rate of $684 or more per week or (b) an hourly basis at a rate of $27.63 or more per hour;[9]

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[8] See notes above.

[9] For the hourly computer professional phase-in schedule for Washington employees, *see* https://lni.wa.gov/forms-publications/F700-213-000.pdf (last visited June 30, 2022). In 2022, the minimum compensation for exempt computer professionals is $52,743.60 on a salaried basis, or $50.72 per hour on an hourly basis.

- The employee must be employed as a computer systems analyst, computer programmer, software engineer, or other similarly skilled worker in the computer field performing the duties described below;

- The employee's primary duties must consist of at least one of the following:

    a) The application of systems analysis techniques and procedures, including consulting with users to determine hardware, software, or system functional specifications;

    b) The design, development, documentation, analysis, creation, testing or modification of computer systems or programs, including prototypes, based on and related to user or system design specifications;

    c) The design, documentation, testing, creation or modification of computer programs related to machine operating systems; or

    d) A combination of the aforementioned duties, the performance of which requires the same level of skills.

(iv) Working Employees "Off the Clock"

The definition of "employ" under the FLSA includes "to suffer or permit to work." It is a violation if an employer either requires or allows a nonexempt employee to work hours without recording them on their time record and receiving pay for them. If the unrecorded hours push an employee's total hours over 40 for the workweek, there will also be an overtime violation. Nonprofit employers should pay special attention to rules governing any "volunteer" hours by their employees (*see supra* CHAPTER 66).

(v) "Comp Time" Not Allowed

Nonprofit employers, often short on resources and long on missions to accomplish, may be tempted to offer compensatory time or "comp time" in lieu of overtime pay. An example of this is when an employee works 45 hours in a workweek, instead of paying the employee five hours worth of overtime wages, 5 hours of paid time off are offered in exchange for those five extra hours worked. According to the Washington Department of Labor & Industries, the WMWA does not prohibit offering comp time to an employee who requests it in lieu of overtime pay. However, the FLSA prohibits the practice for all employees, except certain public

sector employees such as firefighters. Nonprofit employers should resist setting up any form of comp time, whether formal or informal, for nonexempt employees.

CHAPTER 69. Employee Leave Laws

a. The Family and Medical Leave Act

The Family Medical Leave Act ("FMLA") is the most commonly known leave requirement. However, many nonprofit employers will not be covered by the FMLA because they have too few employees. A private employer is covered by the FMLA if it employs 50 or more employees for each working day during each of 20 or more calendar workweeks in the current or preceding calendar year. The 20 workweeks need not be consecutive. Private elementary and secondary schools are covered regardless of the number of employees they employ so some nonprofits could be included by this provision.

If an employer is subject to the FMLA, then the employee is eligible for FMLA leave, as long as these three conditions are met when the leave commences:

- The employee has been employed by the employer for at least 12 months at the time the leave commences;
- The employee has been employed for at least 1,250 hours of service during the 12-month period immediately preceding the commencement of the leave; and
- The employee is employed at a work site where 50 or more employees are employed by the employer within 75 miles of that worksite.

If an employee is eligible for FMLA leave, the employee is entitled to take leave for any of the following reasons:

- For the birth of a child, and in order to care for a newborn child;
- For the placement with the employee of a son or daughter for adoption or foster care;
- To care for the employee's spouse, child, or parent with a serious health condition;

- Because of a serious health condition that makes the employee unable to perform one or more of the essential functions of their job ("essential functions" is defined according to the ADA); or

- Because of "any qualifying exigency" arising out of the fact that the spouse, child, or parent of the employee is on active military duty or has been notified of an impending call to active duty status in support of a contingency operation.

FMLA regulations define one or more of the following circumstances as "qualifying exigencies":

- **Short-Notice Deployment:** to address any issue that arises from the fact that a covered military member is notified of an impending call or order to active duty in support of a contingency operation seven or less calendar days prior to the date of deployment.

- **Military Events and Related Activities:** to attend any official ceremony, program, or event sponsored by the military that is related to the active duty or call to active duty status of a covered military member, or to attend family-support or assistance programs and informational briefings sponsored or promoted by the military, military service organizations, or the American Red Cross that are related to the active duty or call to active duty status of a covered military member.

- **Childcare and School Activities:** to arrange for alternative childcare when the active duty or call to active duty status of a covered military member necessitates a change in the existing childcare arrangements, or to provide childcare on an urgent, immediate need basis, or to enroll a child in or transfer to a new school or day care facility when enrollment or transfer is necessitated by the active duty or call to active duty status of a covered military member; or to attend meetings with staff at a school or a daycare facility, such as meetings with school officials regarding disciplinary measures, parent-teacher conferences, or meetings with school counselors when such meetings are necessary due to circumstances arising from the active duty or call to active duty status of a covered military member.

- **Financial and Legal Arrangements:** to make or update financial or legal arrangements to address the covered military member's absence while on active duty or call to active duty status; and to act as the covered military

member's representative before a federal, state, or local agency for purposes of obtaining, arranging, or appealing military service benefits while the covered military member is on active duty or call to active duty status, and for a period of 90 days following the termination of the covered military member's active duty status.

- **Counseling:** to attend counseling provided that the need for counseling arises from the active duty or call to active duty status of a covered military member.

- **Rest and Recuperation:** to spend time with a covered military member who is on short-term, temporary rest and recuperation leave during the period of deployment.

- **Post-Deployment Activities:** to attend arrival ceremonies, reintegration briefings and events, and any other official ceremonies or programs sponsored by the military for a period of 90 days following the termination of the covered military member's active duty status.

- **Death of a Covered Service Member:** to address issues that arise from the death of a covered military member while on active duty status.

- **Additional Activities:** to address other events that arise out of the covered military member's active duty or call to active duty status provided that the employer and employee agree that such leave shall qualify as an exigency and agree to both the timing and duration of such leave.

An eligible employee of a covered employer is also entitled to up to 26 weeks of FMLA leave in a single 12-month period to care for a spouse, child, parent, or next of kin who is a covered service member recovering from a serious illness or injury sustained in the line of duty while on active duty. To be a "covered service member," the relative must meet all of the following requirements:

- Be a member of the armed forces, National Guard, or reserves;

- Suffer from an illness or injury incurred on active duty that may render him or her medically unfit to perform the duties of his office, grade, rank, or rating (i.e., a "serious injury or illness"); and

- Be undergoing medical treatment, recuperation, or therapy, be in outpatient status, or be on the temporary disability retired list as a result of the serious injury or illness.

FMLA military caregiver leave is also available during "a single 12-month period" during which an eligible employee is entitled to a combined total of 26 weeks of all types of FMLA leave.

b. Washington Paid Family Medical Leave[10]

Paid Family and Medical Leave (PFML) is a statewide insurance program available to eligible Washington employees that provides paid time off to give or receive care for qualifying events defined by the law. It is administered by the Employment Security Department (ESD).[11] The program is funded by premiums paid by employees and employers. A withholding of a small percentage of employees' wages is deducted from their paychecks to cover their portion of the premiums and is submitted quarterly to the ESD.

1. (i) Eligibility and Benefits

To be eligible for PFML benefits, an employee must have worked for an employer in Washington for at least 820 hours in four of the last five completed calendar quarters. An eligible employee may receive PFML benefits for the following amounts of time within a one-year period:

- **Family Leave of up** to 12 weeks of leave to:
    - bond with the employee's newborn child, newly-adopted child, or newly-placed foster child within the 12 months following the birth, adoption, or placement of the child;
    - care for a family member with a serious health condition; or
    - prepare for a family member's pre- and post-deployment activities, as well as time for childcare issues related to a family member's military deployment.
- **Medical Leave** of up to 12 weeks for the employee's own serious health condition

[10] The prior version of this handbook contained information on the Washington Family Leave Act, which is no longer in effect. The Family Leave Act sunset on December 31, 2019, and all benefits associated with this law are no longer applicable. Workers who need leave may instead apply for Paid Family Medical Leave (PFML), an insurance program administered by the Employment Security Department.

[11] For more information on PFML, *see* https://paidleave.wa.gov/ (last visited June 30, 2022).

- **Combined Family and Medical Leave** of up to 16 weeks of leave, for a combination of Medical Leave and Family Leave (with up to an additional two weeks of leave if the employee experiences a pregnancy-related disability)

For purposes of PFML, a family member is defined as the employee's child (including step-child, adopted child, foster child, or child to whom the employee stands in loco parentis, is a legal guardian, or is a de facto guardian), grandchild, grandparent, parent (including parent-in-law, adoptive, de facto, foster parent, step-parent, or legal guardian), sibling, spouse, or registered domestic partner.

While on PFML leave, the employee will be entitled to partial wage replacement, receiving a portion of their average weekly pay, up to a set maximum amount. An employee desiring to take PFML leave must apply to the ESD, which pays the benefits.

2. (ii) Employee Protections

If the employee has worked for the employer for at least 12 months and has worked at 1,250 hours in the 12 months before taking leave, they must be restored to the same or an equivalent job when they return from PFML leave.

Employers cannot discriminate or retaliate against employees for requesting or taking PFML. Under the law, employers are required to inform their employees about the Paid Family and Medical Leave program by posting a notice in a place customarily used to post other employment-related notices. The notice is available at https://paidleave.wa.gov/app/uploads/2021/03/Paid-Leave-ER-notice-to-EE-2021-03-01.pdf.

c. Washington Paid Sick Leave

As of January 1, 2018, employers in Washington are required to provide paid sick leave for all employees who are not exempt from the WMWA. There is no minimum employee headcount threshold; even an employer with only one employee working in the state must allow that employee to accrue and use paid sick leave. All nonexempt employees are covered, including temporary, part-time, and seasonal employees.

(i) Accrual

An employee must accrue paid sick leave hours according to the following guidelines:

- Employees must accrue paid sick leave at a minimum rate of 1 hour for every 40 hours worked. Employers cannot cap the amount of sick leave an employee can accrue.

- Paid sick leave must be paid to employees at their normal hourly compensation.

- Employees are entitled to use accrued paid sick leave beginning on the 90th calendar day after the start of their employment.

- Unused paid sick leave of up to 40 hours may be carried over to the following year.

- Employers may provide employees with more generous carry-over and accrual policies.

(ii) Usage

An employer must allow an employee to use paid sick leave for the following reasons:

- An absence resulting from an employee's mental or physical illness, injury, or health condition;

- To accommodate the employee's need for medical diagnosis, care, or treatment of a mental or physical illness, injury, or health condition; or an employee's need for preventive medical care;

- To allow the employee to provide care for a family member with a mental or physical illness, injury, or health condition; to provide care for a family member who needs medical diagnosis, care, or treatment of a mental or physical illness, injury, or health condition; or to provide care for a family member who needs preventive medical care;

- When the employee's place of business has been closed by order of a public official for any health-related reason, or when an employee's child's school or place of care has been closed for such a reason; and

- For absences that qualify for leave under the state's Domestic Violence Leave Act ("DVLA"). For more information on the DVLA, *see* https://lni.wa.gov/workers-rights/leave/domestic-violence-leave.

A covered "family member" includes:

- A child, including a biological, adopted, or foster child, stepchild, or a child to whom the employee stands in loco parentis, is a legal guardian, or is a de facto parent, regardless of age or dependency status;
- A biological, adoptive, de facto, or foster parent, stepparent, or legal guardian of an employee or the employee's spouse or registered domestic partner, or a person who stood in loco parentis when the employee was a minor child;
- A spouse;
- A registered domestic partner;
- A grandparent;
- A grandchild; or
- A sibling.

Employers must allow employees to use paid sick leave in increments consistent with the employer's payroll system and practices, but may not require usage increments greater than one hour, unless they obtain a variance from the Department of Labor and Industries.

The WMWA also protects employees from retaliation for exercising their rights under the Minimum Wage Requirements and Labor Standards Act. This includes the right to file a complaint for wages owed, lawfully use paid sick leave, and exercise protected rights.

It is also important to keep in mind that some cities in Washington, including Seattle, also have sick leave laws which may impose different requirements in some instances. Consult with an attorney before adapting an existing PTO policy to comply with local or state sick leave laws.

More information on Washington's sick leave law, including sample sick leave policies, can be found at https://www.lni.wa.gov/workers-rights/leave/paid-sick-leave/.

d. Pregnancy and Parental Leave Under the WLAD

Washington State Human Rights Commission regulations also require covered employers to grant employees leave for sickness or disability due to pregnancy or childbirth.[12] (*See* WAC 162-30-020(4)(a)) ("An employer shall provide a parent a leave of absence for the period of time that they are sick or temporarily disabled because of pregnancy or childbirth. Employers must treat a person on pregnancy-related leave the same as other employees on leave for sickness or other temporary disabilities."). As noted above, the WLAD covers employers with 8 or more employees.

e. Washington Military Family Leave Act

The Washington Military Family Leave Act ("WMFLA"), Chapter 49.77 RCW, allows an employee whose spouse is a member of the United States armed forces, National Guard, or reserves, who has been notified of an impending call or order to active duty, or who has been deployed, or who is on leave from deployment, a total of 15 days of unpaid leave per deployment.

The employee may take the 15 days of leave before the deployment of the military spouse or when the military spouse is on a leave from the deployment. For each new deployment of the military spouse, the employee may take another family military leave of up to 15 days.

The employee must give notice to their employer of the intent to take the family military leave within five business days of receiving official notice of the call or order to active duty or deployment, or within five business days of official notice of the military spouse's upcoming leave from the deployment. To be eligible, the employee must work an average of at least 20 hours per week for the employer. Family military leave is only available during a period when Congress has declared war, the President has declared war by executive order, or military reserves have been called to active duty. The law covers any employer with one or more employees.

f. Washington Domestic Violence Leave Act

The Washington Domestic Violence Leave Act ("WDVLA"), Chapter 49.76 RCW, provides leave for employees who are victims of domestic violence, sexual assault, or stalking. The law also allows for leave for an employee with a family member

[12] An employer should also consider accommodations for an employee's pregnancy as appropriate.

(child, spouse, parent, parent-in-law, grandparent, or person with whom the employee has a dating relationship) who is a victim of domestic violence, sexual assault, or stalking. Domestic violence/sexual assault leave may be taken in blocks or intermittently, and the amount of leave is unspecified except that an employee's time off is restricted to a "reasonable" amount.

The WDVLA permits leave to be taken for the following purposes:

- To seek law enforcement or legal assistance or to prepare for or participate in any legal proceeding related to domestic violence, sexual assault, or stalking;

- To seek health care treatment for physical or mental injuries from domestic violence, sexual assault, or stalking, or attend to such health care treatment for a family member;

- To obtain (or assist a family member in obtaining) services from a domestic violence shelter, rape crisis center, or other social services;

- To obtain (or assist a family member in obtaining) mental health counseling related to domestic violence, sexual assault, or stalking; or

- To participate in safety planning, to temporarily or permanently relocate, or to take other actions to increase the safety of the employee or family member relating to domestic violence, sexual assault, or stalking.

Employees must give notice to their employers of the need for this leave no later than the end of the first day the employee takes the leave. Employers may require verification to support the need for the leave, which can take the form of police reports, court documents, or the employee's own written statement of the need for the leave. The law covers any employer with one or more employees.

g. Washington Family Care Act

The Washington Family Care Act ("WFCA") enables an employee to use their choice of sick leave or other available paid time off to care for:

- A child of the employee with a health condition that requires treatment or supervision; or

- A spouse, parent, parent-in-law, or grandparent of the employee who has a serious health condition or an emergency condition

An employee using paid time under the WFCA must comply with the terms of any collective bargaining agreements (union negotiated agreements) or employer policies applicable to use of the leave, except for any terms relating to the choice of leave. The law covers any employer with one or more employees. Employees are eligible for WFCA leave if they are currently employed.

h. Leave Required by Local Jurisdictions

Some cities in Washington, including Seattle and Tacoma, have their own sick leave laws, which may impose different requirements than Washington's law, in certain circumstances. As a general rule, where there is a conflict between the local and state regulations, the regulation that is more favorable to the employee applies. Nonprofit organizations should be sure to check for any local leave requirements.

3. (i) Tacoma

An amended version of Tacoma's paid sick leave law took effect on January 1, 2018, to align more closely with Washington's sick leave law. Tacoma's law differs in the following respects:

- Tacoma law also covers overtime-exempt employees;
- Leave may be used for additional reasons, including if a child's school or place of care is closed by a public official or for bereavement leave; and
- A written policy is required if an employer opts to use a PTO policy for paid sick leave that applies to all hours.

Tacoma's paid sick leave ordinance applies to employees who work in Tacoma, including part-time, seasonal and temporary staff, and overtime-exempt employees working at least 80 hours in Tacoma. For further guidance on Tacoma's sick leave law, *see* https://www.cityoftacoma.org/cms/one.aspx?objectId=75860.

4. (ii) Seattle

Seattle also amended its Paid Sick and Safe Time ("PSST") ordinance after the state law was implemented, effective January 14, 2018. As in Tacoma, both exempt and nonexempt employees in Seattle are entitled to accrue paid sick leave. A major difference between the Seattle and Washington laws is the rate of accrual. Under the Seattle ordinance, employees accrue paid sick leave at different rates based on the size of the employer or "Tier size," as outlined in the chart below. For further

guidance on Seattle's PSST ordinance, *see* https://www.seattle.gov/laborstandards/ordinances/paid-sick-and-safe-time.

General Information:	**Small (Tier 1) Employer**	**Medium (Tier 2) Employer**	**Large (Tier 3) Employer**
Full Time Equivalents (FTEs)	One employee and up to 49 FTEs	50–249 FTEs	250 or more FTEs
Accrual of PSST per hours worked	1 hour per 40 hours	1 hour per 40 hours	1 hour per 30 hours
Carry over of unused PSST (per year)	40 hours	56 hours	72 hours *108 hours for employers with PTO

Note that the Seattle PSST ordinance requires leave for any employee who works within Seattle city limits, even on an occasional or part-time basis — regardless of where the employer is located.

CHAPTER 70. Employee Handbooks

a. Should You Have One?

An employee handbook is a compilation of policies and procedures that an employer decides to use in running their business and wishes to communicate to their employees. There are many positive reasons to have an employee handbook and few negative ones, provided the handbook is properly written. An employee handbook allows you to communicate policies and procedures in a comprehensive and consistent way and helps to ensure that all employees receive copies of important policies. Having employees sign a receipt for the handbook provides an efficient method to document employee receipt of all pertinent policies and procedures.

b. Preserving the "At Will" Employment Relationship

There is one significant concern about having an employee handbook. In Washington, unless otherwise agreed by the employer and employee, employment is deemed to be terminable "at will." This means that an employee may resign at any time for any or no reason, and the employer may discharge the employee at any time for any reason that is lawful or no reason at all. Washington courts have held that in certain limited circumstances an employee may enforce handbook provisions that contain promises of specific treatment, such as a disregard of at-will employment, in

specific circumstances. There are ways to avoid this situation, but employers are well advised to get legal advice before providing a handbook to employees.

To preserve the "at will" employment relationship, employee handbooks should reserve discretion to the employer to handle any particular employment situation as it determines to be warranted. Handbooks should avoid statements that employees may be discharged or disciplined only "for cause" or "just cause" or after a certain process or procedure. The handbook should not guarantee any particular period of employment or suggest that employment is "permanent" or "guaranteed."

A handbook should contain a prominent disclaimer that makes clear that the employee handbook and all provisions in the handbook are general guidelines and do not constitute a contract or an assurance of either particular treatment or continued employment. The disclaimer should include a statement that the employee acknowledges and understands that their employment is terminable at will. The disclaimer should define the term "at will." The disclaimer should also state that the employee understands that the employer may change the handbook and its provisions at any time. If there was a previous handbook or set of policies, the disclaimer should state that such handbook is no longer in effect. Finally, it should be expressly stated which management person, if any, has the authority to change an employee's at-will status and that this may only be done by specific written agreement. It is recommended that an employer have each employee read, sign, and date an acknowledgement of receipt of the handbook and an acknowledgement of the disclaimer.

c. Matters to Include in an Employee Handbook

The following matters are suggested employer policies and procedures to include in an employee handbook:

- Employment-at-will status
- Equal employment/nondiscrimination policies
- Harassment prevention policy and specific complaint procedures
- Work hours, lunch period, rest breaks, flextime policies
- Overtime eligibility, authorization, and reporting
- Policies and procedures relating to use of vacation, sick leave, bereavement leave, military leave, jury duty, etc.

- Procedures for using family and medical leave (if applicable)
- General employee conduct policies including attendance, use of alcohol and drugs, nonexclusive examples of conduct that may result in discipline, and nonexclusive examples of the types of discipline that may be imposed
- General descriptions regarding the availability of employee benefits (medical and dental insurance, life insurance, disability insurance and retirement plans)
- Observed holidays
- Safety policies
- Social media policies
- Emergency procedures
- Employee use of employer email and Internet access
- Employee use of employer phones and other equipment

CHAPTER 71. Payroll Taxes

Employers need to comply with the various federal, state, and local payroll tax obligations applicable to the jurisdictions in which their employees are working. These payroll tax obligations can evolve rapidly with changes in the law and the workforce. Many Washington employers have faced an increase of payroll taxes in recent years (for example, a state paid family and medical leave tax in 2020, a City of Seattle payroll tax in 2021, a state long-term care tax in 2022). At the same time, many employers are allowing or encouraging remote, hybrid, or mobile work, which can multiply the number of jurisdictions in which an employer needs to report and pay payroll taxes. *See* CHAPTER 71 for more on payroll taxes.

a. Federal

(i) Federal Income Tax Withholding

Employers are required to withhold federal income taxes from employee wages in accordance with the employee's W-4. An employer should treat a new employee who fails to provide a W-4 as if the employee had checked the box for "single or married filing separately" without any adjustments. *See* CHAPTER 71 for more on payroll taxes.

(ii) Federal Social Security Tax

As part of the Federal Insurance Contributions Act ("FICA"), the federal government imposes a 12.4% social security tax on employee wages up to the wage base limit ($142,800 for 2021). Employers and employees generally each pay half of the social security tax (6.2% each). Employers are required to withhold and remit the employee's share of social security tax to the IRS. *See* IRS Publication 15 (Employer's Tax Guide), https://www.irs.gov/pub/irs-pdf/p15.pdf, for additional information on an employer's social security tax obligations. *See* CHAPTER 71 for more on payroll taxes.

(iii) Federal Medicare Tax

As part of FICA, the federal government imposes a 2.9% Medicare tax on employee wages. Unlike social security tax, there is no wage base limit to the Medicare tax. Employers and employees generally each pay half of the Medicare tax (1.45% each). Employers are required to withhold and remit the employee's share of Medicare tax to the IRS. Employers must withhold an additional 0.9% Medicare tax on annual wages in excess of $200,000. *See* IRS Publication 15 (Employer's Tax Guide), https://www.irs.gov/pub/irs-pdf/p15.pdf, for additional information on an employer's Medicare tax obligations. *See* CHAPTER 71 for more on payroll taxes.

(iv) Federal Unemployment Tax

As part of the Federal Unemployment Tax Act ("FUTA"), employers are generally required to pay federal unemployment tax for each employee. The FUTA rate is 6.0% of employee wages up to the wage base limit ($7,000 for 2021). However, employers are generally entitled to a credit against the federal unemployment tax for amounts paid in state unemployment taxes, up to a maximum credit of 5.4% of the FUTA taxes. After accounting for the maximum credit, the FUTA rate is 0.6%. The employer pays federal unemployment tax and may not deduct any portion of the tax from the employee's wages.

Employers that are exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code are also exempt from federal unemployment tax. *See* IRS Publication 15 (Employer's Tax Guide), https://www.irs.gov/pub/irs-pdf/p15.pdf, for additional information on an employer's federal unemployment tax obligations. *See* CHAPTER 71 for more on payroll taxes.

(v) Federal Payroll Tax Reporting and Responsible Person Liability

It is extremely important to properly withhold and timely deposit both employees' and the employer's share of taxes withheld or owed. Most employers must deposit federal income tax withheld from employees and both the employer's and employees' share of social security and Medicare taxes on either a monthly or semi-weekly basis, depending on the size of the employer's deposits. Most employers must deposit federal unemployment tax quarterly. Deposits must be made with the IRS by electronic funds transfer. Failure to make such deposits may subject the employer to civil and potentially criminal penalties.

In addition to making the required deposits, most employers are required to file an employer's quarterly federal tax return (Form 941) with the IRS showing the amounts withheld and deposited. Smaller employers may qualify to file an employer's annual federal tax return (Form 944) in lieu of the quarterly returns. Employers must also file an employer's annual federal unemployment (FUTA) tax return (Form 940). Failure to file employer tax returns may subject the employer to civil and potentially criminal penalties. For more information on employer withholding and filing requirements, *see* IRS Publication 15 (Employer's Tax Guide), https://www.irs.gov/pub/irs-pdf/p15.pdf.

Withheld federal income, social security, and Medicare taxes are considered trust fund taxes. If trust fund taxes are not paid by the employer, the IRS may recover the taxes from any officer, employee, director, trustee, volunteer, or other person that the IRS determines was responsible for collecting, accounting for, or paying over such taxes and willfully failed to do so. A responsible person's failure is "willful" if the person knows the required actions of collecting, accounting for, or paying over trust fund taxes aren't taking place, or recklessly disregards obvious and known risks to the government's right to receive the trust fund taxes.

b. State

Washington employers must complete a master business application with the Business Licensing Service of the Washington Department of Revenue. The application allows an employer to obtain a business license and register with all state agencies for which registration is required. By completing the master business application, an employer registers for workers' compensation with the Department of Labor and Industries, and registers for unemployment insurance and other state payroll taxes with the Employment Security Department. Both agencies will send the

employer information about their reporting obligations. Depending on the nature of the organization's activities, an employer may also need to register with the city or county in which it is conducting its business. For additional information, *see* https://dor.wa.gov/open-business/apply-business-license.

(i) Washington State Unemployment Tax

Most Washington employers are required to pay state unemployment tax for each employee. The tax rate varies by employer based on the employer's experience rating (i.e., how much its former employees have collected in unemployment benefits) or, for new employers, based on average experience ratings for employers in the same industry. State unemployment tax is paid on wages up to the state wage base limit ($56,500 for 2021).

Employers that are exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code have the option of either participating in the state unemployment tax system or reimbursing the state for the cost of unemployment benefits paid to former employees. The Employment Security Department may require "reimbursable employers" to post a bond or security deposit.

Corporate officers are exempt from unemployment tax and benefits unless the employer makes a voluntary election to cover its officers. If a corporation does not elect to cover its officers, it must notify its officers that they are ineligible for unemployment benefits.

Employers must file tax and wage reports and pay state unemployment taxes each quarter with the Employment Security Department. For more information, *see* the Employment Security Department's Employer Tax Handbook, https://esdorchardstorage.blob.core.windows.net/esdwa/Default/ESDWAGOV/employer-Taxes/ESD-Employer-Tax-Handbook-1.pdf.

(ii) Washington State Family and Medical Leave Tax

Washington imposes a 0.4% paid family and medical leave tax on employee wages up to the federal social security tax wage base limit ($142,800 for 2021). Employers must withhold 63.33% of the tax (0.2533% of the wages) from the employee or may pay this amount on the employee's behalf. Employers with 50 or more employees must pay the remaining 36.67% of the tax (0.146% of the wages); employers with less than 50 employees may elect to pay the employer portion of the tax in order to obtain additional benefits for its employees.

Employers must file tax and wage reports and pay family and medical leave tax each quarter with the Employment Security Department.

(iii) Washington State Long-Term Care Tax

In 2021, Washington State passed a statute under which, as of January 1, 2022, a 0.58% long-term care tax was to have been imposed on employee wages to fund long-term care coverage. Unlike state unemployment or family and medical leave taxes, there was no wage base limit for the long-term care tax. Employers were to withhold the tax from the employee or pay the tax on the employee's behalf. Concluding that the plan needed adjustments, its requirements have since been postponed until July 1, 2023. It is unclear what changes may be made to the statute before it ultimately goes into effect.

Under the statute originally passed, employees were permitted to opt out of the long-term care program (both the tax and the benefits) if the employee was 18 years or older, had purchased private long-term care insurance by November 1, 2021, and applied for exemption with the Employment Security Department by December 31, 2022. This provision will likely be modified with the new effective date. Once the statute takes effect, employers will file tax and wage reports and pay long-term care taxes each quarter with the Employment Security Department.

(iv) Washington State Workers' Compensation Premium

Washington is one of only four states that requires employers to participate in a state workers' compensation insurance system, or to obtain permission to self-insure (rather than allowing employers to purchase private insurance without specific permission). Workers' compensation premiums vary based on the occupation or industry's risk classification and the employer's experience rating.

Workers' compensation premiums are paid into four funds: accident, medical aid, stay-at work-program, and supplemental pension funds. Employers pay the accident fund premium and half of each of the medical aid, stay at work, and supplemental pension fund premiums. Employers must withhold the employee's one-half of the medical aid, stay at work, and supplemental pension fund premiums.

Employers must file reports and pay workers' compensation premiums each quarter with the Department of Labor and Industries. For more information, *see* the Department of Labor and Industries' Employer's Guide to Workers' Compensation in Washington State.

(v) Washington State Payroll Tax Reporting and Responsible-Person Liability

As with federal payroll taxes, it is important to withhold and pay state payroll taxes properly and timely. Failure to make quarterly returns or payments with the Employment Security Department and Department of Labor and Industries may subject the employer to civil and potentially criminal penalties.

The officers with control or supervision of Washington payroll taxes may become personally liable for any such unpaid taxes. This is important to note because many board members and Executive Directors are unaware that they could be personally liable for unpaid taxes.

c. Local

In addition to federal and state payroll taxes, employers should consider whether they have any local payroll tax obligations. For example, the City of Seattle imposes a payroll tax on employers that pay at least one Seattle employee more than $150,000 and had more than $7,000,000 in Seattle payroll expenses during the preceding calendar year. The payroll tax is paid by the employer and cannot be collected from the employee.

d. Out-of-State and Remote Workers

Employers should carefully consider the tax and other legal consequences of hiring an employee located outside Washington or allowing or requiring in-state employees to work outside Washington temporarily.

(i) State Income Tax Withholding

Although Washington does not currently have an individual income tax, Washington employers who employ a worker in a state or local jurisdiction with an income tax will need to register to withhold and report their employee's state and local income tax. Employers may also need to register and withhold income tax when their Washington-based employees work remotely on a temporary basis. Unfortunately, employer withholding requirements for workers temporarily working in a state vary widely by state. In many states, employers are technically required to withhold income tax on the first day an employee performs services in the state. Other states have withholding thresholds based on the employee's compensation or the number of days worked in the jurisdiction.

(ii) State Payroll Taxes

Washington employers who employ a worker outside Washington will also need to register and comply with the unemployment, workers' compensation, and other payroll tax obligations applicable in the employee's jurisdiction.

Unlike personal income tax withholding, employers do not generally need to register and pay unemployment, workers' compensation, or other payroll taxes in other states with respect to employees who are based in Washington but working temporarily outside Washington.

CHAPTER 72. Other Employer Obligations

a. Federal Requirements

(i) EIN

An employer identification number ("EIN"), also known as a federal employer identification number, is used to identify the tax accounts of all employers, including nonprofit organizations. Employers are required to use the EIN on all of the items that the employer sends to the IRS and the Social Security Administration.

(ii) Verification of Worker Identity and Eligibility to Work

Employers are required to verify that each new employee is legally eligible to work in the United States. This includes completing the U.S. Citizenship and Immigration Services ("USCIS") Form I-9, Employment Eligibility Verification. Employers can obtain this form from USCIS offices or by visiting the USCIS website at https://www.uscis.gov/i-9. Employers must maintain completed Forms I-9 in their files for three years after the date of hire or one year after the date employment ends, whichever is later.

(iii) Occupational Safety and Health

Both federal and state law require employers to maintain a safe, healthful workplace for employees. The Occupational Safety and Health Act ("OSHA") is the federal law. It is mirrored by the Washington Industrial Safety and Health Act ("WISHA"), which is enforced by the Washington Department of Labor & Industries. Both OSHA and WISHA require employers to track workplace injuries or illnesses. Prompt reporting of such instances to the State sets in motion the processing of any workers' compensation required by the circumstances.

(iv) Affordable Care Act

The Affordable Care Act ("ACA") contains benefits and responsibilities for employers depending on their size and structure. An employer's size is determined by the number of its full-time employees, including full-time equivalents. The structure and requirements of the ACA are the subject of much debate in Congress, and changes may occur. For more information on current ACA requirements that may apply, please visit https://www.irs.gov/affordable-care-act/employers.

b. State Requirements: Workers' Compensation and Unemployment Compensation

In Washington, employers must complete a Master Business Application with the State of Washington. *See* CHAPTER 11 Nuts and Bolts of Incorporating and CHAPTER 56 B&O Tax. The application allows an employer to obtain a business license and register with all required state agencies. By completing the Master Business Application an employer registers for workers' compensation with the Department of Labor and Industries and unemployment insurance with the Employment Security Department, and both agencies will send the employer information about employee quarterly report forms. Depending on the nature of the organization's activities, an employer may also need to register with the city or county in which it is conducting its business. For additional information, *see* http://www.dol.wa.gov/business.

c. Posting Requirements

Nearly every statute or ordinance designed to protect employees — federal, state, or local — contains a provision requiring employers to have an official poster in a location accessible to employees that describes the provisions of the particular law. Even if an employer is otherwise in compliance with substantive requirements of an employment law, it may be in violation if posters are not present in the workplace.

d. Hiring Considerations

Washington State has several additional restrictions on hiring that employers should keep in mind when posting a new position.

Washington's Fair Chance Act

Effective March 13, 2018, the Washington Fair Chance Act (WFCA) prohibits inquiries regarding applicants' conviction histories until the employer has

determined the applicant is "otherwise qualified" for the position. Once the employer has initially determined that the applicant is otherwise qualified, the employer may make further inquiry,

More specifically, with few exceptions, Washington employers are prohibited from:

- Advertising job openings in a manner that excludes people with arrest or conviction records from applying, such as using advertisements that state "no felons," "no criminal background," or that otherwise convey similar messages

- Including any question in an employment application, inquiring orally or in writing, receiving information through a criminal history background check, or otherwise obtaining information about an applicant's arrest or conviction record, until *after* the employer has initially determined that the applicant is otherwise qualified for the position

- Having automatic disqualifiers or categorically disqualifying an individual based on a criminal record before initially determining the person is otherwise qualified for the position

- Rejecting or disqualifying an applicant for failure to disclose a criminal record prior to initially determining the applicant is otherwise qualified for the position

The law, however, does not apply to:

- Any employer hiring a person who will or may have unsupervised access to children under the age of 18 or a vulnerable adult or person, as defined by Washington law

- Any employer, including a financial institution, who is expressly permitted or required under any federal or state law to inquire into, consider, or rely on information about an applicant's or employee's criminal record for employment purposes

- Various law enforcement agencies or criminal justice agencies in Washington

- Any employer seeking a nonemployee volunteer

- Any entity required to comply with the rules or regulations of a self-regulatory organization, as defined by the Securities Exchange Act

Ban on Salary History Inquiries

Washington employers are limited in when and what they can ask about an applicant's prior salary. In particular, Washington's Equal Pay and Opportunities Act ("EPOA") prohibits employers from:

- seeking the wage or salary history of an applicant for employment, either directly from the applicant or from a current or former employer, and
- requiring that an applicant's prior wage or salary history meet certain criteria.

The law, however, does permit employers to confirm an applicant's wage or salary history, but only if the applicant has voluntarily disclosed their wage or salary history, or if the employer has already negotiated and made an offer of employment to the applicant that includes an offer of compensation.

Additionally, the EPOA requires employers with 15 or more employees to provide, upon request by an applicant who has been offered a position, the minimum wage or salary for the position. Importantly, this requirement also applies to internal transfers and promotions. If no wage scale or salary range exists, the employer must provide the minimum wage or salary expectation set by the employer prior to either posting the position, making a position transfer, or making the promotion. Beginning January 1, 2023, Washington employers with more than 15 employees will be required to include in every job posting a "wage scale or salary range" as well as information about other compensation and benefits for the position.

CHAPTER 73. Setting Executive Compensation

One of the most important tasks facing the board of directors of a nonprofit is setting the compensation for the executive director or chief executive officer and other senior management. A salary which is set too low may fail to attract the talent necessary to best achieve the goals of the entity. But there also are clear dangers to approving an excessive compensation package. Executive compensation that is unreasonably high can result in penalties imposed by the Internal Revenue Service ("IRS"), as well as distrust by members, potential donors and the general public. Moreover, setting appropriate compensation is a fiduciary function, involving decisions regarding the appropriate use of entity assets.

The IRS recommends that nonprofits follow a three-step process in setting executive compensation that is reasonable. Following and documenting compliance with such a process creates a rebuttable presumption that the compensation package is reasonable, shifting the burden of proving otherwise to the IRS. In addition, 501(c)(3) organizations required to describe the process used to approve executive compensation and provide compensation information regarding executives in the annual filing of the Form 990. The three steps are summarized as follows:

1. The board should arrange for a comparability review by an independent body. In this case, an independent body can be a committee of the board, provided that the person to be receiving the compensation is not a member of the committee.

2. The independent body should review comparable salary and benefits data. Data is comparable if it reflects nonprofit entities of similar size and mission, and the same geographic region.

3. The independent body should document (a) the persons who participated in the review, (b) the independence of the participants, (c) the process used to determine the compensation, and (d) the decision (for example, via Board resolution).

See https://www.irs.gov/charities-non-profits/charitable-organizations/rebuttable-presumption-intermediate-sanctions. It should be noted that the executive compensation package includes the value of employee benefits, deferred compensation, and fringe benefits as well as salary.

If an executive is deemed to have received an excessive benefit, such as an unreasonably large compensation package, the IRS can impose sanctions under section 4958 of the Internal Revenue Code. Such sanctions can include repayment of the excessive benefit and imposition of an excise taxes on the executive who receives the excessive benefit and the persons responsible for approving or failing to prevent the excessive benefit. Those same parties could also face personal liability for breach of fiduciary duty. Payment of excessive compensation can also be deemed to constitute prohibited private inurement, a violation for which the IRS is authorized to revoke an entity's federal nonprofit status.

An additional hurdle was added by the recent Tax Cuts and Jobs Act, which imposes an excise tax on annual compensation in excess of $1 million or severance

payments in excess of three times the executive's average annual compensation for the previous five years.

In consideration of the duties of the board and significant potential liabilities, it is recommended that the board of a nonprofit adopt the following best practices with respect to executive compensation:

- Establish a compensation committee (or other independent body) authorized to set executive compensation.
- Utilize the IRS' procedures to establish a rebuttable presumption of reasonable compensation, utilizing appropriate comparability data and considering the full range of compensation and benefits.
- Adopt a comprehensive conflicts of interest policy (the IRS requires an explanation from any nonprofit that does not have such a policy).
- Adopt a written compensation policy, stating the entity's goal of linking compensation to performance, strategy, values, and mission, and referencing comparable peer groups, and target market position with respect to salary level.
- Have the executive compensation approved by the full board (except for conflicted members).
- Review the executive's performance no less frequently than annually to determine whether goals and expectations are being met.

CHAPTER 74. Employee Benefits

a. Introduction

The term "employee benefits" refers to a broad category of non-cash benefits offered by an employer to its employees. Such benefits can include tax-deferred retirement accounts, group insurance, health care benefits and various other benefits. Although no employer is required to offer any such benefits to employees, nonprofit must consider offering a competitive benefits package in order to attract and retain the staff needed to accomplish its goals.

In considering which benefits to offer, a nonprofit employer must consider the direct and indirect costs. In addition to any employer contributions that are contemplated, costs will include, depending on the type of plan, drafting, annual

administration (internal, external, or both), annual legal compliance such as testing and reporting and disclosure (internal, external, or both), liability insurance, and potential claims. Failure to satisfy the applicable compliance rules can result in financial penalties and lawsuits. Accordingly, a nonprofit employer should consider its ability to bear the financial burden of a plan, its willingness to be exposed to risk, its ability to administer (or pay to administer) the plan, as well as evaluate the type of benefits offered by employers likely to be competing for the same talent.

One characteristic that nearly all employee benefit plans share is that they are subject to federal regulation pursuant to both the Internal Revenue Code ("the Code") and the Employee Retirement Income Security Act of 1974 ("ERISA"). As a general matter, the relevant provisions of the IRC are designed to result in no income tax, or delayed income taxation, on employees with respect to the benefits provided. The conditions imposed to obtain the desired tax result include, depending on the type of plan, nondiscrimination rules, funding rules, contribution limits, and vesting schedules.

Plans subject to ERISA must satisfy rules pertaining to reporting and disclosure, vesting, protection of assets, plan administration, and fiduciary responsibility. It should be noted that ERISA applies to most types of employee benefit plans, and compliance is not elective. If a program of benefits is subject to ERISA, compliance with the statute is required.

b. Retirement Benefits

An employer can provide retirement benefits under one or more of a variety of plans. Excluding special arrangements for executives, all of the retirement benefit plan alternatives allow for money to be set aside for employees currently (in a trust, custodial or insurance arrangement), but not available or subject to income tax until distributed. The types of plans available to provide retirement benefits to a broad classification of employees include defined benefit plans (i.e. a classic pension plan), money purchase defined contribution plans, profit sharing plans, simplified employee pensions, 401(k) plans, and 403(b) plans. The types of plans differ as to characteristics such as funding rules, contribution limits, whether contributions are made by the employer, the employee or both. With the exception of 403(b) plans, all of these plans are available to for profit employers as well.

All of these retirement programs are subject to ERISA, although the applicable statutory requirements may vary depending on the type of plan and classification of

employees covered. A few key attributes of the retirement plans most commonly utilized by nonprofit employers follows:

- 403(b) and 401(k) Plans: Probably the most common choices for nonprofit employers, these plans provide for employee pre-tax deferrals of salary, and, if the employer chooses, additional employer contributions. Employees can be allowed to choose the investment funds to which their accounts are allocated from the choices allowed by the employer. The plans are similar in most respects, but deferrals under a 401(k) plan are subject to a nondiscrimination test not applicable to 403(b) plan, and an additional catch up contribution opportunity can be provided under a 403(b) plan. The tax requirements for 403(b) plans are set forth in section 403(b) of the Code. The primary tax qualification rules for 401(k) plans are set forth in sections 401 and 415 of the Code.

- Simplified Employee Pensions: Instead of establishing and maintaining a separate retirement plan, an employer can make contributions to the individual retirement accounts of its employees. Such arrangements are available only to employers with 100 or fewer employees who do not provide another retirement plan and who do not hire employees under lease agreements.

- Profit Sharing Plans: These plans provide for an annual employer contribution in an amount determined by the employer. The amount can vary and be determined each year depending on the employer's financial ability. The primary applicable tax qualification rules are set forth in sections 401 and 415 of the Code.

- Money Purchase Defined Contributions Plans: These plans provide for a stated employer contribution each year. Some plans are designed to require employee contributions as well. Because of the annual funding requirement and the emphasis on employer funding, these plans are less common with nonprofit employers. The primary applicable tax qualification rules are set forth in sections 401, 412, and 415 of the Code.

- Defined Benefit Pension Plans: Defined benefit plans provide a retirement benefit expressed pursuant to a formula which takes into consideration the employee's compensation and years of service. The annual funding for the future benefit is actuarially determined. Defined benefit plans can be expensive to fund and administer, and are not commonly offered by

nonprofit employers. The primary applicable tax qualification rules are set forth in sections 401, 412, and 415 of the Code.

c. Welfare and Fringe Benefits

Many employers offer benefit plans which, while not retirement benefit plans, are subject to ERISA and/or the IRC. Examples of such plans are:

- Medical, dental and vision plans
- Health reimbursement and flexible spending accounts
- Disability insurance and group accident and sickness plans
- Long-term care insurance plans
- Housing assistance plans
- Volunteer Employee Beneficiary Associations
- Unemployment, vacation, paid time off and holiday pay plans
- Severance pay plans
- Apprenticeship and training programs
- Scholarship funds
- Prepaid legal services

It also should be noted that some of such plans may be subject to laws in addition to ERISA and the IRC. For example, health benefit plans are subject to the Affordable Care Act if the employer has 50 or more full time employees, welfare plans utilizing insurance policies are subject to state insurance laws, and state labor laws apply to certain arrangements. Employers considering offering such benefits should seek advice regarding regulatory requirements and carefully consider their financial and administrative capacity to offer such benefits.

d. Executive Deferred Compensation

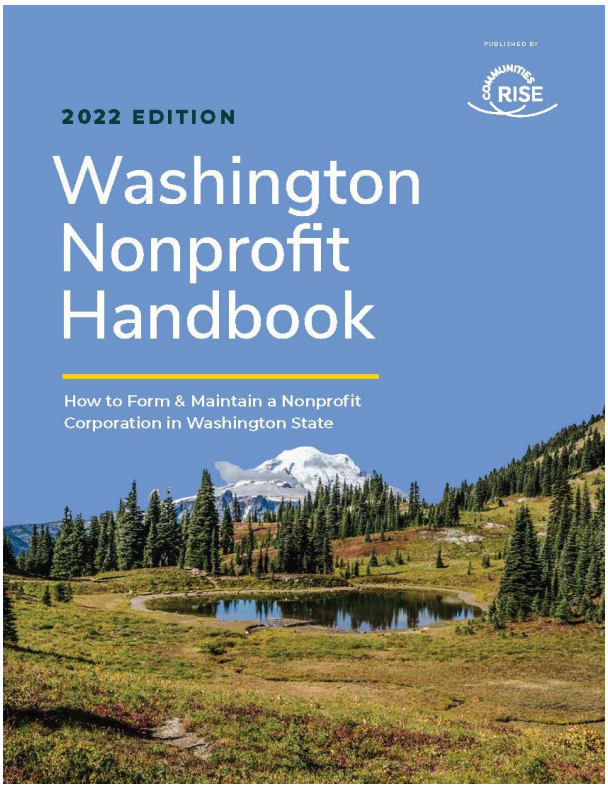
Attracting and retaining appropriate executive talent can be a particular challenge for nonprofit entities. In addition to appropriate salary and participation in the menu of employee benefits offered to employees generally, employers often

consider establishing a deferred compensation arrangement. Under such an arrangement, the employer agrees to pay the executive money in the future in return for current service. Subject to certain conditions, the deferred compensation is not included in the executive's income tax until a later date. As with other aspects of employee benefit plans, the subject of deferred executive compensation is complicated and employers are advised to seek the advice of experts. However, the following information may assist an employer in evaluating its alternatives.

- A nonprofit employer can establish a plan under section 457(b) of the Code. Such plans are called 457(b) plans, and can be offered only to highly compensated employees with significant executive duties. In many respects these plans operate similarly to 401(k) plans and 403(b) plans, but there are key differences including the fact that any assets set aside for the payment of benefits remain the property of the employer, subject to the claims of the employer's general creditors, until paid.

- An employer can create an arrangement, either in a separate plan document or as a provision of an employment agreement, agreeing to pay compensation to an executive at some future date or upon the occurrence of a future event, such as retirement. Such an arrangement is subject to rules under section 409A of the Code regarding the timing of deferrals and distributions. Section 409A of the Code also precludes an employer from setting aside assets to pay the deferred compensation benefits in a vehicle protected from the claims of the employer's creditors. In addition to the rules under IRC section 409A, when such an arrangement is implemented by a nonprofit employer, it is subject to additional rules under section 457(f) of the Code. Among other requirements, section 457(f) of the Code provides that the amounts credited to an executive's account under the plan are includable in the executive's taxable income when they are vested. This provision results in the plan providing a "golden handcuff" in the sense that the executive has an incentive to keep working for the employer in order to ensure receipt of the deferred compensation, but also results in uncertainty for the executive as the assets are not protected in a trust and remote from the employer's creditors.

- These executive compensation arrangements are subject to certain provisions of ERISA, but are exempt from many of the more burdensome provisions.



PART 11 INTELLECTUAL PROPERTY CONSIDERATIONS

Chapter 75 Application of Intellectual Property Law to Nonprofits
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PART 11. INTELLECTUAL PROPERTY CONSIDERATIONS

CHAPTER 75. Application of Intellectual Property Law to Nonprofits

Intellectual property law can be a very detailed and esoteric topic, but here we will only focus on a few intellectual property issues that nonprofit corporations commonly encounter.

A nonprofit corporation can own, sell, and license intellectual property such as patents, trademarks, and copyrights. Intellectual property is important for a nonprofit corporation, whether it is created by the nonprofit or is used by it in the operation of its business. Intellectual property is an ever-increasing portion of assets for private and non-profit corporations.

The five basic types of intellectual property discussed in this chapter are: patents, copyrights, trademarks, trade secrets, and publicity rights.

a. Patents

Patents are a form of protection issued by the United States Patent and Trademark Office. There are three main types of patents: utility, design, and plant:

(i) utility patents protect new and useful machines, manufactured goods, processes, or compositions of matter, and any improvements to any of the foregoing

(ii) design patents protect original and ornamental designs for a manufactured good

(iii) plant patents protect distinct and new varieties of plants

Although there are some nonprofit corporations that may be very involved with patents (such as university foundations, technology or research-based organizations, or hospitals), most nonprofit corporations will not be applying for or obtaining patent rights, so we will not discuss them further here. However, nonprofit corporations often indirectly work on patents. For example, they may be contracted by a for-profit entity that holds a patent to conduct further research on the subject of the patent. If interested, a nonprofit corporation can obtain more information on patents from the patent section of the U.S. Patent and Trademarks Office website.

b. Copyrights

Under the Copyright Act 17 U.S.C. §102(a), copyrights are a form of protection that protects "original works of authorship fixed in any tangible medium of expression". Items protected by copyright include written text (such as books and blogs), photographs, videos, graphics, music, website content, artwork, workshop materials, curricula, and computer software. A copyright owner can prevent a third party from, among other things, copying, distributing, or creating new or adapted versions of the work (also called "derivative works"). As soon as a person creates an original work of authorship, the author has a copyright in it — nothing more needs to be done. However, additional rights can be obtained by registering a copyright with the U.S. Copyright Office. Recording (also can be called "registering") a copyright will help the nonprofit corporation protect its work against infringement. To prove copyright infringement, a claimant must show:

(i) ownership of a valid copyright registration is prima facie evidence (*prima facie* is a legal term which means it is sufficient evidence to prove ownership, unless specifically rebutted) of a valid and original copyright,

(ii) copying of original elements, and

(iii) substantial similarity between the infringing work and copyrighted work.

There are additional advantages to registering a copyright. For the entire duration of the copyright, a copyright owner has the rights to reproduction, adaptation, distribution, public performance, and public display (this is true for unregistered copyrights as well). Additionally, a registered copyright owner may sue an infringer for infringement, and recover statutory damages and attorney fees if the work is registered before the infringement occurred or within three months after first publication. Finally, if the copyright is registered within five months of publication, it is considered evidence of the validity of the copyright. This means that rather than having to prove that you are the owner of a valid copyright, the court will presume that you satisfy the ownership requirement for bringing a case of copyright infringement. More information on copyrights and how they may be registered is available on the U.S. Copyright Office website. The duration of protection and exclusive rights under the Copyright Act is limited, covering 120 years from creation or 95 years from publication, whichever is earlier. Since copyrights are often misunderstood in the nonprofit world, a more detailed explanation of copyrights is provided below in CHAPTER 76.

c. Trademarks

Trademarks are logos, business or product names, tag lines, packaging, sounds, symbols, colors, designs or a combination of these used in association with goods that identify the source of origin for a good. Similarly, a service mark is like a trademark except that it identifies the source of origin for a particular service rather than a particular good. For ease of discussion, any reference to "trademarks" in this section will mean both trademarks and service marks. Trademarks are protected under both state and federal law. A federally registered trademark gives the trademark owner exclusive rights to use the mark nationwide, whereas state registration offers protection and exclusive rights limited to the state of registration. Unlike copyright and patent protection, trademark protection doesn't have a set duration as long as the trademark owner complies with the trademark filing requirements, is registered, and continues to use the trademark in commerce.

Another important thing to remember with trademarks is that failure to monitor or protect your trademark may result in loss of rights. It is helpful to speak to an attorney to utilize certain mechanisms that will proactively protect the trademark and prevent unauthorized third parties from using either a confusingly similar or the same trademark in the same or related industry. A nonprofit corporation has a potential claim against any third-party that subsequently uses the same or similar trademark in such a way that consumers are likely to be confused between the nonprofit corporation and the third-party, and/or their respective goods or services. Since every nonprofit corporation probably has one or more trademarks, a more detailed explanation of trademarks is set forth in the subsequent CHAPTER 76.

d. Trade Secrets

A trade secret is any information that derives economic value from not being known (e.g., product formulas, detailed information on suppliers or customers, ways of doing business, personnel information, client list, financial data, fundraising strategies, unique organizational mailing lists, even software etc.) and where the owner must take reasonable efforts to keep the information secret. A nonprofit corporation has a potential claim against a third-party that acquires, discloses, or uses its trade secret without consent. Such efforts will probably include having employees and contractors sign a confidentiality agreement. Sample confidentiality agreements and other templates are available online at Resources for Nonprofits page of the Communities Rise website.

e. Publicity Rights

Washington and other states, allow an individual to prevent others from using their name, voice, signature, photograph, likeness, or other personally identifiable characteristics. These are often referred to as "Publicity Rights" or "Personality Rights". The scope of this protection varies from state to state, so it's important to determine your state's specific protections. A basic rule of thumb is that a nonprofit corporation should not use the name, picture, or other characteristics that identify any living or deceased individual, without that individual's consent, even if the use is not being done for profit. Washington law explicitly states that an infringement of this right can occur in connection with not-for-profit fundraising, through website content, nonprofit events, or solicitation of donations. Nonprofit corporations should be vigilant especially when they interact with vulnerable individuals, for example, minors, elderly, individuals who are functionally, mentally or physically unable to care for themselves. The Communities Rise Resources webpage *has* a sample photo or model release.

Most products or information can be protected under a combination of intellectual property rights. For example, software can be protected under patent, copyright, or as a trade secret; business processes or methods can be protected under patent law or trade secrets; and some intellectual property may not be protectable other than as trade secrets. Ultimately, the decision on how to protect your intellectual property hinges on whether the nonprofit corporation would be at a disadvantage if the know-how or content was part of the public record. Patent, trademark, and copyright applications are published and made available to the public. Thus, some nonprofit corporations may want to protect their intellectual property as a trade secret for competitive reasons.

CHAPTER 76. Trade Names and Trademarks

Nonprofit corporations often confuse trademarks and copyrights. As discussed above, copyrights protect original creative works fixed in a tangible medium, whereas trademarks protect names, logos, and phrases used to identify goods or services. It is the fiduciary duty of the board of directors of a nonprofit corporation to identify, safeguard, and manage its intellectual property assets to "advance its charitable goals and protect its assets" (Goldschmid, H., 1998[13]). The importance of intellectual property is highlighted in the Internal Revenue Service Form 1023 (application for tax-exemption). Under Part IV (Your Activities), Line 7 of

[13] The fiduciary duties of nonprofit directors and officers: Paradoxes, problems, and proposed reforms. Journal of Corporation Law, 23(4), Goldschmid, H., 1998.

the Form 1023, nonprofit corporations are required to describe the types of intellectual property they will create and how they plan to manage them. The IRS expects nonprofit corporations to identify, understand, and articulate ownership and usage of intellectual property assets. Further, it is the responsibility of the nonprofit not only to manage, use, and protect its intellectual property, but also try to seek opportunities to generate income through contractual arrangements.

This chapter will explore the application of copyright and trademark law in the nonprofit sector.

a. Copyrights for Nonprofits

As noted in CHAPTER 75, the Copyright Act protects original works of authorship that are fixed in a tangible medium. Works of authorship include literary, musical, dramatic, architectural, and pictorial works, as well as pantomimes, sound recordings, and motion pictures. Furthermore, a work qualifies for copyright protection only if it is original and is fixed in a tangible form.

It is important to emphasize that registration is not required for copyright protection, but is highly recommended for the reasons mentioned in CHAPTER 75. Once a copyright is registered it does not need to be renewed. However, if the nonprofit corporation revises the work or adds additional elements to the registered work, it would have to register the revised content to protect the additional elements of the work.

Due to the volume of intellectual property a nonprofit corporation may create, it may be unreasonable to register all works with the Copyright Office. Therefore, it is recommended that the nonprofit corporation identifies work that it believes would add substantial value to the corporation. Furthermore, as a deterrent to unauthorized copying, the nonprofit corporation can insert a copyright notice in all its materials. Registration is not required to use the © notice symbol. You may use the following copyright notice on your materials:

© [insert year of publication] [Name of Nonprofit Corporation] All rights reserved.

A nonprofit may also add a phrase to identify any rights it may want to give to a third-party to use the protected work, for example:

© [insert year of publication] [Name of Nonprofit Corporation] All rights reserved. Reproduction, copies, and distribution may be made only for personal use or noncommercial educational purposes.

Tracing ownership of intellectual property may be difficult, particularly if more than one person creates the work. Typically, a nonprofit corporation will own original works of authorship as "work made for hire" if an employee of that corporation develops or creates the work as part of the scope of their employment. However, if the employee creates the work outside of the employees' typical duties, the employee retains ownership in that work. For example, if an accountant takes photographs at the annual company gala, those photos are considered to be owned by the accountant because photographing an event exists outside of the accountant's general scope of duties. To avoid such situations, it is best practice to ensure that all employment contracts reiterate that an employee assigns, transfers all rights they have or may have in their work and any other work that they submitted to the corporation during the employment period.

However, it gets trickier when a nonprofit corporation utilizes another individual or entity, such as consultants or independent contractors, to create works. Such works may be considered "work for hire" only if they satisfy the following criteria:

- The work must fall within one of the nine categories listed in the Copyright Act, which are: a contribution to a collective work, a part of a motion picture, a translation, a compilation, a test, an answer material for a test, an atlas, an instructional text, or a supplementary work;

- The agreement must explicitly state that the work shall be considered a work made for hire; and

- The agreement must be signed by both parties.

In cases when the situation does not satisfy the elements for work for hire, the nonprofit corporation may own the work product but not the copyright for the work. For example, if a software developer is hired as an independent contractor to create a custom program without a transfer of intellectual property rights the nonprofit corporation will not be able to create modifications or upgrades. Similarly, another unfortunate situation that a lot of nonprofits face is when board members or volunteers create content without a signed assignment of rights document. The board members or volunteers will likely retain ownership of the intellectual property

rights in the work and can then prevent the nonprofit corporation from using the work if they so choose.

It is part of the board of director's fiduciary duty to secure ownership of intellectual property rights. To do so, the nonprofit corporation should require all individuals who create intellectual property materials to execute an assignment of rights, which must state that the nonprofit corporation will own the right, title, and interest in the created works.

Nonprofit corporations often work in collaboration with other nonprofits to create works such as videos, educational content, and curriculum. When creating such original content, both parties should discuss ownership of the work and execute a joint ownership agreement prior to beginning the collaboration. Such agreement will formalize the terms of the collaboration, including whether they have joint ownership interests in the work and who obtains any profits from the exploitation of the work.

Another important element in the world of copyrights is the scope of protection of the work. If a work is created based on or derived from preexisting works (this is known as a derivative work), or incorporates elements from the preexisting work, only the original elements in the new work created may be protected under copyright law for the author of these original elements. For example, in a revision of the artwork or text on a website, only the new content will be protected under a claim for copyrights of the new work.

Finally, as mentioned above, the Copyright Act does not require registration for federal copyright protection. However, it is highly recommended as it provides substantial benefits and is an inexpensive and simple process.

Under copyright law, unauthorized use of another person's work is copyright infringement. It is important to remember that a work is protected by copyright law even if you have purchased a copy of the work, or if it is publicly available. Thus, when you purchase a book, you only own that particular copy, and have not purchased the copyright to the book itself. This means you cannot make copies of the book and distribute them, or otherwise infringe the copyright owner's rights. Likewise, even though a picture, digital content, or video clip may be publicly available on the Internet, you cannot copy or use them without the permission of the copyright owner. Before using works owned by someone else, reach out to the copyright owner and ask for their written permission or check the terms of use posted on their website for license guidelines, or guidelines on usage of content.

Nonprofit corporations sometimes allow users of their website to post their own content on its website, such as blog posts, articles, or artwork. If your website offers a platform for such use, then your nonprofit corporation should include a Digital Millennium Copyright Act 1998 ("DMCA") provision on its Website's Terms of Use. The DMCA safe harbor provisions will protect the nonprofit organization from all monetary liability from copyright infringement of its users. Please consult with an attorney to take advantage of the DMCA safe harbor.

b. Trade Names and Trademarks

There is often confusion surrounding the difference between a trade name and a trademark. A trade name is the name of a business, and it is usually also a trademark because it indicates the source of origin for the goods or the service provided by the business. For example, Microsoft Corporation is a trade name, and "Microsoft" is also a trademark.

Rather than trying to understand the differences between a trade name and a trademark, it is easier if a nonprofit corporation just assumes its trade name will also function as a trademark, and therefore pick a trade name with trademark registration in mind.

Under trademark law, a nonprofit corporation can be sued for trademark infringement if it uses a trademark that is the same as, or similar to, the trademark of a prior user. If people are likely to confuse the nonprofit corporation and the senior user, and/or their respective goods and services, it can be considered trademark infringement. Thus, if a nonprofit corporation begins using a business name without conducting any prior research, and later finds that there is another entity with senior rights with the same or similar name, the nonprofit corporation may have to change its name, reprint materials, change signage, and incur additional expenses.

In order to avoid this, it is important for a nonprofit corporation to do preliminary research before choosing a business name. This usually involves at least five basic steps: (i) searching the database available at the U.S. Trademark Office's website, (ii) performing some general searches using the internet, (iii) conducting different social media searches, (iv) checking the Washington Secretary of State's and Department of Revenue's website; and (v) investigating to see whether an appropriate domain name is available.

Initially, a nonprofit corporation should go to the U.S. Patent and Trademark Office's trademark site. The site allows the nonprofit corporation to use the

Trademark Electronic Search System (TESS) to see whether a particular trademark has been applied for or registered. The site also contains various background information related to trademarks.

If TESS does not indicate that the same or a similar trademark has been applied for or registered, a nonprofit corporation should then conduct additional searches on Google, Bing, other internet search engines, as well as social media sites to see if an entity or product or service with the same or similar name already exists.

Finally, since a nonprofit corporation will probably want a website, it should see if an appropriate domain name is available, and then register the domain. This can be done at sites such as www.GoDaddy.com, www.tucows.com, or www.GoogleDomains.com. You may also consider purchasing similar domain names for example, "charityname.org", "charityname.com," this will prevent cyber squatters from using a confusingly similar domain name in the future.

A nonprofit corporation should be forewarned that it is often very difficult to find an appropriate business name and trademark. At times, it may be very frustrating because all the desired choices will be seemingly taken. A nonprofit corporation can increase its chances of finding a suitable name by choosing arbitrary or fanciful terms (e.g. made-up words like "Dasani" or real words like "Apple" that have no connection to the good or service). Another thing to consider is whether social media handles and domain names are available for use; social media handles and domain names offer tremendous value to a corporation in establishing its reputation in its community.

After completing the above searches and identifying a few potential names that seem to be available, a nonprofit corporation should consider consulting with an experienced attorney. The attorney may be able to point out problems that the nonprofit was unaware of, or may indicate that a situation that appeared risky to the nonprofit corporation is not very problematic. In any event, it is best to have several alternative names to discuss with the attorney. It can be a frustrating and expensive lesson for a nonprofit corporation to launch a new business without the proper investigation, as your use of another's mark will be trademark infringement and you may subsequently receive a "cease and desist" letter from a prior user that forces the nonprofit corporation to change its name and all materials that contain the old name.

The above research can be done while the nonprofit corporation's articles of incorporation are being prepared, and the eventual name chosen can be inserted prior to the articles of incorporation being filed. Once the articles of incorporation

are filed, a Washington Master Business Application must also be filed (as discussed in CHAPTER 12). The Master Business Application contains a section where the nonprofit corporation can register its trade names. Although it may not be mandatory, this section should be used to register the nonprofit corporation's trade names because registration by this method is inexpensive and can be done simultaneously with filing the other information initially required by the Master Business Application. Usually, the nonprofit corporation's corporate name is also a trade name. In some cases, the acronym of a nonprofit corporation's corporate name may also be an additional trade name. For example, the acronym "ACLU" may be an additional trade name for the American Civil Liberties Union. As noted above, these trade names are also usually trademarks. However, trade name registration will not offer the same protection as trademark registration under state or federal law.

In the United States, nonprofit corporations accrue rights in a trademark as soon as the trademark is used in commerce in connection with the nonprofit corporation's business. These are called "common law" trademark rights, and no registration is required. Generally, once trademark use has started, the only people who can require a nonprofit corporation to stop using its trademarks are those who can show that they began using the same or similar marks before the nonprofit corporation. This is another reason why conducting thorough searches is important. They give the nonprofit corporation confidence that it has a good defensive legal position, and that there are likely no prior users.

From a legal point of view, it is always better if a nonprofit corporation supplements its common law rights, and also registers its trademarks under state and/or federal law.

A nonprofit corporation may register a Washington State trademark through the Washington Secretary of State's website. Information can be found at https://www.sos.wa.gov/corps/Trademarks.aspx. State trademark registration may prevent other entities with similar goods or services from subsequently obtaining a Washington State registration for the same mark, because either the registered trademark will be included in searchable databases and will discourage other parties from filing for such mark, or the Secretary of State may refuse to register a similar mark for similar goods or services. It also allows a nonprofit corporation to bring a claim against a subsequent user for state trademark infringement, in addition to a claim for common law trademark infringement.

Nonprofit corporations may obtain more expansive trademark rights by registering the trademark at the federal level with the U.S. Patent and Trademark Office. The application for this registration is now usually submitted online from the U.S. Patent and Trademark Office website. While federal trademark registration is always recommended (especially if you are offering goods and services in more than one state), the costs for such registration are more substantial than state registration, and the application review process is more rigorous and time-consuming. Therefore, whether a nonprofit corporation should in fact undertake federal registration requires a cost/benefit analysis that depends on the corporation's resources and goals. A knowledgeable attorney can help the nonprofit corporation with this decision.

Unfortunately, there is no government agency or private party (except the trademark owner) charged with enforcing a nonprofit corporation's trade name or trademark rights. Thus, a nonprofit corporation will bear the costs of such action. Such enforcement may require the corporation to hire an attorney, which may be relatively expensive and thus not a viable option. For many nonprofit corporations with limited resources, it will be important to remember that, even if they obtain state and/or federal registration, there is no guarantee that another party will not subsequently use a similar trademark, or that another party will willingly stop such use. Because of this situation, some argue that from a pragmatic point of view, the expanded rights provided by state and federal trademark registrations are not as important to cash-strapped nonprofit corporations that are mainly worried about their defensive position. Although such registrations are always recommended if budgets permit, they may be more useful to the nonprofit corporation that wants to strengthen its offensive position, so that it has a better case when pursuing third parties to have them stop using the same or similar trademarks.

c. A Word About Fair Use

Some nonprofit corporations mistakenly believe that they have leeway to use the intellectual property of others without permission because they are not for-profit enterprises. This understanding is false, but we will not go into all the details here. If you copy or use someone else's intellectual property without their permission, that is infringement. Fair use is a defense against trademark or copyright infringement.

In trademark fair use, a nonprofit corporation is permitted to use a trademark owned by another party if it is necessary to describe the owner's goods or services (for example, "we use Microsoft Office software") or if the nonprofit corporation has acquired a license from the intellectual property owner. However, (i) the nonprofit

corporation may only use so much of the trademark as is necessary to identify the good or service, (ii) the logos of the owner should not be used (or if permitted to use the logo, then it must be in line with their trademark usage guidelines), (iii) the trademark should not be used in a manner that suggests the owner endorses or sponsors the nonprofit corporation and (iv) the marks should be used in compliance with any other guidelines provided by the intellectual property owner.

In copyright fair use, there is no hard and fast rule, and each situation must be analyzed on a case-by-case basis. One must evaluate the purpose of the use, the nature of the work being used, the amount of the work being used, and the effect of the use on the potential market for the work. A use of a copyrighted work without permission is not "fair use" merely because the purpose was to help a nonprofit corporation. In today's world, where copyright owners can use internet bots, web crawlers, and other automated technologies to more easily determine when their photos, articles, videos etc. are being used, it is highly recommended that nonprofits always obtain permission first. Even if the nonprofit may potentially have a fair use argument, the time, effort, and cost it takes to respond to, and argue with, the copyright owner may not be worth it. And there is always the possibility the owner will file an infringement lawsuit.

CHAPTER 77. Ownership of Intellectual Property

There are many complicated rules regarding the ownership of intellectual property, and a nonprofit corporation should seek the assistance of an attorney if it has any specific questions, or if it is in a field that uses or develops intellectual property extensively. In general, a nonprofit corporation should have a written agreement with each of its employees and independent contractors regarding who owns the intellectual property they may create (as discussed in the previous chapter). There is a rule of law that holds that if a nonprofit corporation does not have an agreement with an independent contractor regarding the transfer of intellectual property ownership, then the intellectual property such independent contractor creates (such as a brochure, a logo, or a web site) might be owned by the independent contractor—even if the nonprofit paid the independent contractor to create it.

It can be very surprising for a nonprofit corporation to find that it may not be able to freely modify and redistribute a brochure or web site that it paid for because it did not have a proper intellectual property assignment from the independent contractor who created it. Moreover, an "independent contractor" in this case is not just an unrelated design firm or web site developer; it might be anyone that the

nonprofit corporation does not provide employee benefits to or pays social security taxes for. Thus, "volunteers" or "interns" who spend time at the nonprofit corporation on a regular basis will probably fall within this category, and should sign intellectual property assignments.

It is best to have a custom intellectual property agreement created for each specific situation, but often a nonprofit corporation does not have the time or money to have one drafted. There are three types of common intellectual agreements that are applicable to nonprofits:

- The independent contractor agreement is for a situation when a nonprofit corporation hires an independent contractor to perform some services (such as creating a brochure or logo). It includes language that transfers the intellectual property to the nonprofit corporation and also includes a confidentiality provision so that the independent contractor has an obligation to protect the nonprofit corporation's trade secrets. Independent contractor agreements can of course be much more complicated and contain many other provisions; this is just a very simple template. Most independent contractors have their own contracts, in that case, please review the language to ensure that the assignment or transfer of rights language is included.

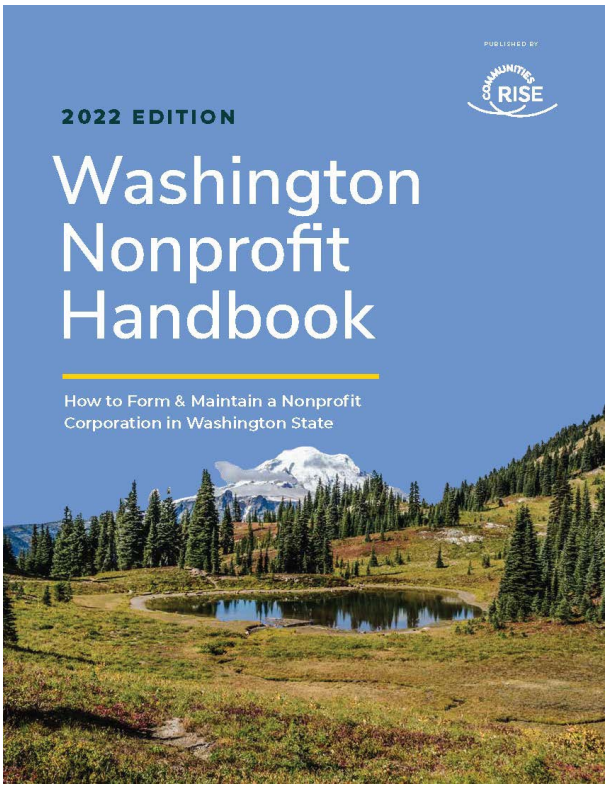
- The intellectual property and confidentiality agreement is a document that could be signed by all new employees as a condition of being hired. By signing the agreement, the new employee expressly assigns all intellectual property to the nonprofit corporation and agrees to protect the nonprofit corporation's trade secrets. If a nonprofit corporation would also like existing employees to sign an agreement like this, it should carefully discuss the situation with an attorney. The nonprofit corporation may have to take additional steps to better ensure that the agreement can be enforced against existing employees. A sample intellectual property and confidentiality agreement is available on the Communities Rise Resources webpage.

  The sample intellectual property and confidentiality agreement can also be signed by independent contractors who have not signed an independent contractor agreement. Note that the sample intellectual property and confidentiality agreement does not have a description of services, deadlines, and other provisions that the sample independent contractor letter agreement has, and thus may be more suitable for volunteers,

consultants, interns, and other individuals who are not employees of the nonprofit corporation but who provide assistance without being retained for a specific project. A good intellectual property and confidentiality agreement must clearly identify the intellectual property created and transferred or must be general enough to capture the work product of the individual.

- The sample release agreement, model release, or photo release agreement is for a situation when a nonprofit corporation is creating a training or educational video, is taking photos or videos of people, or is otherwise involved in a project with many people involved and it is too cumbersome to have them sign something like the sample independent contractor letter agreement or the sample intellectual property and confidentiality agreement. Also, such agreements do not cover publicity rights. Another situation where you would want individuals to sign a release is when you would like to use their personal information in a newsletter or other materials. Ordinarily, a nonprofit corporation might use a "model release" for this type of situation, but the sample release is designed to be a model release, plus a release for anyone else that is involved in the production (directors, producers, photographers, crew members or anyone else who is seen in, or helps with the creation of, the work, should sign the release since they all potentially will have intellectual property rights in the work). The sample release agreement should be modified to fit the particular situation, and if any of the people involved are minors the form should be signed by their parents or legal guardians. A sample release agreement is available on the Communities Rise Resources webpage.

As with other sections of this Handbook, this Part on Intellectual Property has only provided a very brief and simplified description of some of the issues that a nonprofit corporation might face. It has described how certain things might be done by a nonprofit corporation in a relatively independent and inexpensive manner. Unfortunately, "one size fits all" advice and form agreements can never cover all the potential issues, so it is always best for a nonprofit corporation to consult with a knowledgeable attorney.



PART 12 PERSONAL INFORMATION SECURITY AND ONLINE PRIVACY ISSUES FOR NONPROFIT ORGANIZATIONS

Chapter 78 Personal Information Security
Chapter 79 Internet Advertising and Privacy Laws

PART 12. PERSONAL INFORMATION SECURITY AND ONLINE PRIVACY ISSUES FOR NONPROFIT ORGANIZATIONS

CHAPTER 78. Personal Information Security

Almost every organization collects personal information from individuals, whether from employees, volunteers, donors, or recipients of services. This personal information may be necessary or useful for your organization's activities, such as payroll processing and sending solicitation requests. With the ability to use personal information, comes the responsibility to use it only for the intended/extended purposes and to keep that data safe. Sensitive information such as social security numbers, credit card numbers, financial account numbers, date of birth, health information, and other data can be used to commit financial fraud and identity theft.

To protect individuals against such threats, federal laws and many states require organizations to protect personal information, and in most cases, to notify individuals if information is improperly disclosed. Note that this Chapter is intended to cover only commonly applicable personal information security guidelines and requirements. Not all data protection laws are covered here. If you handle financial information, health information, driver's license numbers and social security numbers, other laws and regulations may apply.

The topic of personal information is complicated because many existing laws only address commercial entities, who are not the only agencies or organizations that are responsible for handling and safeguarding personal information. Does this mean that nonprofits should not worry? First, the law in this area is unclear. For example, a nonprofit may not be covered under a law if it provides its own fundraising but may be covered if it uses an outside commercial party. Second, laws may exclude certain tax exemption types of nonprofits (such as a 501(c)(3)) but may apply to all other nonprofit designations. Third, laws may apply for a 501(c)(3) where it has commercial operations such as running a store where it benefits from the profits. Fourth, the topic of personal information has become very important and a nonprofit's reputation can be put at risk if personal information is not handled properly.

Arguably, reputation risk alone is the most important reason why nonprofits should make the topic of personal information critical to their operations and act as if the laws apply regardless of whether they do or not (see http://blog.charitynavigator.org/2015/04/donor-privacy-policies.html for why Charity Navigator, the largest evaluator of charities, includes an assessment of the nonprofit's privacy policy in its evaluations).

a. Protecting Information

The Federal Trade Commission ("FTC") and a few states outside of Washington specifically require organizations to take measures to protect information. Under Section 5 of the Federal Trade Commission Act, 15 U.S.C. sections 41-58, the FTC has instituted numerous actions against entities who failed to adequately secure personal information, including at least one nonprofit corporation. Of the states that have data protection laws, most prescribe broad requirements to "reasonably secure" sensitive personal information.

This section gives a general overview of what your organization can do to help protect and secure personal information. Additional tips and guidance can be found on the FTC's website, which contains a wealth of information for businesses that is equally applicable to nonprofit organizations.

(i) Data Minimization

Organizations can best protect information by not having it in the first place. Avoid collecting unnecessary information by eliminating unnecessary fields in forms. Reduce the amount of data you have by storing information in redacted or truncated form, for example, by using only the last four digits of credit cards in databases. Delete information that you no longer need.

(ii) Securing Data

Data in physical form is a common source of identity theft. Keep physical documents safe by limiting access to areas where personal information is kept to only those individuals who have a legitimate "need to know." Require employees and volunteers to lock documents containing sensitive data in file cabinets or drawers for storage.

Protection of data in electronic form is best handled by information technology personnel and professionals with expertise in data security. Every individual in your organization, however, should know what they can do to help keep electronic data secure. For example, avoid storing sensitive data on portable devices such as CDs, DVDs, USB flash devices, laptops, and phones. Strongly consider encrypting data you must keep on such portable devices and, if practical, any place you store sensitive data. At minimum, use some form of security technology using strong password protection. Encrypt sensitive data you send over the internet, including data sent via e-mail. Make sure web pages that collect sensitive information over the internet use Secure Sockets Layer (SSL) security. A site is secure

if the letter "s" follows "http" in the site URL. In other words, if the webpage URL starts with "http," it is not secure. If it starts with "https," SSL security is used.

Use and regularly update firewalls, antivirus, and antispyware software to protect systems and computers connected to the internet. Finally, make sure that the vendors you use also protect any personal information you allow them to process or store on your behalf. Organizations may be held responsible for the actions of its vendors. It is important to have a written agreement or terms in place with every vendor who receives or processes personal information on your behalf. This includes, for example, vendors providing billing, marketing, technical services, even cloud storage providers. These terms should clearly spell out what the vendor can do and cannot do with the data, and other important privacy and security-related restrictions.

(iii) Data Disposal

Many state laws, including Washington's RCW 19.215, specifically require that you properly dispose of sensitive data. In Washington, "sensitive data" includes financial information and health information. Information that is improperly disposed of can end up in the hands of dumpster divers or other types of identity thieves. Under Washington law, proper destruction involves "shredding, erasing, or otherwise modifying personal information in records to make the personal information unreadable or undecipherable through any reasonable means."

Make sure all employees shred or properly incinerate any paper documents. Disposal in recycling bins is not a secure way to dispose of documents unless the bins themselves are secure and assurances are in place that the documents will be securely disposed. When disposing of old computer equipment, wipe the hard drives of data using appropriate wiping utility programs. If such technology is not economically feasible, you can also remove the hard drive and physically destroy it by simply smashing it.

b. Security Breach Notification

Laws in several states, including Washington's RCW 19.255, require your organization to notify individuals in the event of a data security breach. The laws in each state vary, but many states have similar requirements. The breach notification law in Washington requires an organization to notify affected individuals where there has been a breach of computerized data in the form of a name in combination with sensitive information such as social security number, credit card data, financial account number, or driver's license number. Some states also require notification

where the compromise involves paper data. Some states also add other data elements such as date of birth, medical information, or mother's maiden name.

Washington requires notification in the form of a physical writing to the affected individuals. Organizations may provide substitute notice by publication or e-mail in the event of larger breaches. Washington, like many states, also requires notification to major credit reporting agencies in the event of breaches of a certain size. A few other states also require reporting to consumer protection agencies.

Other requirements and certain exceptions apply under the notification laws. Notably, Washington and most other states do not require notification when the lost or stolen data has been encrypted. If you have the type of data that could trigger notification laws, keeping that data encrypted could help you avoid the requirements under these laws.

Because timing of notifications is usually an element under state laws and commonly the subject of investigation by state agencies, one of the most important things for an organization to do in the event of a breach is to act quickly to secure technical and legal advice to respond to a breach and notify individuals as soon as possible.

CHAPTER 79. Interest Advertising and Privacy Laws

The internet has become an important tool for nonprofit organizations to more easily solicit donations, publish information via websites, provide e-newsletters to members, and much more. Nonprofit organizations must comply with important laws governing internet advertising and privacy as well as ensure that any online solicitations comply with state and federal regulations.

One of the most important things all nonprofit organizations should do is to embrace transparency and accountability. Today, donors are using the internet to keep tabs on the charities they support and to find out more about the ones they are considering supporting. Organizations can make it easy for them by ensuring that all relevant data about itself is easily accessible. If your organization files a Form 990 or has an annual audited financial statement, consider making this information available on your website or providing a direct link to your GuideStar or similar listing.

The internet allows us to obtain a wealth of information about consumer behavior when visitors utilize a website, purchase items, or make online donations. Any website can easily obtain consumer information by simply monitoring the visitors to the website, collecting reactions to ads placed on other websites, or adding

members to your distribution lists. Types of information obtainable include how many people viewed your ad, what percentage of people clicked on the ad, what percentage of people purchased your product after seeing the ad, which pages on your website are visited most often, the names of other websites your customers have visited, and customers' e-mail addresses and other personal information.

On one hand, this data allows you to better serve your visitors, target your message, and simplify the experience for users of your website. On the other hand, misuse of all this information can potentially lead to fraud, violations of consumer privacy, or identity theft. As a result, consumers are increasingly wary of providing personal information, and more laws are being passed to protect their rights.

a. General Legal Requirements

Even before the ascendancy of the internet, privacy laws had been passed by the U.S. government to protect the privacy of consumers' personal information and shield consumers from fraudulent, deceptive, or misleading advertising practices. These same laws apply to the internet.

The FTC publishes guidelines to help businesses apply these laws to practices on the internet. Specifically, the FTC has published Advertising and Marketing on the Internet: Rules of the Road. This publication has a simple message for all internet advertisers: "Advertising must tell the truth and not mislead consumers. In addition, claims must be substantiated." The FTC recommends that businesses and organizations:

- Place disclosures on the same webpage as the claim they apply to, and when necessary, provide adequate visual cues to indicate that a consumer must scroll down on the page to view the disclosure;
- When hyperlinking to disclosures, make the link obvious and noticeable, label the link accurately and indicate its importance, place the link near relevant information, ensure that the link takes consumers directly to the disclosure, and monitor link usage to ensure its effectiveness;
- Display disclosures prior to purchase or prior to donation; and
- Ensure that an advertisement's "text, graphics, hyperlinks, or sound do not distract consumers' attention from the disclosure."

If you sell other companies' products on your website, be aware that the FTC may also hold you responsible for misleading ads and product descriptions, even when those materials are provided by the manufacturer.

b. Children's Online Privacy Protection Act

The Children's Online Privacy Protection Act (COPPA) requires that businesses and organizations "obtain verifiable parental consent for the collection, use, or disclosure of personal information from children." 15 U.S.C. section 6502(b)(1)(A)(ii). COPPA is enforced by the Federal Trade Commission and COPPA does not generally apply to nonprofit organizations. Still, nonprofit organizations should take extra precautions to either block children or safeguard personal information of children utilizing their websites.

c. Health Insurance Portability and Accountability Act ("HIPAA")

Unlike many Federal laws, like COPPA which does not directly apply to nonprofit organizations, HIPAA applies to any organization which handles personally identifiable health information, often referred to as PHI. Of most concern, are nonprofits that provide social services where personal information on health in general, mental health, alcohol or drug abuse is gathered or utilized in providing services. HIPAA requirements on organizations which handle PHI can be very complex. And, penalties for noncompliance can be very significant. Nonprofit organizations that handle PHI or have questions about whether HIPAA applies to them, are best advised to seek legal assistance with attorneys who specialize in this area.

d. Your Organization's Privacy Policy

(i) The Changing Privacy Law landscape

Before discussing the privacy policy, it is important to talk about the privacy law landscape. While this Handbook is focused on the State of Washington, it is important for non-profit organizations to be aware that they may be handling personal data for persons from other states or countries. Your donors may not be limited to just the State of Washington. You may have personal data for individuals from across the US and beyond. And many states and foreign jurisdictions have implemented or are in the process of implementing privacy legislation that might affect how you handle the data, what rights the users have to what you can do and cannot do with the data, what notification obligations you have if there is a security incident, and many other safeguard requirements to consider. While many of these

privacy laws are targeted at commercial organizations, that is not always the case especially when dealing with personal information of foreign citizens. As of 2022, the State of Washington has been working on its own "Privacy Act" but has not yet passed it into law. We will have to wait to see whether and to what extent and such Washington Privacy Act that becomes law impacts non-profits.

The point of the prior paragraph is to point out the complexity that surrounds handling personal information by non-profits and the fact that privacy and security law is in a state of change. Nonprofit organizations need to remain diligent to changes and need to ensure that they stay abreast of changes in Washington and beyond that impact their handling of personal data. A search of the internet will show organizations that can assist by helping draft or reviewing your privacy policies, recommending security technologies and audits, and helping you stay current with changing legal requirements. Communities Rise and 501 Commons, two organizations which support nonprofits, are good resources for privacy or security training and referrals. Your county Bar associations are a good resource for referrals to lawyers who specialize in privacy law. The International Association of Privacy Professionals also has many resources and training available. Many of these organizations have privacy policy templates that are a great resource for drafting new policies or using as a check against your existing privacy policies to make sure you have adequately covered all major areas.

(ii) Your Privacy Policy

All organizations, including non-profits, should have a privacy policy conspicuously posting on their website.

A privacy policy:

- Explains to individuals how your organization will collect, use, and secure any information you obtain about them;
- Demonstrates a level of responsibility to your members and donors, forming a bond of trust that will increase their confidence in you and willingness to do business with you;
- Helps your organization meet legal requirements; and
- Functions as a guideline for making business and organizational decisions.

Should you copy a privacy policy from another website or use a sample policy? Before using a sample privacy policy or copying one, review it carefully and

understand your organization's practices to make sure that every statement in the privacy policy accurately reflects what your organization is really committed to doing.

There are certain pieces of key information to be included in your privacy policy. Once you have established this policy, it should be posted on your website and shared with all individuals involved with your organization (including consultants or contractors) to ensure that everyone understands the commitment your organization has made to its members, donors, and users of your services. The following sections include the major areas to include in your privacy policy.

(iii) What Information Is Collected and How

Your privacy policy should clearly state what consumer information you collect from anyone who visits your website (or communicates with your organization in any other manner). There are two broad types of consumer information:

- Personally identifiable information ("PII") is the most sensitive type of information because it can be used to identify an individual. PII includes a person's legal name, e-mail address, physical mailing address, social security number, phone number, medical records, and bank account numbers or other financial data. Consumers feel most secure when the only PII you collect is information they provide to you directly, such as by filling out a form on your website.

- Non-PII is anonymous information that cannot be used to identify an individual. Non-PII is often used to track how visitors navigate your website, which pages were viewed most often, what other websites they have visited, and similar data. You should also identify the technologies and methods your organization uses to collect PII and non-PII. Disclosing the methods used to collect this information can increase trust and confidence in your organization and help individuals decide whether to share their information with you.

(iv) How Collected Information Is Used

Your privacy policy should describe exactly how you will and will not use the information you collect. Use this as an opportunity to sell them on your website's features and services. For instance, some organizations use cookies to track what articles are read so that they can suggest related articles.

Because e-mail spam is such a problem, the first question individuals usually have for an organization is "Will you give my e-mail address to anyone else?" Individuals are usually most comfortable when their e-mail addresses are used only by the organization they directly give them to. However, there are many situations where organizations can benefit from sharing e-mail addresses. When it comes to sharing e-mail addresses, best practice is to inform the user what you want to do with their email and provide them the opportunity to opt-in or say yes you can use my email for this purpose. Whether you plan to share information or not, it is vital that your privacy policy accurately describes your practices and, in the process, reassures individuals so they will continue to provide the information you need to successfully provide services you offer.

(v) How Consumers Can Opt Out

Generally speaking, it is a best practice that PII only be collected with the individual's consent. If PII is collected without the consumer's consent, your privacy policy should clearly explain how the consumer can opt out of your data collection process. The actual steps for opting out depend on the type of information you collect and the technologies you use to do it.

If you allow third-party advertising companies, such as 24/7 Real Media or DoubleClick, to run advertisements on your site, you should consider telling consumers about these companies' information collection process and, if offered, how to opt out of such data collection. However, you do not have to provide the exact instructions: simply point individuals to the appropriate page on the third party's website. Alternatively, if the third-party advertiser is a member of the Network Advertising Initiative ("NAI"), point your customer to the NAI opt-out page.

(vi) How Collected Information Is Kept Secure

The security section of your privacy policy should describe how you ensure that all consumer information is protected from unauthorized disclosure and theft. If you share information with third parties, what steps do you take to ensure that they keep the information secure? Avoid describing the level of security in absolutes. There is no such thing as absolute assurance of security.

(vii) With Whom You Share Collected Information

It is not necessary that you list in your privacy policy every single company, organization, business partner, or entity that you might share collected information with. You should, however, mention types of entities you will share information with,

such as other nonprofit organizations, business partners, credit card companies, and government agencies. It is vital that you have in place an agreement or terms for the sharing of information that limits or prohibits any further uses of the data being shared. For example, for a company that is providing credit card services for your organization, its terms need to specifically state that it will make no further use of any personal information shared.

(viii) Date Stamp Your Privacy Policy and Provide Contact Information

Privacy policies change over time. It is important to include the effective date of the policy and information on how changes will be handled and posted. Additionally, provide a contact point for anyone who has questions or comments about your policy or practices. A physical address and an appropriate e-mail address should be provided to the consumers. It is important that their questions be acknowledged and responded to in a timely fashion.

e. CAN-SPAM for Nonprofits

No legitimate nonprofit organization wants to be known for sending spam out to potential donors. The federal law regulating spam is the Controlling the Assault of Non-Solicited Pornography and Marketing Act of 2003, 15 U.S.C. sections 7701-7713 (2003) (the "CAN-SPAM" Act). The CAN-SPAM Act is a federal law regarding the sending of commercial e-mail. And the law (and its steep penalties) potentially applies to activities of nonprofit organizations.

Under the CAN-SPAM Act, e-mails containing transactional or purely informational content are generally not covered. Examples of transactional content would include confirmation of registration or receipt of a donation, invoice and account information, and notice of expiration of services. Commercial e-mails that promote a product or service would trigger CAN-SPAM requirements. For nonprofits, CAN-SPAM may apply where emails promote paid seminars, gift shops, of sales of books, clothing, or commercially similar articles. There are certain actions that anyone engaged in sending commercial content in e-mails must do in order to comply with the rules of the CAN-SPAM Act:

(i) Use a Valid Header

Make sure the "from" line in the e-mail accurately and clearly reflects the sender. Use appropriate e-mail addresses such as "products@nonprofit.org," "programs@nonprofit.org," or "memberservices@nonprofit.org" to identify your

organization. To donors and members, this also provides a level of comfort because they know and trust the organizations they support.

(ii) Use a Valid Subject Line

There currently are no labeling requirements for the subject line ("ADV" for advertisement, for example). What is required is that the subject line not mislead recipients as to the content of the message. For example, if your e-mail message is designed to solicit membership, the subject line should not be "I got your message," "Hello from a friend" or other similar statements. Rather, use a subject line that is more truthful, such as "Invitation to join ABC Organization" or "Special offer for new members."

(iii) Provide Clear and Conspicuous Notice of the Opportunity to Opt Out

Notice of the opportunity to opt out of future commercial e-mails must be in every e-mail message containing a commercial solicitation offer and must be provided to all individuals receiving the message, whether or not they have opted in to receive commercial or solicitation e-mail offers.

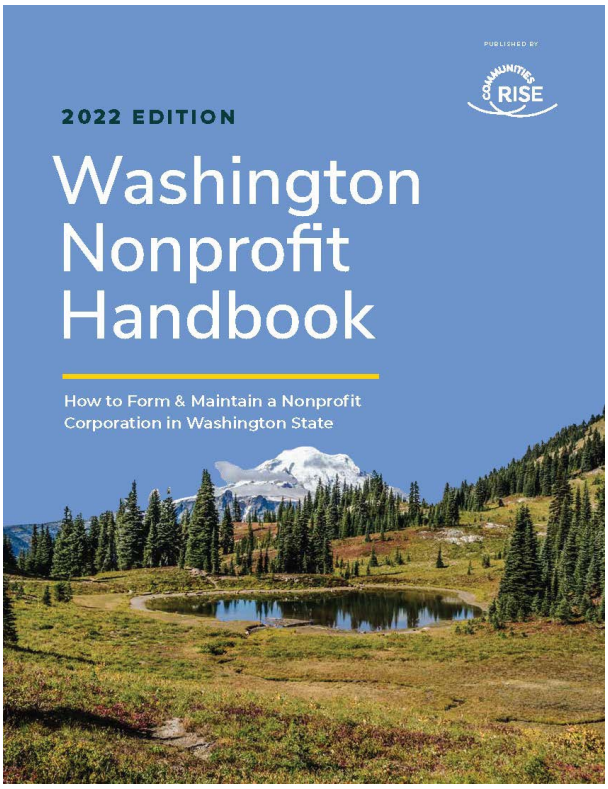
(iv) Provide a Functioning Opt-Out Mechanism in Every Commercial E-mail Message

A functioning opt-out mechanism can be a return e-mail address or other internet-based mechanism that can receive opt-out requests for at least 30 days after the transmission of the original message. The keys here are that the mechanism must be internet-based, and it must function. Also, the sender may not send subsequent offers more than ten business days after a recipient has requested to not receive further advertisements or offers. Further, if the recipient has opted out, the sender may not rent, exchange, or otherwise transfer or release the e-mail address of the recipient. Note that many organizations use third party email services that are CAN-SPAM compliant and that will perform the opt-out process and manage your email address lists automatically to ensure you stay in compliance.

(v) Provide a Valid Physical Postal Address of the Sender

A valid physical postal address must be included in every e-mail. A street address or post office box would be considered a valid physical postal address. Solicitations via e-mail are also considered to be covered under the rules established

in the Charitable Solicitations Act ("CSA"). *See* CHAPTER 49 and CHAPTER 50 for more information about CSA rules.



PART 13 FINANCIAL

Chapter 80 Internal Controls
Chapter 81 Restricted Funds And Accounting Issues Specific To Nonprofits

PART 13. FINANCIAL

CHAPTER 80. Internal Controls

Internal controls are the policies, procedures, and activities that ensure the effective and efficient use of a nonprofit's resources. The governing body (Board of Directors, trustees, etc.) has a fiduciary responsibility to ensure that adequate internal controls are in place and operating in order to:

- safeguard the organization's assets
- ensure reliable and accurate financial reporting
- ensure compliance with laws, regulations, and grant and contract terms and conditions
- accomplish the goals and objectives of the organization
- ensure efficient and effective operations

The governing body has a fiduciary responsibility to act in the best interest of the Organization by protecting its property, its financial assets, and its reputation. This financial oversight includes understanding organizational risks and setting policies and procedures in order to prevent fraud and to assure accurate reporting to the public, the funders, the Internal Revenue Service (IRS), and the Secretary of State.

a. Governance Policies

Instituting governance policies that prevent the opportunity for an individual to make a decision that may be influenced by personal interest is central to creating an internal control system. Here is a list of suggested policies:

- **Executive Compensation Policy:** This policy ensures there is integrity to the process of setting the pay rate for executive directors in order to avoid the conflict of senior management making decisions about their own compensation. *See* CHAPTER 73 on Setting Executive Compensation.
- **Conflict of Interest Policy:** This policy describes the process of managing conflicts of interest of board members and key employees.
- **Record Retention Policy:** This policy describes the process of determining when to destroy organizational records. Managing financial records effectively is essential to proving or disproving fraud.

- **Whistleblower Policy:** This policy describes the process of employees' ability to report potential wrongdoing by others involved in the organization (supervisors, management, other employees, board members) without fear of retaliation.

- **Gift Acceptance Policy:** This policy describes the process and criteria of determining whether the organization should accept a gift.

- **Investment & Spending Policies:** These financial policies describe processes and criteria in making decisions on investment or spending.

b. The Five Components of a Successful Internal Control Structure

(i) Control Environment

The control environment is often referred to as "the tone at the top". It is the foundation of standards, processes, and structures that enable an organization to carry out internal controls. The Board of Directors and senior management are responsible for establishing the tone of the organization by modeling and enforcing expected standards of conduct. They create a culture of transparency, integrity, and accountability.

Principles to keep in mind when creating a control environment:

- The control environment demonstrates commitment to high standards, integrity and ethical values

- The Board of Directors demonstrates independence from management in exercising oversight of the development and performance of internal control over financial reporting

- The Board of Directors and senior management establish structure, authority, and responsibility to achieve financial reporting objectives

- The Board of Directors and senior management are committed to the competence of personnel

- The Board of Directors and senior management hold individuals accountable for practices and procedures relating to their internal control responsibilities

(ii) Risk Assessment

Risk is defined as the possibility that an event will occur and adversely affect the achievement of objectives. Risk assessment involves a dynamic and iterative process for identifying and assessing risks to the achievement of objectives. To assess risk accurately, the objective being assessed must be specific.

Practical considerations when assessing risk:

- The entity clearly specifies financial reporting objectives to enable the identification and assessment of risks relating to these objectives.
- Management adopts accounting policies that are appropriate for the entity and consistent with the organization's reporting framework.
- Mechanisms are in place to identify risks, including changes in operating, economic, and regulatory environment, participating in new programs or activities, offering new services, communication at various levels of management, application processes, information technology infrastructure.
- It can be helpful to use a risk assessment worksheet to identify risks. It is a good idea to revisit and revise such a worksheet annually. The risk assessment worksheet could include the following actions:
    - Identify risks relevant to the control objective and ask "what could go wrong?"
    - Identify controls and other actions that eliminate or mitigate each risk;
    - Use judgment that incorporates what is in the best interests of the organization to assess whether risk is too much, too little, or just right;
- The entity considers the potential for fraud in assessing risks to the achievement of financial reporting objectives
    - Does the Board give adequate time and attention to financial oversight? Financial oversight is the cornerstone of avoiding fraud. The Board must have quality information and sufficient time to exercise its financial oversight responsibilities. Risk assessments

should consider if there is adequate time at board meetings to discuss the financials, and whether there is a finance committee with oversight responsibilities and expertise

- If there is a Finance Committee, what are their responsibilities, and do they have adequate information, time and expertise to carry out their responsibilities?

(iii) Information and Communication

Management should use relevant quality information from both internal and external sources to support the functioning of internal control over financial reporting. Communication is the continual, iterative process of providing, sharing, and obtaining necessary information.

Practical considerations when designing the information and communication system:

- Financial personnel should meet with line management (fund development, program staff) to discuss operating results
- Ensure that established and agreed-upon deadlines exist for period end reporting, which include review by management
- The current chart of accounts is adequate to maintain accountability and provide for the following:
    - resources with or without donor restrictions
    - functional reporting of expenses
    - tracking unrelated business income
    - tracking fund-raising costs
    - compliance with terms
    - conditions of grants
- Are financial reports internally distributed regularly and on a timely basis?
- Are financial reports provided regularly and on a timely basis to the Board? The Board of Directors has the responsibility of financial oversight to

ensure transparency, integrity of the financials, and to ensure that the organization is financially sound. It is critical that the Board of Directors receive and have adequate time to review financial reports.

- Does the Board (or Finance/Audit Committee) meet with the external auditor and hold management accountable to address control deficiencies reported? The ability for the Board or Finance/Audit Committee to meet with an external auditor, separate from management, is a common internal control that functions as a check and balance on the control of the organization's finances.

- Does the organization have a clear and well-communicated whistleblower policy and reporting mechanism that encourages the reporting of wrongdoing without fear of retaliation?

(iv) Monitoring

Develop and perform ongoing and/or separate evaluations to ascertain whether these components of internal control are present and functioning.

Practical considerations when designing the monitoring system:

- Ongoing monitoring is built into operations throughout the organization and includes explicit identification of what constitutes a deviation from expected control design or performance, which then signals a need to investigate both potential control problems and changes in risk

- The organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for correction action, including senior management and the Board of Directors

(v) Control Activities

The control activities are either delineated in the organization's procedures or informally followed**.** Control activities are the actions established that mitigate risk. They are performed at all levels of the entity, at various stages within business processes, and incorporated through the organization's technology. The activities may be preventative or detective in nature and may encompass a range of manual and automated activities such as authorizations and approvals, verifications, reconciliations, and business performance reviews. Segregation of duties is one of the key concepts that will be included in developing the control activities, and is discussed below.

a. What is Segregation of Duties?

A key to the internal control activities is the segregation of duties. Segregation of duties is the concept of separating initiation, approval (authorization) and review of a transaction in order to prevent fraud and error.

When creating internal controls that segregate duties, consider who has access to financial systems. Key areas of access can include: bank account access, organizational credit cards, blank check stock, cash/checks received, accounting systems, donor database, payroll system, and approval authority. In each of these areas, create internal controls in which more than one person has to be involved to have access to these areas or conduct financial tasks.

Examples of duties to segregate to the extent possible:

- Duties involving inflows (contributions, revenue, receipts):
    - Authorizing/approving bills
    - Handling/having custody of cash and receipts
    - Recording accounting transactions
    - Reconciling accounting records
    - Accessing the donor database
- Duties involving disbursements (vendors, credit cards, reimbursements, payroll):
    - Approval/authorization of all the categories listed above
    - Recording transactions in the accounting system
    - Authorizing disbursements (including check signing and electronic funds transfer)
    - Handling/having custody of checks
    - Reconciling accounting records

When you cannot fully segregate duties due to small staff size or cost considerations, consider implementing, mitigating, or compensating controls. Examples include:

- Managers or board members review financial statements and other detailed reports on a regular and timely basis
- Managers or board treasurer review reports of the detailed transactions
- Managers select transactions for review of supporting documents
- Managers periodically conduct counts of physical inventory, equipment, and other assets and compare them with the accounting records
- Managers occasionally review reconciliations of account balances such as cash, A/P, and AIR, or perform them independently

Note: "Manager" is defined as someone other than the person with the concentration of duties who is also knowledgeable about the subject matter and has the ability and willingness to question the person with concentration of duties.

b. Fraud

Fraud is one of many risks that nonprofit organizations face. Understanding what fraud is and how to avoid it is crucial to the nonprofit's status, reputation, and longevity. Fraud is the wrongful or criminal deception intended to result in financial or personal gain. With respect to organizational finances, there are three basic types of fraud:

- Outright asset theft (fraud *against* the organization)
- Deceptive financial reporting (fraud *by* the organization)
- Improper use of the organization's name, reputation or confidential information (fraud *through* the organization)

(i) What Factors Allow Fraud to Occur?

Understanding the factors that lead to fraud is critical to preventing fraud from occurring. The three most common factors that contribute to fraud are:

- **Economic motivation:** An individual who commits fraud is motivated by personal economic reasons. Potential motivations include financial distress, substance abuse, gambling, overspending, or other destructive behaviors.
- **Rationalization:** The person committing fraud usually has a rationalization to justify the fraud. Typical rationalizations include

perceived injustice in compensation or appreciation; the idea that the fraudulent act is equivalent to "borrowing" from the organization; or the belief that the organization does not "need" the assets nor will it miss them.

- **Opportunity:** The person committing fraud must have the opportunity or access to resources. For example: a volunteer or employee that has exclusive access to assets and information may believe a fraud can be committed and successfully concealed. Opportunity is the one factor that the nonprofit organization can control.

(ii) What Can A Nonprofit Organization Do To Prevent Fraud?

By establishing practices and procedures called internal controls, nonprofits can remove perceived opportunities for employees or volunteers to commit fraud. Effective internal control systems have the additional benefit of increasing the efficiency of operations; safeguarding assets against loss and unauthorized use or disposition; improving reliable financial reporting, and ensuring compliance with applicable laws and regulations.

CHAPTER 81. Restricted Funds and Accounting Issues Specific to Nonprofits

Understanding what is a restricted donation and having best practices and policies in place to manage such restricted donations is critical to being in compliance with the law. The law requires nonprofit corporations that accept restricted donations to comply with the donor's restrictions and document the expenditure of those restricted donations appropriately. A restricted donation is a contribution received by the organization with a restriction placed on the contribution by the donor. The instrument (letter, e-mail, will, etc.) should contain the donor's intent. A donor-imposed restriction is a donor stipulation that specifies a use for a contributed asset that is more specific than broad limits resulting from:

8. The nature of the not-for-profit
9. The environment in which it operates
10. The purposes specified in its articles of incorporation or bylaws or comparable documents

Some restrictions are temporary in nature and other restrictions are perpetual.

In order to comply with donor restrictions it is critical that the organization:

- Communicate with the donor in order to establish the donor's intent
- Document the intent
- Comply with the intent
- Document the expenditures that meet the intended purpose
- Ensure that the financial reporting is consistent with the underlying records

a. Best Practices and Procedures for Managing Restricted Donations

The Board of Directors or delegated Executive Director should approve all restricted gifts and ensure that the gift aligns with the Organization's gift-acceptance policy.

The organization should create, implement, and maintain procedures for donor-restricted contributions. The procedures should include:

1. Verifiable documentation exists for restricted donations
2. The staff assignment of responsibility for assuring compliance with the donor's restriction
3. The staff assignment of responsibility for identifying when restrictions are met so the resources can be appropriately used and accounted for
4. An approval process for all expenditures
5. Maintenance of separate records for each restricted donation to demonstrate the fulfillment of its purpose
6. Review of reclassifications made between net asset classes (net assets with donor restriction and net assets without restrictions) by the appropriate person
7. A financial reporting system that is in alignment with the underlying records and documentation
8. Monitoring of the restricted accounts
9. Preparation of status reports for review by the Board

b. Uniform Prudent Management of Institutional Funds Act (UPMIFA)

Effective on January 1, 2022 Washington state replaced the previous Washington Nonprofit Corporation Act with a new Act. There are changes to the section on Charitable Assets Held by Nonprofit Corporations, designed to protect the assets. The significant change is that previously, these assets were regulated under trust law. With the new Nonprofit Corporation Act, these assets now must conform to Washington's Uniform Prudent Management of Institutional Funds Act (UPMIFA, Chapter 24.55 RCW). This rule applies to all nonprofit corporations that hold charitable assets.

Nonprofits that hold assets subject to donor-imposed restrictions (such as endowments and assets subject to donor-imposed restrictions on use) will be subject to this change.

c. Investing Institutional Funds

The Uniform Prudent Management of Institutional Funds Act (UPMIFA) provides in RCW 24.55.015 the Standard of Conduct in managing and investing institutional funds. Some of the points to note include:

- Subject to the intent of a donor expressed in a gift instrument, an institution, in managing and investing an institutional fund, shall consider the charitable purposes of the institution and the purpose of the institutional fund.

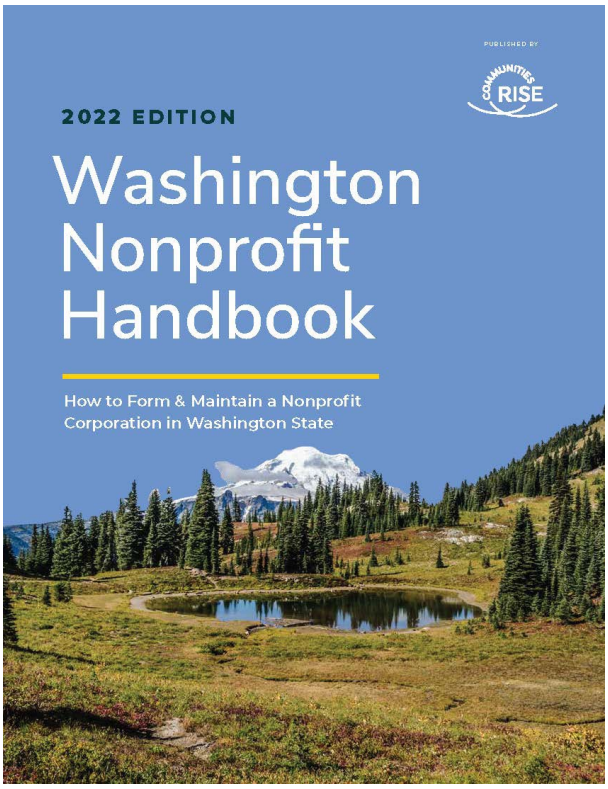
- The fund must be managed in good faith and with the care an ordinary prudent person in a like position would exercise under the same circumstances.

d. Expenditure or Accumulation of Endowment Funds

The UPMIFA provides in RCW 24.55.025 Appropriation for expenditure or accumulation of endowment funds – Rules of construction. Notable points include:

- Subject to the intent of a donor expressed in the gift instrument, an institution may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established.

- To limit the authority to appropriate for expenditure or accumulate, a gift instrument must specifically state the limitation.



PART 14 CEASING OPERATIONS

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Chapter 84 Dissolving a Nonprofit Corporation
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PART 14. CEASING OPERATIONS

CHAPTER 82. Considerations Before Ceasing Operations

A time may come when the directors or members of a nonprofit determine that it is no longer feasible or desirable to keep the corporation operating in its current state. In some instances, ceasing operations is not necessary; the directors may find other approaches to correcting problems. For example, if the board of directors finds that a nonprofit corporation is no longer able to fulfill its mission, the board might consider broadening or narrowing the scope of the corporation's purpose and/or reducing or changing its activities. Likewise, if the directors are ready to step away from a nonprofit, it may be possible to elect a new board of directors with the energy and resources to manage the corporation. If these options are not realistic, then the directors must decide the best approach to ceasing operations. The options include merger, dissolution, or, in the event of financial difficulties, bankruptcy. This Part provides a general overview and discussion of each procedure and some considerations for the board of directors (or members if the organization has voting members) when faced with the decision to cease operations. The material will focus on mergers and dissolutions (both voluntary and involuntary) but will also discuss bankruptcy and involuntary liquidation.

The decision to cease operating is an important one. Like all aspects of a director's actions, the steps to cease operating must be undertaken with a focus on the best interests of the corporation. Before undertaking a merger or dissolution, the board — and members, if they have voting power — should ask themselves what is best for the corporation and the public it serves. Several questions that will help a board and/or members decide which approach to take in ceasing operation, are:

- Do current members/directors wish to keep operating the nonprofit?
- Is there an organization that might be interested in acquiring the assets of the nonprofit?
- Is there an organization with a similar purpose available as a potential merger partner?
- Are there significant designated charitable assets or significant liabilities associated with the nonprofit?
- Is there dissension that might require court intervention?

- Is there an organization that might be interested in taking over the nonprofit?

The directors may decide that greater efficiency in carrying out the corporation's objectives could be obtained by merging with another nonprofit corporation or eligible entity. The directors may decide that bankruptcy and liquidation is necessary to make arrangements with creditors, or the directors may just determine that the most sensible course is dissolution. A merger may be appropriate where one or more corporations with a similar purpose exists. If the organization has substantial liabilities, however, merger may not be a good (or available) option and dissolution will be the preferred route. In each case, the board must pay attention to applicable laws and to restrictions on gifts received by the nonprofit. Normally, the directors or members control the operations. However, there are certain instances in which the corporation will be subject to involuntary dissolution or liquidation.

CHAPTER 83. Merger or Consolidation of a Nonprofit Corporation

This Chapter focuses on the legal mechanics of a merger of two or more nonprofit corporations. There is much more to the process, however, than the legal formalities. Identifying a suitable partner for a merger, bringing together the cultures of the different organizations, and handling public relations are just a few of the many business tasks involved in a merger. Directors and, if applicable, members should consider the potential economic, organizational, and strategic benefits and detriments of merging before any decision is made.

Washington law permits nonprofit corporations to merge with each other, including a merger into a new nonprofit corporation, created pursuant to the merger. This is similar to a consolidation, although that is not a separate concept under Washington law. The law also permits nonprofit corporations formed in this state to merge with other eligible entities or nonprofit corporations formed outside of Washington.

Specific restrictions apply to mergers involving a charitable corporation. A charitable corporation may only merge with another charitable corporation; a foreign corporation that would be a charitable corporation if it were a Washington corporation, or a Washington or foreign for-profit or nonprofit corporation; or unincorporated entity, if the charitable corporation is the "surviving" corporation and continues to qualify as a charitable corporation after the merger.

In a nonprofit corporation merger, two or more corporations join together, with one of those corporations emerging at the end of the process as the surviving corporation. A corporation is the "surviving" corporation if it has more than 50% voting power in the merged corporation. In other words, one of the corporations continues to exist, while the other is merged into it. When two corporations merge, the surviving entity will normally receive any bequests designated for the merged organization. For example, Nonprofit A and Nonprofit B merge with B surviving. Although A no longer exists, any bequests designated for A in wills or trusts would pass to B as A's successor in merger. If A were to simply dissolve and distribute its assets to B, any bequests designated for A would not pass to B. This succession is a reason to look favorably at merging instead of dissolution, but keep in mind that in our merger example, B also assumes all of A's debts and liabilities, even contingent ones. Where liabilities are a concern, a merger may not be as desirable an option.

a. Effecting a Merger

The officers of the merging corporations may spend many hours negotiating and documenting the terms of the merger. However, the merger is not legally in effect until certain steps have been taken and specific documents filed with the Washington Secretary of State. Mergers are governed by the Washington Nonprofit Corporation Act (the "Act"), which should be reviewed and followed at all stages of the process. In addition, the articles of incorporation and bylaws of the organizations should be reviewed for additional requirements, such as approval of an affiliated organization.

(i) Plan of Merger

The process for performing a merger begins with each corporation adopting a plan of merger. That plan must identify:

- The names of each nonprofit corporation or eligible entity that will merge and the name of the nonprofit corporation or eligible entity that will be the survivor of the merger;
- The terms and conditions of the merger;
- The manner and basis of converting the memberships of each merging nonprofit membership corporation and the eligible interests of each merging eligible entity into memberships, eligible interests, securities, or obligations, the right to acquire the foregoing, cash, other property or other consideration, or any combination of the foregoing;

- The articles of incorporation and bylaws of any corporation, or the organic records of any eligible entity, to be created by the merger; or if a new corporation or eligible entity is not to be created by the merger, any changes to the survivor's articles or bylaws or organic records;

- Whether the corporation is a charitable corporation or is holding assets for charitable purposes;

- If the corporation is a charitable corporation or is holding assets for charitable purposes, a plan setting forth how the merging entities will comply with RCW 24.03A.715 and 24.03A.725; and

- Such other provisions as deemed necessary or desirable. *See* RCW 24.03A.730(4).

(ii) Board of Directors or Membership Approval

The plan of merger must then be adopted by the boards of directors of each corporation and, if one or both of the corporations has voting members entitled to vote on the plan of merger, the plan of merger must be approved by their respective membership. *See* RCW 24.03A.735. For a corporation that has members with voting rights, the board of directors must submit the plan for approval to the members entitled to vote on the plan and deliver a board recommendation, stating that the members approve the plan. If the board of directors makes a determination that because of conflicts of interest or other special circumstances it should not make such a recommendation, it shall deliver to the members the basis for that determination. Unless the articles of incorporation or bylaws, or the board as part of a condition of its submission of the plan of merger to the members, requires a higher voting threshold, the approval of the plan of merger by the members and class of members entitled to vote thereon requires the approval of a majority of those members and class of members at a meeting at which a quorum is present. If a membership corporation has no members entitled to vote on the merger, then the corporation must deliver notice of the proposed merger to all members of the corporation at least five days prior to the meeting at which the board will adopt the plan of merger. In addition to approval by the board of directors or members, a plan of merger must also be approved in the form of a record by any person or group of persons whose approval is required under RCW 24.03A.705 to amend the articles of incorporation or bylaws. Adoption and approval of a plan of merger by all required persons pursuant to RCW 24.03A.735 constitutes adoption and approval of all

changes to the approving party's articles of incorporation, bylaws, or other organic documents contained within the plan of merger.

(iii) Articles of Merger

Upon approval of the plan of merger by each of the corporations, articles of merger must be prepared, executed by an authorized officer or other authorized representative, and filed by the surviving corporation with the Secretary of State with the appropriate filing fee. The articles of merger must include the names of the parties to the merger, changes to the articles of incorporation of the surviving corporation or the articles of incorporation of the new corporation if a new Washington nonprofit is created as a result of the merger, and a description of the process used by each corporation to approve the plan. If a party to the merger is a noncharitable corporation holding property for charitable purposes, and the survivor is not a charitable corporation, the articles of merger must include a statement that the Attorney General has approved, or is deemed to have approved, the merger pursuant to RCW 24.03A.715. If a foreign nonprofit corporation or foreign eligible entity is a party to the merger, the articles of merger must include a statement that the participation of the foreign corporation or foreign eligible entity was authorized as required by the organic law of the corporation or eligible entity. If the Secretary of State determines that the articles of merger conform to law and that all fees have been paid, the Secretary of State files the documents and issues a certificate of merger.

The merger becomes effective upon the filing of the articles of merger, at the time specified in the entity filing as its effective time or at a later date and time as provided in the plan of merger that is not later than 90 days after the filing of the articles of merger. If a delayed effective date is specified and no time is specified, the merger will be effective at 12:01 a.m. on the date specified. If the Secretary of State refuses to file articles of merger or if a correction to the filing record is required, a different effective time for the articles of merger may apply pursuant to RCW 23.95.220(4) and RCW 23.95.225.

(iv) Foreign Corporations

If one or more of the corporations included in the merger is not incorporated in Washington, the merger procedure differs from the procedure described above. Each "foreign", or non-Washington, corporation must follow the law of the state in which it was incorporated. If the surviving corporation or new corporation will be a "foreign" corporation, then the corporation must (a) obtain a certificate of authority

prior to transacting business in Washington, (b) file an agreement that it may be served with process in Washington, and (c) appoint the Secretary of State as its agent to accept service of process.

(v) Limitations on Property Held for Charitable Purposes, Approval Required by the Attorney General, and Prohibited Financial Benefit

In addition to the other restrictions and requirements of a nonprofit corporation in a merger, additional limitations apply if property held for charitable purposes is held by a party to the merger. *See* RCW 24.03A.715. Property held for charitable purposes by a party to a merger may not be diverted from charitable purposes pursuant to the merger. A surviving nonprofit corporation remains bound by any restriction imposed on property held for charitable purposes by any party to the merger unless the restriction is modified pursuant to Washington law. If a condition of property held for charitable purposes by a nonprofit corporation requires the transfer of such property upon a merger, then the property must be transferred in accordance with that condition.

Unless the survivor of a merger is a charitable corporation, a corporation that is not a charitable corporation but holds property for charitable purposes shall deliver to the Attorney General notice of its intent to consummate a merger. The notice must be delivered to the Attorney General at least twenty days before the meeting at which the proposed transaction is to be approved. Such a merger may not be implemented without the approval of the Attorney General, or the approval of the court in a proceeding to which the Attorney General is made a party. *See* CHAPTER 25 for more on notice to Office of the Attorney General.

A person who is a member, director, officer, interest holder, or is otherwise affiliated with a party to a merger that is a charitable corporation or other eligible entity with a charitable purpose may not receive a direct or indirect financial benefit in connection with a merger. Exceptions apply to a charitable corporation, the federal government, a tribal government, a state or local government, a governmental subdivision, or an eligible entity that is organized exclusively for charitable purposes. This prohibition does not apply to the receipt of reasonable compensation for services rendered.

(vi) Completion of the Merger

Once the merger is in effect, the corporations are now a single corporation. The existence of the corporations that do not survive the transaction cease. The

surviving corporation obtains all the property, contracts, and other rights and duties that the Act provides and is also responsible for all the liabilities and obligations of each of the corporations involved in the merger. A devise, bequest, gift, grant, or promise contained in a will or other instrument, in trust or otherwise, made before or after a merger, to or for any of the parties to the merger, inures to the survivor, subject to the express terms of the will or other instrument. In the case of a merger, Washington law deems the articles of incorporation and bylaws of the surviving corporation to be amended in the manner stated in the plan of merger.

(vii) Merger Distinguished from an Asset Sale

As a final note, mergers should be distinguished from transactions in which a corporation simply sells or transfers its assets. The process of effecting a merger involves changing the actual corporate entities involved. In contrast, if a nonprofit corporation continues to exist but sells or otherwise disposes of all or substantially all of its assets, other than through the ordinary course of business, a separate set of statutory rules apply. In such asset disposition transactions, approval is required by either the corporation's members having voting rights with respect to the transaction or, if none, by a majority of the corporation's directors, in each case at a meeting in which a quorum is present. Additional approval by the Attorney General or the court in a proceeding to which the Attorney General is made a party is required for a charitable corporation or a nonprofit corporation holding property for charitable purposes.

CHAPTER 84. Dissolving A Nonprofit Corporation

Washington law provides several methods for dissolving a nonprofit corporation. A corporation can be dissolved voluntarily by action of its own directors and members, administratively by the Washington Secretary of State for failure to comply with filing requirements of that office, or in very limited circumstances, by a superior court judicial decree.

a. Voluntary Dissolution

When the directors and members of a nonprofit believe it is in the best interests of the corporation to discontinue as a legal entity, certain actions may be taken in order to dissolve the nonprofit corporation. This process is referred to as voluntary dissolution and is summarized below.

(i) Resolution to Dissolve

The first step in a voluntary dissolution is the adoption of a resolution by the board of directors. Unless the articles of incorporation or bylaws require a greater vote, a majority of the directors in office of a nonprofit corporation may authorize the dissolution of any nonprofit corporation that is not a membership corporation or is a membership corporation without members entitled to vote on its dissolution. If the corporation has members, but no members with voting rights with respect to the dissolution, then the corporation must deliver notice of the proposed dissolution to all members at least 10 days prior to the meeting at which the board of directors authorizes the dissolution.

If the corporation has members with voting rights with respect to a dissolution, then the corporation must give proper notice of the proposed meeting of members to all members and the board shall recommend dissolution to the members entitled to vote on the dissolution, unless the board determines that because of conflict of interest or other special circumstances it should make no recommendation and communicates the basis for its determination to the members entitled to vote on the dissolution. For a nonprofit corporation with members with voting rights with respect to a dissolution, members must approve the proposal to dissolve at either an annual or special meeting. Unless the articles of incorporation, the bylaws, or the board as a condition of its recommendation for dissolution requires a greater vote or a greater number of members to be present, the adoption of the proposal to dissolve by the members and class of members entitled to vote requires the approval of at least a majority of those members and class of members at a meeting at which a quorum is present.

(ii) Notice of Adoption of a Resolution to Dissolve

Once the required dissolution resolutions have been adopted, the corporation must cease to conduct its affairs except as necessary to complete the dissolution. In addition, the Act requires a notice of the proposed dissolution be provided to each known creditor of the corporation, to the Attorney General with regard to any assets held for a charitable purpose, and to the Washington State Department of Revenue. The notice to the Attorney General should contain the plan of distribution described below. *See* CHAPTER 25 for more on notice requirements to the Office of the Attorney General. The notice to the Washington State Department of Revenue must request a clearance certificate which certifies that the corporation does not owe any taxes to the state. To bar certain claims by claimants, a dissolved nonprofit corporation may also publish notice of its dissolution and request that persons with claims against the

dissolved corporation present them in accordance with the notice pursuant to RCW 24.03A.920.

(iii) Plan of Distribution for Corporations Holding Property for Charitable Purposes

Once a resolution to dissolve has been approved, a nonprofit corporation holding property for charitable purposes, including a charitable corporation, must prepare a plan called "the plan of distribution". The plan of distribution provides a description of certain property held for charitable purposes, gift restrictions on such property, and how the corporation's assets will be distributed. Like the resolution to dissolve, the plan must be approved by the members having voting rights, if any, after the board adopts a resolution recommending a plan of distribution and directing the submission thereof to a vote at a meeting of members having voting rights, or, if there are no such members then by a majority vote of the directors in office at a meeting of the board. A plan of distribution requiring member approval is adopted upon receiving votes from a majority of the members and class of members entitled to vote at a meeting at which a quorum is present. If the members entitled to vote on the dissolution approve the proposal to dissolve but do not approve the proposed plan of distribution in all material respects, then the board may either accept the plan of distribution, as approved by the members, or propose a new plan of distribution to the members for approval.

The Act outlines the order of distribution of a nonprofit corporation's assets upon dissolution. The plan of distribution must comply with these statutory requirements.

First, the corporation must apply its assets toward satisfying all of its liabilities and obligations prior to distributing assets elsewhere or adequate provision must be made to pay, satisfy, and discharge those liabilities. The corporation's liabilities and obligations include all corporate debts, including, presumably, payroll, withholding, and state taxes. Withholding is particularly important to pay in a timely manner because of the ability of the IRS to seek payment from directors personally.

Second, all property held for charitable purposes by the corporation, including all assets of a charitable corporation remaining after satisfaction of the corporation's liabilities, must be applied and distributed consistently with the corporation's articles of incorporation, such that property is not diverted from charitable purposes, including:

- in accordance with any trust instrument and chapter 11.110 RCW;

- to the extent not held upon a condition requiring a transfer by reason of the dissolution and not subject to any gift restriction, to an entity operated exclusively for charitable purposes, to the federal government, a tribal government, or a state or local government for a public purpose, or subject to one or more gift restrictions requiring the property to be used exclusively for the same charitable purposes for which the dissolving corporation holds the property;

- to the extent not held upon a condition requiring a transfer by reason of the dissolution and subject to restrictions that do not require modification at the time of dissolution, by transfer subject to all restrictions applicable to the property; and

- to the extent not held upon a condition requiring a transfer by reason of the dissolution and subject to restrictions that require modification at the time of dissolution, as such restrictions shall be modified by RCW 24.03A.190 and then pursuant to a properly adopted plan of distribution.

Third, if the corporation holds any assets subject to a condition requiring their return or transfer upon dissolution, then any such assets must be returned or transferred in accordance with that condition.

Fourth, for other assets of a corporation other than a charitable corporation, if any, then such assets must be distributed in accordance with the corporation's plan of distribution, and to the extent the articles of incorporation or bylaws do not govern distribution of assets on dissolution, to any persons the board may select. The plan of distribution should also meet the requirements of federal tax law.

Before a nonprofit corporation holding property for charitable purposes, including any charitable corporation, delivers articles of dissolution to the Secretary of State for filing, the corporation must notify the Office of the Attorney General by registered or certified mail at its Olympia office, of the intent to dissolve. The notice must be mailed at least 20 days before the meeting at which the corporation plans to adopt the plan of distribution. The corporation may not adopt a plan of distribution without the approval of either the Attorney General or of a court in a proceeding to which the Attorney General is a party. However, if the Attorney General fails to object within 20 days of the corporation's delivery of the plan of distribution to its office, then state law deems the Attorney General to have given its

approval. *See* CHAPTER 25 for more on notice and approval to the Office of the Attorney General.

(iv) Articles of Dissolution and Certificate of Dissolution

The final step of voluntary dissolution is filing articles of dissolution with the Secretary of State. The articles of dissolution must be accompanied by a revenue clearance certificate issued by the Washington State Department of Revenue. Until 120 days from the effective date of the dissolution, the nonprofit can revoke the dissolution process as explained in the next section. The articles of dissolution must be signed by one of the corporation's authorized officers or authorized representatives and must set forth the following statutorily required information, including:

- Identification of the corporation by its legal name;
- Date of the corporation's incorporation;
- The effective date of the dissolution, which may be the date on which the articles of dissolution are filed or any date and time up to thirty days thereafter;
- Whether it is a membership corporation, and if it is a membership corporation, whether it has members that have a right to vote on its dissolution;
- If the corporation is not a membership corporation or has no members that have a right to vote on its dissolution, that the dissolution was authorized by the requisite number of directors;
- If the corporation is a membership corporation that has members that have a right to vote on its dissolution, that the requisite number of members has approved the proposal to dissolve;
- Whether the corporation is a charitable corporation or is holding property for charitable purposes;
- If the corporation is a charitable corporation or is holding property for charitable purposes, that the Attorney General has approved, or is deemed to have approved, the corporation's plan of distribution pursuant to RCW 24.03A.908; and

- That the net assets of the corporation remaining after dissolution have been, or will be, distributed in accordance with the corporation's articles of incorporation and bylaws and the corporation's adopted plan of distribution.

If the Secretary of State finds that the articles of dissolution conform to law, the Secretary of State will accept the articles for filing and issue a certificate of dissolution. At that point, the corporation is dissolved.

(v) Revocation of Voluntary Dissolution

The corporation may revoke its dissolution within 120 days of the effective date of the dissolution. Like the decision to dissolve, the decision to revoke dissolution is made by resolution and must be approved in the same manner as the dissolution was authorized unless the dissolution authorization permitted revocation by action of the board alone, in which event the board may revoke the dissolution without member approval even if it was originally required for the dissolution. Upon the adoption of a resolution revoking the earlier dissolution resolution, the corporation must file articles of revocation of dissolution with a copy of its articles of dissolution. A charitable corporation or a nonprofit corporation holding property restricted to charitable purposes shall not deliver articles of revocation of dissolution to the Secretary of State for filing without the approval of the Attorney General pursuant to RCW 24.03A.912(4). Revocation of dissolution is effective upon the effective date of the articles of revocation of dissolution, although it relates back to and takes effect as of the effective date of the dissolution. Upon the effective date of the revocation of dissolution, the corporation can resume carrying on its activities as if the dissolution had never occurred.

b. Involuntary Dissolution

The Act provides that a nonprofit corporation may also be dissolved involuntarily, either administratively by the Secretary of State or judicially by the superior court.

(i) Administrative Dissolution

The privilege of operating as a nonprofit corporation carries with it certain operating requirements, including filing requirements with the Secretary of State. Nonprofit corporations that fail to strictly adhere to these requirements or that cease operation without filing articles of dissolution risk being dissolved by administrative

action. Administrative dissolution may occur even where the board of directors or the members do not wish to cease operations of the corporation.

Washington law requires the Secretary of State to administratively dissolve any corporation that:

- Has failed to pay any fee, interest, or penalty required to be paid to the Secretary of State when due;
- Has failed to deliver an annual report to the Secretary of State not later than 120 days after it is due;
- Has failed for 30 days to appoint or maintain a registered agent in Washington; or
- Has a period of duration stated in its public organic record that expired.

If any of these conditions occur, the Secretary of State mails written notice to the corporation to provide it with an opportunity to correct the problem and avoid dissolution. If the corporation fails to correct the problem, the Secretary of State dissolves the corporation. A corporation that has been administratively dissolved may apply to the Secretary of State for reinstatement as an active corporation by bringing all of its filings up to date and by paying any back fees and a reinstatement fee.

The possibility of administrative dissolution should provide nonprofit corporations with substantial incentive to comply with the legal requirements of maintaining a corporation. Small and informally operated nonprofit corporations often fail to comply with corporate filing requirements, sometimes with serious consequences. While the Secretary of State must notify a corporation prior to an administrative dissolution and give the corporation an opportunity to cure the problem, the Secretary of State is only required to send this notice to the corporation's registered office. Consequently, if the corporation has not maintained an accurate, current filing with the Secretary of State as to its registered office, then the corporation may not receive the notice. Nonetheless, the administrative dissolution will be valid. *See* CHAPTER 13 for more on Registering and Filing with the Office of the Secretary of State.

The loss of corporate status may jeopardize the organization's federal tax-exempt status because that status is dependent upon the existence of the

corporation. In addition, the corporation may find that another entity took its name during its dissolution period. Corporate names must be distinguishable from those of other entities on file with the Secretary of State. If during an administrative dissolution period, another corporation reserves or adopts the same or similar name, then the dissolved corporation may be required to change its name as a condition of reinstatement.

A corporation's opportunity to reinstate as a matter of right is limited to no later than five years after the effective date of dissolution. If more than five years have elapsed, then the corporation can seek reinstatement only through a special process pursuant to RCW 23.95.620. This late reinstatement option, however, requires judicial review and there are no assurances that reinstatement will be granted.

(ii) Judicial Dissolution

Under rare circumstances, the superior court can dissolve a nonprofit corporation by decree pursuant to a proceeding commenced by the Attorney General, fifty members or members holding at least five percent of the voting power, a director, or a creditor of the nonprofit corporation. A corporation may also bring a proceeding to have its voluntary dissolution continued under court supervision. In an action commenced by the Attorney General, the superior court has the authority to dissolve the corporation if the corporation has procured its articles of incorporation through fraud; the corporation has exceeded or abused the authority conferred upon it by law; the directors are deadlocked in the management of corporate affairs causing irreparable injury to the corporation or its purposes to be threatened or suffered and the members, if any, are unable to break the deadlock; or the corporation is misapplying or wasting property held for charitable purposes.

Except as provided in the articles of incorporation or bylaws, judicial dissolution can occur in a proceeding by fifty members or members holding at least five percent of the voting power, or a director, if it is established that:

- The directors are deadlocked in the management of the corporate affairs causing irreparable injury to the corporation or its purposes to be threatened or suffered and the members, if any, are unable to break the deadlock;

- The directors or those in control of the corporation have acted, are acting, or have expressed intent to act in a manner that is illegal, oppressive, or fraudulent;

- The members are deadlocked in voting power and have failed, for a period that includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have, or otherwise would have, expired;

- The corporate assets are being misapplied or wasted; or

- The corporation has insufficient assets to continue its activities and it is no longer able to assemble a quorum of directors or members.

Judicial dissolution can occur pursuant to a proceeding brought by a creditor of a nonprofit corporation, if it is established that the creditor's claim has been reduced to judgment, the execution on the judgment returned unsatisfied, and the corporation is insolvent; or the corporation has admitted in a record that the creditor's claim is due and owing and the corporation is insolvent.

c. Effect of Dissolution

Once a nonprofit corporation has been dissolved, its claim to exist as an entity distinct from its members, officers, or directors continues only to the extent provided by state law. In the case of a voluntarily dissolved corporation, state law provides that upon adoption of a resolution of dissolution by the members or board of directors, as applicable, the corporation must cease to conduct its affairs, except in so far as may be necessary to "wind up" the corporation's affairs.

The administrative dissolution of a corporation by the Secretary State causes the existence of the corporation to immediately cease, subject only to the corporation's right of reinstatement. The board of directors of an administratively dissolved corporation, however, continues to hold title to the corporation's property as trustees for the benefit of the corporation's creditors and members. This provision prevents a gap in ownership of the corporation's assets given the likelihood that, because a corporation's dissolution was involuntary, no distribution plan for the corporation's assets existed at the time of dissolution. If a charitable corporation, or a corporation holding property for charitable purposes, has been administratively dissolved and has not been reinstated, then neither the corporation nor any other person may transfer or distribute to any other person any property held for charitable purposes by the corporation unless the corporation has complied with the procedures for adopting a plan of distribution pursuant to the requirements of RCW 24.03A.908(2) and following the procedure set out in RCW 24.03A.908(3) and has obtained the approval of the Attorney General of the plan of distribution, following the requirements of RCW 24.03A.908 (4) and (5).

Certain creditor claims may be time-barred if proper creditor notices are given by the nonprofit corporation. However, unless time-barred or unless the applicable statute of limitations has expired, a dissolved corporation may still be sued by a party to whom the corporation owes money, or is otherwise liable due to some event that occurred prior to dissolution. The corporation or its members, board of directors, and officers retain the authority to, and are advised to, defend such actions.

Corporate dissolution may also create an issue as to whether individuals who incur liability while acting on behalf of a dissolved corporation are entitled to the protection of the corporate form. One of the principal benefits of incorporation is the limitation on individual liability that follows from it. Individuals who continue to act on behalf of the dissolved corporation, with or without knowledge of the dissolution, may be personally liable for their actions. While Washington courts have not addressed this issue in the context of a nonprofit corporation, the Washington Supreme Court has addressed this issue regarding a for-profit corporation. In that case, the Washington Supreme Court concluded that the individual acting on behalf of the dissolved corporation was not personally liable for his actions. Nevertheless, the possibility of personal liability should present individuals with a powerful incentive to avoid administrative dissolution.

CHAPTER 85. Bankruptcy

A thorough discussion of the bankruptcy process is beyond the scope of this Handbook. Instead, this Chapter highlights some of the issues specific to nonprofits in the bankruptcy process. A nonprofit considering bankruptcy will almost certainly need to seek legal assistance before filing a bankruptcy petition. It can be a complicated procedure, and once a petition has been filed, there are restrictions placed on a debtor. For example, payment of attorneys' fees and non-routine business transactions all require the consent of the court after a Chapter 11 petition is filed. Moreover, at least one commentator has warned that an entity in reorganization may no longer be tax-exempt when it comes out of the process. *See* Evelyn Brody, *The Charity in Bankruptcy and Ghosts of Donors Past, Present, and Future*, 29 Seton Hall Legis. J. 471 (2005). Finally, if the goal of the directors is reorganization under the bankruptcy code, the board should consider how a bankruptcy filing will impact donors' willingness to support the organization.

Although for-profit corporations can be made the subject of involuntary bankruptcy proceedings, creditors of nonprofit corporations cannot force these into involuntary bankruptcy proceedings. However, a nonprofit may file for voluntary bankruptcy under either Chapter 7 or Chapter 11 of the U.S. Bankruptcy Code.

Chapter 7 is titled Liquidation. As the name implies, the assets of the debtor are gathered and distributed to pay creditors. In a Chapter 7 proceeding, the organization is controlled by an independent bankruptcy trustee who may not be knowledgeable of the organization's business and who sells off the assets and makes distributions to creditors. Chapter 11 is titled Reorganization. Chapter 11 is a mechanism by which a financially distressed organization may be able to emerge financially viable once more. Under Chapter 11, the debtor normally becomes a debtor in possession and can continue operating in its normal course of business under its existing management. A debtor in possession is also allowed to develop its plan of reorganization, describing how creditors are to be paid. However, Chapter 11 is a difficult, time-consuming, and expensive process.

Once a petition is filed, an automatic stay is imposed. The stay prevents creditors from taking any actions to enforce pre-petition liens. The stay does not apply to regulatory enforcement by a governmental unit. Actions that have been allowed to continue despite a bankruptcy petition have included the revocation of a nonprofit's charter and the revocation of tax-exempt status. *See In the matter of Jesus Loves You, Inc.*, 40 B.R. 42 (Bankr. M.D. Fla. 1984); *Universal Life Church, Inc. v. United States*, 128 F.3d 1294 (9th Cir 1997).

Once a petition is filed, a bankruptcy estate is created consisting of all of the debtor's property and interests in property. The Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") amended the bankruptcy code to require that the distribution of property from federally tax-exempt organizations comply with non-bankruptcy law. Thus, one issue for nonprofits in the bankruptcy context is the identification of the bankruptcy estate. For example, the treatment of restricted gifts, endowments, pledges, and other forms of gifts and donations carrying limitations on their use may not be clear. The restrictions may prevent the funds from becoming part of the bankruptcy estate. If restricted gifts and other assets survive the bankruptcy, the courts can use the doctrine of *cy pres* to distribute the gifts in a way that carries out the intent of the donor. Under the *cy pres* doctrine, assets are used for another charitable purpose that most closely aligns with the donor's intent when the original purpose becomes impossible, impracticable, or illegal.

Directors and officers should follow the restrictions placed on gifts to the corporation. Ignoring restrictions was costly to the Allegheny Health, Education and Research Foundation. The directors and officers of that foundation paid $94 million to settle claims brought by the attorney general. Other risks include exposing otherwise restricted gifts to creditor claims. (Brody, *supra* at 487-88; Robert White, *Charities in Distress: Selected Issues*, ABI-CLE (July 13-16, 2006)).

BAPCPA also amended the bankruptcy code to allow a greater role for the state and attorney general in bankruptcy proceedings where charitable assets are at stake. Daniel J. Callaghan, *An Overview of the Role of the Attorney General in Bankruptcy Proceedings Involving Charitable Organizations*, ABI-CLE 207 (July 13-16, 2006). Several provisions of BAPCPA are applicable to the bankruptcy of health care facilities (both profit and nonprofit) including special procedures to protect patient privacy and an exception to the automatic stay for the Secretary of Health and Human Services. Nonprofit health care facilities should take special care to ensure that they are complying with the new bankruptcy requirements.

CHAPTER 86. Endowment Funds

Endowment funds require special consideration when ceasing operations. These funds are restricted as to their use by the nonprofit. Typically, endowment funds are designated so that the recipient nonprofit may use the income from the fund while preserving the principal. Special steps must be followed to release endowment fund restrictions before the funds can be distributed.

Washington has adopted the Uniform Prudent Management of Institutional Funds Act ("UPMIFA"), RCW 24.55. UPMIFA governs the management and investment of institutional funds, including endowment funds, by an institution. An institution governed by UPMIFA includes any entity or organization, other than an individual, that operates exclusively for a charitable purpose. *See* RCW 24.55.010(4). A charitable purpose is broadly defined to include relief of poverty, the advancement of education or religion, the promotion of health, the promotion of a governmental purpose, or any other purpose of which the achievement is beneficial to the community. *See* RCW 24.55.010(1). An institutional fund is a fund held by an institution exclusively for charitable purposes, subject to certain exceptions. *See* RCW 24.55.010(5). An endowment fund is all, or part, of an institutional fund that is not wholly expendable on a current basis under restrictions set out in a gift instrument. *See* RCW 24.55.010(2).

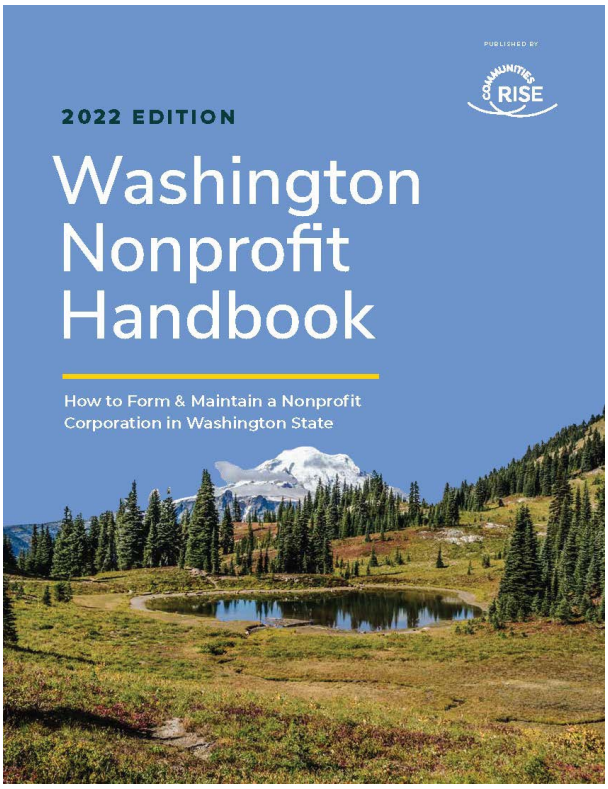
In order to release restrictions imposed on endowment funds:

- The nonprofit may ask the donor to consent (on record) to the release or modification of a restriction;
- A nonprofit may petition a court with jurisdiction (generally the superior court) to release or modify a restriction. The Attorney General must be notified and given the opportunity to be heard on the matter;

- If (a) the fund has a total value of less than $102,500 (increasing by $2,500 on July 1 of each year after 2021), (b) it has been more than 20 years since the fund was established, and (c) the nonprofit uses the property in a manner consistent with the charitable purposes provided for in the gift instrument, the nonprofit may release or modify a restriction if the nonprofit determines that a restriction on the management, investment, or purpose of a fund is unlawful, impracticable, impossible to achieve, or wasteful. The nonprofit must give 60-days notification to the Attorney General prior to the release or modification of the restriction. *See* RCW 24.55.045.

Even if a release of the restrictions imposed on the fund is obtained, the endowment fund may not be used for purposes other than charitable purposes.

Directors and other persons responsible for managing and investing institutional funds should pay particular attention to restricted gifts. Some restrictions designate a successor charity in the event the primary beneficiary ceases to exist or fails to use the funds as required. Directors and other persons responsible for managing and investing institutional funds are subject to a specific standard of conduct and failure to follow the conditions imposed on restricted gifts may result in unexpected consequences for directors and other responsible persons, including personal liability. *See* RCW 24.55.015.



Appendices

Appendix A	Biographies of Handbook Authors and Lead Editors
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APPENDIX A

Biographies of Handbook Authors and Lead Editors

Judy Andrews

Judy Andrew's practice focuses on nonprofit corporation law and tax-exempt organizations. For 30 years, she has represented nonprofit organizations on corporate and tax exemption issues including incorporation and determination of tax-exempt status, legal obligations of directors, organizational structure and roles of board and staff, conversion, merger and affiliation issues, and federal tax-exemption issues. In addition, she has worked as bond counsel and underwriter's counsel on many special fund revenue bond and nonrecourse revenue bond financings. In 1992, Judy spearheaded the writing, editing and publishing of the handbook "How to Form a Nonprofit Corporation in Washington State," as chair of the Community Involvement Committee of the King County Bar Association Young Lawyers' Division. She has served on the editorial committees of the second and third editions of the handbook. She is a frequent speaker on nonprofit corporate and federal tax topics. Judy is an adjunct professor at Seattle University School of Law. She also gives workshops on the formation and maintenance of 501(c)(3) organizations for attorneys and members of the public. Judy is of counsel at The Apex Law Group. She was appointed by the Secretary of State to serve on the Secretary of State's Charities Advisory Council.

Judy Andrews is a Co-Lead Editor and authored Parts 2 How To Form a Nonprofit, Part 3 Governance and Operations, Chapters 14-24 and Part 9 Fiscal Sponsorships, Joint Ventures and Other Collaborations.

Lynda Atkins

Lynda Atkins is an assistant attorney general in the Consumer Protection Division of the Washington State Attorney General's Office. Her practice focuses on matters relating to nonprofits, charities, charitable trusts, and UPMIFA. Lynda has been with the Attorney General's Office since 2017 and practicing law since 2007. She previously worked for the Colorado Attorney General's office in the Revenue and Utilities Section and began her legal career in private practice doing tax and estate planning.

Lynda Atkins co-authored Chapter 25 Enforcement And The Role of The Office of the Attorney General.

Nancy Bacon

Nancy Bacon works at the intersection of nonprofits, learning, and leadership. She created popular courses on nonprofit topics used across Washington State, including Boards in Gear, Finance Unlocked for Nonprofits, Let's Go Legal, and Build a Movement. After founding the learning program at Washington Nonprofits and two other nonprofit learning programs, Nancy now leads Nancy Bacon Consulting LLC where she works with nonprofits and associations across the U.S. to create and deliver learning programs that help nonprofit people achieve their mission. Nancy received a B.A. in Economics and German Literature from Swarthmore College and a Master of Public Administration from the University of Washington's Evans School of Public Affairs. Nancy co-hosts the Nonprofit Radio Show, a podcast designed to provide bite-size, practical support to small and rural nonprofits.

Nancy Bacon authored Chapter 1. What is a nonprofit? and Chapter 2. Are you sure you want to do this?

Putnam Barber

Putnam Barber is a retired leader of nonprofit organizations and a former member of the Secretary of State's Charities Advisory Council. He has taught courses on nonprofits at Seattle University and the University of Washington and written several published papers about the history and scope of the regulation of charitable solicitations. He has also served on several boards of directors for Washington state and national nonprofits.

Putnam Barber authored Chapter 22. Sarbanes-Oxley – Document Retention and Protections for Whistleblowers, Chapter 51. Nonprofit Mailings, and Chapter 54. Liquor and Cannabis at Nonprofit Events.

Jeff Brennan

Jeff Brennan worked in the telecommunications field for over 30 years. His areas of responsibility ran from sales and marketing to responsibility for launching a new wireless network and running a wireless region in the Northwest. Jeff has an Associate Degree in Radio Communications Technology from the Community College of the Air Force, a BA and MBA in Management from Angelo State University in West Texas, and a Law Degree from Seattle University. Jeff is a member of the Washington State Bar Association. He currently focuses on business and privacy law and holds International Association of Privacy Professional certifications – Fellow Information Privacy (FIP) and Certified Information Privacy Professional credentials for the US, Europe, and Management (CIPP/US, CIPP/E and CIPM). Jeff has volunteered with Communities Rise to conduct privacy policy seminars and assisted nonprofits

address specific privacy requirements. On a national level, Jeff supports the Kantara Initiative's FIRE work group efforts in the area of identity management.

Jeff Brennan authored Part 12. Personal Information Security and Online Privacy Issues for Nonprofit Organizations.

Howard Donkin

Howard Donkin, CPA, is the Jacobson Jarvis Director of Tax Services with more than 20 years of experience in serving the not-for-profit community. He is focused on helping nonprofits address tax related issues, including exemption status, unrelated income, compliance and penalty abatement. Howard is a member of the Washington Society of Certificated Public Accountants (WSCPA), Past Chair, Not-for-Profit Committee and NFP Tax Sub-Committee and Member, Legislation Task Force. He is a member of the AICPA Exempt Organization Technical Resource Panel where he studies not-for-profit issues on a national level. Locally, he volunteers his time to Bellevue Rotary Community Grants Committee and the Chair of the Secretary of State, Charity Advisory Council and a frequent speaker at the WSCPA Nonprofit Conference, the NAIS Conference, Communities Rise Nonprofit Law Institute and others.

Howard Donkin authored Chapter 38. Federal Filing Requirements and Chapter 39. Public Disclosure of Exemption Application and Form 990 Returns.

Lorri Dunsmore

Lorri Dunsmore serves as general counsel for a family office. Prior to becoming general counsel, Lorri was a partner at Perkins Coie LLP where she served as Co-Chair of the Tax-Exempt Organizations group and advised individuals and tax-exempt organizations on a wide range of tax and state law issues impacting charitable giving, formation of nonprofits and addressing the specialized needs of tax-exempt organizations. Lorri also advised clients on the formation, operation, management and transfer of family business entities.

Lorri Dunsmore co-authored Part 4. Obtaining Recognition as a 501(c)(3) Entity and Part 5. Maintaining Tax-Exempt Status For Your 501(c)(3) Organization.

Scott Galloway

Scott Galloway is of counsel at Foster Garvey PC and has substantial experience with respect to investment and management of pension and welfare plan assets, and the related prohibited transaction and conflicts of interest rules. He advises large and small employers with respect to the tax, Title I, Title IV, labor, and securities law issues involving pension, profit-sharing, 401(k), stock bonus, stock option, deferred

compensation, and medical and other welfare benefit plans, as well as executive compensation planning.

Scott also has substantial experience advising tax-exempt entities, including credit unions, tribal governments and hospitals with respect to the unique issues presented by such organizations' tax-qualified plans and executive compensation and severance arrangements.

Scott Galloway authored Chapter 73. Setting Executive Compensation and Chapter 74. Employee Benefits and Executive Deferred Compensation.

Mark Hugh

Mark Hugh is the principal of Mark Hugh PLLC, a firm devoted to serving clients with state and local tax issues. His work includes planning and tax reporting reviews for a variety of organizations. He is the instructor of the Washington Tax Series webcasts: *Washington Tax for Service Businesses*, *Washington Sales Tax*, and *Washington Tax Audits*, and the multistate webcast, *State Tax Nexus FAQ: Frequently Awkward Questions*. He is the author and instructor of *Washington Business Tax and New Developments, State Tax Nexus and New Developments*. He is also the author and instructor of *Washington Ethics and New Developments*, a Washington State Board of Accountancy approved course for regulatory ethics, and *Oregon Ethics and New Developments*, an Oregon Board of Accountancy approved course for regulatory ethics. He is a CPA, a graduate from the University of Washington, and holds a master's degree in federal income taxation from Golden Gate University. Mark is currently a member of the Washington State Board of Accountancy, the government body that initially qualifies and monitors the quality of CPA's and CPA firms in Washington.

Mark Hugh authored Part 8. Washington State Taxes and Nonprofit Corporations.

Maha Jafarey

Maha Jafarey is a Corporate Counsel in Microsoft's Experiences and Devices division. Prior to her work at Microsoft, Maha worked as a corporate and intellectual property attorney at The Apex Law Group PLLC. Her work included assisting and guiding nonprofit clients on tax exemption matters; guiding for-profit and nonprofit clients on general counsel matters; and maintaining client's intellectual property portfolio. She holds a master's degree in Intellectual Property and Policy from University of Washington. As part of her pro-bono work, she is a regular speaker on topics such as basics of nonprofit law and intellectual property to members of the public.

Maha co-authored Chapter 6. Alternative Leadership and also authored Part 11. Intellectual Property Considerations.

Jamie Lanier

Jamie Lanier, an associate at Lane Powell, focuses her practice on estate planning, probate, and trust administration for high net worth individuals and families. She also works with fiduciaries and beneficiaries regarding non-judicial resolution of trust and estate disputes. In addition, Jamie advises tax-exempt organizations regarding formation and compliance issues.

Jamie Lanier authored Part 6. International Activities and Grantmaking.

David Lawson

David Lawson is a Partner at Perkins Coie, LLC and counsels organizations and companies on matters involving tax exemption, philanthropy, and social impact, and enjoys helping his clients find innovative ways to benefit their communities more effectively. David's clients include foundations, nonprofit healthcare organizations, trade associations, universities, social service providers, and businesses seeking to make a difference. His deep knowledge encompasses a wide variety of topics relating to federal tax exemption, state nonprofit and charitable trust laws, and laws governing lobbying and issue advocacy. David is a frequent speaker and writer on nonprofit law topics. He serves as the chair of the Nonprofit Corporations Committee of the Washington State Bar Association's Business Law Section. As the recorder of that committee, he played a primary role in drafting Washington's new Nonprofit Corporation Act, which took effect at the beginning of 2022.

David Lawson co-authored Part 5. Maintaining Federal Tax-Exempt Status for your 501(c)(3) Organization Chapters 31 -27 and Chapter 40.

Danny Lisa

Danny Lisa was a special agent with the Washington State Gambling Commission. He is also an instructor at the Basic Law Enforcement Academy in Burien and he teaches the Gambling Investigations class to police recruits.

Danny Lisa authored Chapter 49. Fundraising Involving Gambling, 2018 Edition.

Lindsey McAleer

Lindsay McAleer is counsel at Elias Law Group and focuses her practice on labor and employment counseling for progressive organizations, nonprofits and Democratic campaigns. She provides advice and training to clients and also works with clients to draft employment handbooks and policies, employment contracts, and other

employment agreements. Lindsay also has experience defending complex wage-and-hour class action cases and claims brought under state and federal employment laws, in addition to practicing voting rights litigation. Prior to attending law school, Lindsay taught fifth and sixth grade and coached middle school girls basketball in Phoenix, Arizona.

LIndsey McAleer co-authored Chapters 65-72 on Employment Issues.

Anthony (Tony) McCormick

Tony McCormick is of counsel with Perkins Coie's Trust & Estate Planning practice. Tony counsels his clients in both the tax and non-tax aspects of estate planning, with a specific focus on estate planning strategies to efficiently minimize taxes through the creation of wills, trusts, business entities, and charitable organizations and the use of gifts, sales, and other wealth-transfer strategies. Tony's practice also includes advising individuals and tax-exempt organizations on the wide range of legal issues affecting charitable giving, the formation of nonprofit organizations, and the organizational steps required to maintain a charitable organization's tax-exempt status.

Tony McCormick co-authored Part 4. Obtaining Recognition as a Code Section 501(c)(3) Organization.

Nisha Nariya

Nisha Nariya is an attorney at Perkins Coie. Her practice includes estate planning and non-profit advising. She has experience in establishing tax-exempt entities and advising on legal issues affecting formation, charitable giving, ongoing operations, and compliance to maintain charitable status. Outside of her law practice, Nisha is currently serving on the University of Washington Honors Advisory Board. Nisha completed her J.D. at Georgetown University Law Center.

Nisha co-authored Chapters 29. IRS Processing of Exemption Applications and Chapter 30. Applying with the Form 1023Z.

Jodi Nishioka

Jodi Nishioka is the Executive Director of Communities Rise and has been with the organization since 2011. She has worked for over 30 years on behalf of low-income and communities of color, particularly women, children and immigrant/refugee communities. She started her career as an attorney advocating for immigrant domestic violence survivors and single mothers fighting for child support in legal aid organizations in Boston and Honolulu. Jodi continued her work on behalf of communities impacted by systemic oppression within state and city governments in

Hawaii and Seattle and later with grassroots nonprofit organizations. Currently, Jodi enjoys her work at Communities Rise because it combines her legal skills with her dedication to building power and addressing systemic oppression. Jodi is also on the Board of Directors of JustLead Washington.

Jodi Nishioka is the Co-Lead Editor and Publisher, and co-authored Chapters 15 - 18 on board and executive leadership.

Valerie Pickens

Valerie Pickens is the founder and Manager of Your Financial Solutions, LLC a Certified Public Accounting firm. She is a sole practitioner with over thirty years of accounting, auditing and tax experience.

Valerie has a B.A. degree in Economics from UCLA and is a Certified Public Accountant, a Certified Internal Auditor and a Chartered Global Management Accountant. Her practice includes financial statement audits, reviews and compilations; internal control and consulting for nonprofit organizations. She also focuses on tax advisory and compliance for individuals, corporations, partnerships and trusts. She is a member of the American Institute of Certified Public Accountants, Nonprofit, Tax and Personal Financial Planning Sections, Washington Society of Certified Public Accountants and the National Association of Tax Professionals.

Valerie authored Chapter 80. Internal Controls and Chapter 81. Restricted funds and accounting issues specific to nonprofits.

Stefanie Rossi

Stefanie Rossi has been an employee of the Secretary of State Corporations and Charities Division since 2017. For several years, Stefanie worked as a member of the Charities and Nonprofits Teams, including the role of the Nonprofit Team's Supervisor. Currently, Stefanie works as a Management Analyst to provide support, and test/implement new developments for the Corporations and Charities Filing System (CCFS) in collaboration with the division's leadership, IT developers, and other Stakeholders. Training staff and developing resources for the implementation of system developments is a significant part of Stefanie's role within the support team.

Stefanie authored Chapter 13. Registering and Filing with the Office of the Secretary of State.

Lisa Schaures

Lisa Schaures is an attorney with Seyfarth Shaw LLP. Lisa partners with growing businesses, social ventures, and nonprofits to guide them through everyday general

counsel matters and major events. During her more than 10 years of practice, Lisa has handled governance, conflict of interest, tax, expansion, succession planning, and other general counsel matters effectively and with sensitivity to each client's uniqueness. Lisa received her JD from the University of Oregon, her Master of Laws in Taxation from University of Washington School of Law, and her Bachelor of Arts from Washington State University. She was named to the 2018 "Best Lawyers In America" list, and from 2013-2017, Lisa was named to the Washington "Rising Stars" list for Nonprofit Organizations.

Lisa Schaures authored Chapter 49. Charitable Solicitation in Washington and Chapter 50. Charitable Solicitation Outside of Washington and Internet Solicitations and Part 14. Ceasing Operations.

Kad Smith

Kad has 14 years of relevant experience that led him to start Twelve26 Solutions. A native of West-Berkeley, CA, Kad describes himself as a lifelong "bay-destrian". He is most passionate about changing the material conditions of BIPOC folks across the country. He spends a significant amount of his time focusing on civic engagement, political education, climate justice, and imagining the bridging of world-views across the globe. Kad focuses on providing practical solutions while keeping an eye out for profound possibilities. He specializes in training & facilitation, leading teams through significant changes, and working with leaders who are seeking thought-partnership in their leadership journey. Before founding Twelve26 Solutions, Kad worked as a Project Director at CompassPoint Nonprofit Services. There, he designed & delivered leadership development programs such as the Next Generation Leaders of Color Inland Region and Organizational Equity Leadership Development Program.

Kad co-authored Chapter 6. Alternative Leadership.

Joshua Studor

Joshua Studor is an assistant attorney general and team lead with the Consumer Protection Division of the Washington State Attorney General's Office. His practice focuses on matters related to nonprofits, charities, and charitable solicitations. Josh has been with the attorney general's office since 2014 and practicing law since 2008.

Joshua co-authored Chapter 25 Enforcement And The Role of The Office of the Attorney General.

Nancy Williams

Nancy Williams has been at Perkins Coie LLP, counseling and representing employers in the areas of labor and employment law for more than 40 years. Her areas of

experience include litigation, equal employment opportunity, discipline and discharge, and a wide variety of other employment issues. For several years, Nancy was named a Senior Statesman by *Chambers USA* in recognition of her practice transition and long-term dedication to clients.

Nancy has served as managing partner of Perkins Coie's Seattle office, as firmwide personnel partner and as chair of the Seattle Labor & Employment practice. She has been an active contributor and leader in civic, cultural and professional organizations, including the American Bar Association and Washington State Bar Association. She served as a trustee for the King County Bar Association and continues to be an active participant in its Labor and Employment Law Section.

Nancy co-authored Chapters 65-72 on Employment Issues.

LaVerne Woods

LaVerne Woods is a partner in Davis Wright Tremaine's Seattle office and chairs the firm's Tax-Exempt Organizations group. LaVerne is a past Chair of the American Bar Association Section of Taxation Exempt Organizations Committee and of the Washington State Bar Association's Business Section Nonprofit Corporations Committee. She is a past Chair and current Vice Chair of the Board of Advisors of the New York University School of Law National Center on Philanthropy and the Law, and is an Advisor on the American Law Institute's Restatement of the Law of Charitable Organizations project. She has taught in the University of Washington School of Law's Graduate Program in Taxation and is listed in Best Lawyers in America and in Washington Law & Politics' "Super Lawyers." LaVerne represents nonprofit organizations in matters such as qualification for tax exemption, mergers and restructuring, joint ventures and entrepreneurial activities, intermediate sanctions, creation of "friends of" and supporting organizations, unrelated business income tax, conversions to and from tax-exempt status, advocacy, charitable solicitations, endowment management, and tax-exempt bond financing. She advises for-profit corporations on their corporate philanthropy and helps private foundations establish grantmaking compliance programs and provides grantmaking training workshops. LaVerne is an honors graduate of Yale University and Harvard Law School.

LaVerne Woods co-authored Part 5. Maintaining Federal Tax-Exempt Status for your 501(c)(3) Organization Chapters 31 - 27 and Chapter 40.

APPENDIX B

Glossary

"At Will" Employment

An employment status which is presumed in Washington State unless otherwise agreed upon by the employer and employee. The "at will" employment relationship means that an employee may resign at any time for any reason and, likewise, the employer may discharge the employee at any time for any reason.

1980 United States-Canada Income Tax Convention

Commonly referred to as the "Convention", this treaty provides for reciprocal recognition of exemption for religious, scientific, literary, educational or charitable organizations under limited certain circumstances. As such, exempt organizations in either Canada or the U.S. must automatically receive recognition of exemption without application in the other country.

1992 United States-Mexico Income Tax Treaty

Otherwise known as the "Treaty", this agreement provides for reciprocal recognition of exemption and reciprocal deduction of charitable contributions, subject to limitations to the income arising in the other country.

501(c)(3) Organization

An entity that is exempt from federal income tax under section 501(c)(3) of Title 26 of the United States Code (Internal Revenue Code of 1986, as amended). 501(c)(3) organizations are the most common of the 29 types of 501(c) nonprofit organizations in the U.S.

Articles of Incorporation

The document filed with the Secretary of State (in Washington State) to create a corporation.

Board of Directors

The governing body of a nonprofit corporation; sometimes called the Board of Trustees.

Business and Occupation Tax

A tax imposed on the state and city level on the gross receipts of every person engaged in business activities. While nonprofit organizations are not exempt from such tax obligations, some specific exemptions and deductions may be

applicable depending on the nature of the business conducted and the amount of revenue of the business activity subject to the tax.

Bylaws

The code of rules adopted by an organization or business after incorporation for its governance and regulation.

Charitable Organization

Any organization recognized as tax exempt under Section 501(c)(3) of Title 26 of the United States Code (Internal Revenue Code of 1986, as amended.)

Charitable Solicitations

Any request to the general public for funds for a charitable purpose is considered charitable solicitation.

Charitable Solicitations Act (CSA)

A statute that regulates the activities of persons and entities that raise money for charitable purposes. Under the CSA, charitable organizations must register and report annually to the Secretary of State, and also make certain disclosures when soliciting for charitable contributions.

Charitable Trust Act (CTA)

Nonprofit corporations that meet the definition of a "trustee" are subject to the requirements of the CTA, which empowers the Attorney General to enforce the terms of the trust as the statutory representative of its public beneficiaries. Furthermore, trustees are required to report notice of all judicial proceedings affecting the trust, and to register with and report annually to the Secretary of State.

Commercial Fundraiser

A commercial fundraiser is a person or entity that conducts charitable solicitations on behalf of others in exchange for compensation or other consideration.

Consolidation

When two or more nonprofit corporations consolidate their operations such that each of the original corporations ceases operations and the resulting entity is new and distinct. This process differs from a merger in which one of the merging corporations emerges as the surviving entity.

Consumer Protection Act (CPA)

The CPA, protects consumers from deceptive and/or dishonest practices. The CPA applies to all fundraising activities that fall within the scope of trade or commerce.

Copyright

Copyrights are a form of intellectual property protection afforded to "original works of authorship" that allow the creator of such works to prevent a third party from copying, distributing, or adapting their original product. While these rights are afforded to the owner of the work upon its creation, additional rights (such as the right to sue third parties for infringement) can be obtained by registering the copyright with the U.S. Copyright Office.

Cumulative Voting

A manner of electing directors that may be permitted by an organization's articles of incorporation or bylaws of an organization. Cumulative voting permits each voting member to distribute the votes to which they are entitled to a number of, or just one, candidate.

Direct Lobbying Communication

Attempts made to influence legislation through direct communication with members of legislative bodies or their staff or with government officials involved with the formulation of legislation. Also, communication with the general public that expresses a view in reference to a specific ballot measure.

Disqualified Person

Any person who is in a position to exercise substantial influence over an organization with respect to a transaction. Influential positions include, but are not limited to, those who are substantial contributors, directors, officers, trustees, or family members of disqualified persons.

Dissolution

The act or process of dissolving or terminating a corporation in accordance with the provisions established in the Washington Nonprofit Corporation Act and the organization's articles of incorporation.

Employee

A person who performs work for an organization with the expectation of being paid for that work.

Excess Benefit Transaction

A transaction in which an economic benefit is provided by a 501(c)(3) or 501(c)(4) organization, either directly or indirectly, to a disqualified person and that value is determined to be in excess of the value of the services or property received in exchange.

Excise Tax

A tax that applies to a specific type of income, activity, good, or service. These taxes may also be imposed in response to the engagement in prohibited activities.

Exempt and Nonexempt Employees

The Fair Labor Standards Act and Washington Minimum Wage Act regulate the hours and wages of workers in Washington State. Work beyond 40 hours per week must be compensated at a minimum of one and one-half times the employee's regular rate of pay for each hour worked. To avoid confusion, employees should generally be assumed to be non-exempt from such requirements unless they meet the qualifications for exemption set forth by the U.S. Department of Labor.

Fair Use

The right to use the intellectual property protected by trademarks or copyrights for certain qualifying entities or professionals. Nonprofit status does not entitle an organization to assert fair use claims.

Feasibility Study

A study used to determine whether an idea has the support, commitment, and resources to succeed as a nonprofit organization. Also used to describe a blueprint for an organization's capital campaign.

Fiscal Sponsorship

A cooperative relationship between a tax-exempt entity (the sponsor) and a project which has not secured tax-exempt status (the sponsored organization). In a fiscal sponsorship, the tax-exempt organization agrees to receive and disperse funds for the project, often in exchange for fees or other benefits.

Form 990

The federal informational return which most 501(c)(3) organizations must file annually with the IRS. The type of form required varies depending on the size and type of the organization.

Fraud

Wrongful or criminal deception intended to result in financial or other personal gain.

Friends-of-Organizations

U.S. organizations formed to solicit and receive contributions from United States donors and to spend the funds on behalf of a charitable organization organized outside the United States.

Fundraising Activity

Activities are those activities conducted to further the goals of a nonprofit by either the direct solicitation of money or property, or the anticipated exchange of goods or services for money between the soliciting organization and the organization or person solicited.

Grassroots Lobbying Communication

Communications designed to influence specific legislation by affecting the opinion of the general public and encouraging the public to take action.

Incorporation

The act or process of forming or creating a corporation by filing articles of incorporation with the state.

Incorporator

Any individual or entity participating in the formal organization of a nonprofit corporation; including the signing and filing of the articles of incorporation with the State.

Indemnification

A promise to protect a director or officer from expenses, liabilities and losses incurred by the individual when acting in official capacity, and in good faith, for the benefit of the corporation. Indemnification provisions may be included in the articles or bylaws of a corporation.

Independent Contractor

An individual or entity that provides goods or services under specified terms with duties, pay, the amount spelled out and is distinguished from an employee, who works regularly for an employer.

Internal Controls

Practices and adopted systems which monitor, measure, and direct against risk and fraud and are the responsibility of board members to establish.

Internal Revenue Code

The codified laws of the federal government related to federal taxation.

Involuntary Dissolution

When a nonprofit corporation is dissolved involuntarily by administrative action of the Secretary of State. This happens when the nonprofit fails to adhere to its operating requirements, or by judicial action, if the nonprofit engages in fraud or abuses its authority.

Joint Ventures

When two organizations partner with one another as a strategy to fulfill shared goals. Joint ventures can be project-specific or comprehensive in their scope; both require careful attention to guard against private inurement, especially when a nonprofit organization partners with a for-profit entity.

Listed Persons

Terrorists and terrorist organizations identified under Executive Order 13224.

Mutual Benefit Organization

Organizations are formed and operated for the benefit of some identifiable group, such as condominium associations and social clubs.

Nonprofit Corporation

A corporation that is established for the benefit of the community, a specific group or cause. It does not distribute income or shares to its members, directors, or officers.

Patent

A form of protection within intellectual property law, falling within three main categories: utility, design, and plant.

Private Foundation

A 501(c)(3) organization that is funded by one source or a very few sources (usually one individual, family, or corporation) and operates under more restrictive rules than public charities.

Private Inurement

When a person who is an "insider" with respect to the organization, such as an officer or director, derives a benefit from the organization without giving something of at least equal value in return. The Internal Revenue Code establishes prohibitions against private inurement.

Public Benefit Organization

A Public Benefit Corporation is defined in the Washington Nonprofit Statute (RCW 24.03.500), as a nonprofit, in compliance with the Washington Nonprofit Statute RCW 24.03 and is tax-exempt under section 501(c)(3) of the Code.

Public Charity

A 501(c)(3) organization with income generated from a broad base of support from the public.

Qualifying Distributions

Any amount paid to accomplish religious, charitable, scientific, literary, or other public purposes, usually in the form of a grant. Distributions by the private foundation to a disqualified person with respect to the private foundation, or to a non-operating private foundation are not considered a qualified distribution.

Quid Pro Quo Contribution

Payment to a charity that is partly a contribution and partly a payment for goods or services. If the contribution is in excess of $75, the charity must provide the donor with a written statement that specifies the amount of the payment, above the value of the goods and services provided, that can be considered deductible as a contribution.

Quorum

The minimum number of voting members who must be present in a meeting in order to conduct business. For the board of directors of a Washington nonprofit corporation, this number may not be less than one-third of the total number of directors.

RCW

The Revised Code of Washington, which codifies Washington State statutes.

Reasonable Accommodation

The Americans with Disabilities Act (ADA) requires all employers to provide "reasonable accommodation" to enable employees with disabilities to have access to equal employment opportunities. Such accommodations are changes

in the standard application process, changes that enable the employee to perform the essential functions of their position, and changes that provide equal access to the same benefits and privileges of employment available to employees without disabilities.

Registered Agent

A person or entity designated to receive legal and tax documents relevant to the operation of business. The registered agent must have a registered office, with a mailing address to receive notices. The registered agent may be an individual resident of Washington State, or a corporation or limited liability company authorized to do business in the state.

Resolution

A formal expression of a decision or motion of the governing body of an organization, adopted by a vote.

Sarbanes-Oxley (The Public Company Accounting Reform and Investor Protection Act of 2002)

Commonly known as the Sarbanes-Oxley Act, it was enacted to rebuild public trust in corporate America. In response to several scandals, this act establishes stricter expectations for corporate accountability, especially on the financial affairs of publicly traded corporations. Some provisions, such as those relating to the preservation of records (Title VII) and new protections for whistleblowers (Title XI), extend to the operations of nonprofit organizations.

Section 501(h) Election

An election provides the opportunity for public charities, other than churches, to avoid the ambiguity of the "substantiality" test and to become subject to a more objective standard for lobbying activities. The standards set by the § 501(h) election allow organizations a greater ability to plan lobbying activities.

Segregation of Duties

The concept of having more than one person involved in completing a task in order to prevent fraud and error.

Social Welfare Organization

A public benefit organization that focuses on achieving its goals through advocacy and efforts to influence public policy. Social Welfare Organizations often forego the ability to receive certain grants and tax-deductible donations in exchange for greater freedom to engage in lobbying efforts and are often exempt under 501(c)(4) of the Code.

Solicitation

Any oral or written request for a contribution, or any attempt to make a sale in connection with a charitable purpose

Tax-Exempt

An organization exempt from federal income taxation and organized for specific charitable, educational, scientific, religious or other specific purposes described in the Internal Revenue Code.

Trademark

A logo, business or product name, tag line, or other item that identifies the source of origin for a good.

Trade Secret

Any information that derives economic value from not being known.

Trustee

A nonprofit corporation fits the definition of a trustee if it is either (1) formed for the administration of a charitable trust or (2) holds assets that can only be used for charitable, religious, eleemosynary, benevolent, educational or similar purposes. The Charitable Trust Act empowers the attorney general to enforce the terms of these trusts as the statutory representative of its public beneficiaries.

Unrelated Business Income

An exempt organization should consider income generated from a trade or business activity unrelated business income (UBI) if the activity is regularly carried on and if it is also not substantially related to the charitable purposes of the organization. Such income is subject to the federal UBI tax.

Voluntary Dissolution

A process called voluntary dissolution is available to nonprofits when the directors and members, if any, believe that it is in the best interest of the organization to discontinue its existence as a legal entity.

Volunteer

A person who performs services for an organization without any expectation of, or receipt of, compensation for his or her services.

Whistleblower

An individual within an organization who reports suspected illegal activities within the organization. The Sarbanes-Oxley Act establishes protections for such individuals and criminal penalties for acts of retaliation against them. Nonprofits must develop policies and procedures that encourage the reporting of misconduct and that specifies the protections available for those who do report.

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