

IAFF Local Charitable Activities Manual



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Section 1 – Overview of Non-Profit Organizations

What is a non-profit organization?

Generally speaking, non-profit organizations are organizations that are established to benefit a particular societal need or purpose and that qualify for certain tax benefits as designated by the Internal Revenue Service (IRS). While non-profits may be created for any number of reasons, this Manual will focus on non-profits that are created for charitable, scientific, or educational purposes (also known as 501(c)(3) organizations) and labor organizations (also known as 501(c)(5) organizations). As discussed in greater detail below, each type of non-profit receives tax benefits depending on its IRS designation, and must also abide by specific reporting, disclosure, and compliance requirements.

What is a 501(c)(3) non-profit organization?

A 501(c)(3) organization, most commonly referred to as a “non-profit” or “charity,” is a federally-tax exempt entity (trust, corporation, or association) that is organized and operated exclusively for charitable, scientific, or educational purposes as set forth under Section 501(c)(3) of the Internal Revenue Code.¹ The term “non-profit” is a bit of a misnomer, as non-profits, like other business, typically require revenue or income to survive, and may in fact earn a profit (subject to certain conditions) to carry out their exempt purpose(s).

In order to qualify as a 501(c)(3) organization, none of the organization’s earnings may inure to a private shareholder or individual.² In addition, 501(c)(3) organizations are prohibited from attempting to influence legislation as a substantial part of their activities, and may not participate in any campaign activity for or against political candidates.³ If either of these requirements fails to hold true, the organization will lose its 501(c)(3) status, and be responsible for paying federal income tax.

As noted above, having 501(c)(3) status formally only shields an organization from payment of federal income tax. As discussed more fully below, these entities may still be responsible for paying state taxes; however, most, if not all states will provide an exemption from state income tax if the organization has obtained 501(c)(3) status from the Internal Revenue Service (IRS).

What are the benefits of forming a 501(c)(3)?

There are two major benefits to forming a 501(c)(3) non-profit organization. The first benefit is that income received by the non-profit is typically exempt from federal income tax.⁴ While there are some exceptions to the federal tax exemption, these generally apply to what is

¹ 26 U.S.C. § 501(c)(3).

² U.S. Department of the Treasury, Internal Revenue Service, IRS Publication 4220, *Applying for 501(c)(3) Tax Exempt Status* (Rev. 8-2009).

³ *Id.* at 3.

⁴ *Id.*

known as the unrelated business income tax, or UBIT. In brief, UBIT is a tax imposed on the income a non-profit earns from activities that are not related to the exempt purpose of the organization. (For a more in depth discussion of UBIT, see Section 8 below).

The second benefit is that *donations* made to a 501(c)(3) non-profit are generally tax-deductible to the *donor*. For this reason, individuals and corporations are more likely to support a “non-profit” organization that has obtained 501(c)(3) status than one that has not.⁵ As discussed more fully below, the amount that can be deducted is subject to certain limitations depending on whether the donor received any goods or services in exchange for the donation, the amount of the donation, and the purpose for which donated goods or services are used.

Some other benefits of forming a 501(c)(3) non-profit may include reduced postal rates from the U.S. Postal Service, as well as exemption from state income, sale, and property taxes.⁶

Can a 501(c)(3) be set up to benefit only members of a local?

Probably not. As discussed above, an organization may obtain 501(c)(3) tax-exempt status if it is organized or operated exclusively for charitable, educational, or scientific purposes.⁷ The Federal income tax regulations provide that an organization is not organized or operated exclusively for charitable, educational, or scientific purposes unless it serves a public rather than private interest.⁸ In making this determination, the IRS has held that, “[t]he class [benefiting] must be sufficiently large... so that the community as a whole benefits.”⁹ Since most locals do not include all members of the fire service community the IRS would not likely grant 501(c)(3) status to an organization by its expense policies and rule, that only benefited members of a particular local.

Thus, when setting up a 501(c)(3) organization, it is essential that its purpose benefit a class large enough to pass muster. Some examples of purposes that have met this requirement are as follows:

Example 1: To pursue the charitable purpose of advancing and supporting the health, safety and welfare of fire fighters, first responders, emergency medical service providers and their families, as well as providing support for individuals and communities that are impacted by fire, or by disasters, whether caused by nature or individuals.

Example 2: To promote the advancement of education by supporting and providing: burn prevention education, burn care research, improvement in the quality of life for burn survivors, burn treatment centers and skin banks, and programs and other efforts to reduce and eliminate the suffering of people due to burn-related causes.

⁵ *Id.* at 2.

⁶ *Id.*

⁷ 26 U.S.C. 501(c)(3).

⁸ 26 C.F.R. 1.501(c)(3)-(d)(1)(2).

⁹ Rev. Rul. 83-157, 1983-2 C.B. 94.

Example 3: To pursue the charitable purpose of providing humanitarian assistance to the surviving spouses and family members of fire fighters who are injured or killed in the line of duty; providing educational opportunities, in the form of grants, scholarships, and awards, for the spouses, children, and dependents of fire fighters who are injured or killed in the line of duty; supporting treatment and research to relieve the suffering from occupational diseases of fire fighters; and supporting law enforcement efforts related to crimes of arson.

Example 4: To engage in efforts to reduce the degree of suffering experienced by fire fighters, their families, and other families, and educate the general public, with regard to fires, fire fighting, natural disasters, and disasters that may be caused by individuals.

What is a 501(c)(5) organization and how is it different than a 501(c)(3) organization?

Similar to a 501(c)(3) non-profit organization, a 501(c)(5) organization is also a federal tax-exempt entity. However, unlike a 501(c)(3), which, as noted above, must be organized and operated exclusively for charitable, educational, or scientific purposes, a 501(c)(5) must be organized as a “labor organization” as defined under Section 501(c)(5) of the Internal Revenue Code. Section 501(c)(5) defines “labor organization” as “an association of workers who have combined to protect and promote the interests of the members by bargaining collectively with their employers to secure better working conditions.”¹⁰ As discussed more fully below, all IAFF affiliates may qualify as 501(c)(5) “labor organizations” by registering with the IAFF.

Another important distinction between 501(c)(3) and 501(c)(5) tax-exempt organizations is that *donations made to a 501(c)(5)* (labor organizations) are *not tax deductible* to the donor. This is an important fact to keep in mind for affiliates that engage in fundraising efforts that benefit the local and/or its members. **Under no circumstances should an affiliate claim that donations made to it are tax deductible.** Falsely stating that a donation is tax deductible could result in fines to the Local, and even fines and/or imprisonment of the affiliate officers or individuals making this misrepresentation.

On the other hand, dues and initiation fees paid for union membership are tax-deductible.¹¹ In addition, members can also deduct assessments for benefit payments to unemployed union members; however, members cannot deduct the part of the assessments or contributions that provides funds for the payment of sick, accident, or death benefits.¹² Also, members cannot deduct contributions to a pension fund even if the union requires the contributions.¹³ Finally, members may not be able to deduct amounts you pay to the union that

¹⁰ 26 U.S.C. 501(c)(5).

¹¹ U.S. Department of the Treasury, Internal Revenue Service, IRS Publication 529, *Miscellaneous Deductions* (Rev. 12-2009) at 7.

¹² *Id.*

¹³ *Id.*

are related to certain lobbying and political activities.¹⁴

Does my local automatically qualify as a 501(c)(5) tax-exempt organization?

Not exactly. IAFF affiliates do not *automatically* qualify as 501(c)(5) tax-exempt organizations. However, in October 1940, the IRS recognized the IAFF as a 501(c)(5) tax-exempt entity. In granting the IAFF tax-exempt status, and in response to the IAFF's request to also recognize IAFF affiliates as 501(c)(5) organizations, the IRS issued a letter granting 501(c)(5) status to those IAFF affiliates that wished to take advantage of the IAFF's federal tax exemption. However, this exemption does not automatically apply. IAFF affiliates that wish to take advantage of the IAFF's "umbrella" exemption must contact the General Secretary-Treasurer's office in writing indicating that they wish to claim this exemption **before** claiming this exemption on their federal tax filings. A copy of this letter has been included at the end of this manual.

If a local does not wish to take advantage of the IAFF's 501(c)(5) exemption, it may apply to the IRS to obtain an independent determination that it qualifies for the exemption.

How can my local take advantage of the IAFF's 501(c)(5) tax-exempt status?

Taking advantage of the IAFF's 501(c)(5) tax-exempt status is easy. Simply contact the IAFF General Secretary-Treasurer's office and let them know that you wish to be registered with the IRS as an affiliate of the IAFF for tax-exempt purposes.

Can my local fundraise using the IAFF's 501(c)(5) status?

Yes, once a local affiliate has registered with the IAFF General Secretary-Treasurer's office, it may take advantage of the IAFF's 501(c)(5) status. This means that the local will be exempt from certain types of income taxes (for more detail, see discussion of unrelated business income tax below). However, outside contributions to the local (*i.e.*, contributions from the general public) are **NOT** tax deductible to the donor. As a result, a local affiliate that wishes to fundraise from the public must take extreme precaution that neither it, nor its members, represent that contributions are tax deductible.

Local affiliates attempting to fundraise should avoid using key phrases such as "charity," "non-profit," and "charitable fund" when soliciting contributions from the public, even if they are raising money to benefit their members or members' families for what may *seem* like a charitable purpose. For instance, a local that is seeking to raise money for its "widows and orphans" or "scholarship" fund should make clear that the donations are going to the local to benefit its members, a 501(c)(5) organization, and that donations are not tax deductible (unless, of course, the donations are going directly to a 501(c)(3)).

¹⁴ *Id.*

In addition, whether operating under the IAFF's 501(c)(5) status, or its own status as a 501(c)(3) or 501(c)(5) organization, it must be sure to comply with all state and local laws relating to fundraising. (For a discussion of state and local law requirements, please Section 3 below).

Are donations to 501(c)(5)s (labor organizations) tax deductible?

As discussed above, donations made to 501(c)(5) organizations, including local affiliates that have registered with the IAFF's General Secretary-Treasurer, are not tax deductible to the donor. Therefore, local officers and members should never represent that donors will receive a tax deduction based on their contributions to the local.

Can my local's funds be used for charitable purposes?

It depends. Generally speaking, locals and their leaders have a fiduciary obligation to hold the money and property of the union solely for the benefit of the organization and its members, and to manage, invest, and expend this money and property in accordance with the constitution and by-laws of the organization or any resolutions adopted thereunder.¹⁵ In other words, as long as an expenditure **benefiting the local** is approved in accordance with the local's constitution and by-laws, and **does not personally benefit** a local officer, it is unlikely that a local will run afoul of the duties owed to its members.¹⁶ This also holds true in the context of locals that wish to make charitable donations out of the local's general funds.¹⁷ Thus, if a local wants to make a donation to a charity, it must make sure that it is permissible under the local's constitution and by-laws and that it follows the proper procedure for doing so.

If a local is wary about using union funds to make a donation, there are other ways it can assist and benefit the community. For instance, members are free to volunteer for local charities, and may even assist in fundraising efforts. Perhaps the most well-known of these efforts is the IAFF's partnership with the Muscular Dystrophy Association and the "Fill-the-Boot" campaign.

If a local wants to help a local charity raise money, there are some precautions that it should take. First, the local should verify that the charity is a qualified 501(c)(3) organization and properly registered with all state agencies to conduct business and carry out fundraising efforts. Second, the local should verify that it is permitted, and in fact, covered, under the charity's fundraising licenses to assist the charity when soliciting the general public for donations. Third, the local should enter into an agreement with the charity to limit the local's liability should a lawsuit arise as a result of the joint fundraising efforts. Finally, in no situation should a local benefit financially from its joint fundraising efforts with a local charity. While

¹⁵ See, e.g. 29 U.S.C. 501(a).

¹⁶ *McNamara v. Johnson*, 522 F.2d 1157, 1163, (7th Cir. 1975) (explaining that, in the context of the Labor-Management Reporting and Disclosure Act, Congress looked to union constitutions to establish fiduciary obligations and as long as funds are expended without personal gain and in accordance with those standards, no fiduciary breach occurs).

¹⁷ At least one court has explained that, "it is not uncommon, nor is it improper, for the members of an organization to benefit from the good deeds of that organization. For example, when a law firm buys a table at a charity dinner, the lawyers who attend the dinner benefit in food, exposure and possible stature in the legal community." *Local 1-S v. Pascarella*, 2002 U.S. Dist. LEXIS 21854 (S.D.N.Y. 2002).

these steps may seem cumbersome, they are nevertheless necessary to protect the local, and its officers, against possible liability.

Can a 501(c)(5) (labor organization) make political contributions to federal candidates?

No. The Federal Election Campaign Act of 1971 (“FECA”) prohibits labor organizations from making any political contributions or expenditures. Section 441(b)(a) of FECA states, “[i]t is unlawful for... any labor organization to make a contribution or expenditure in connection with any [regulated] election...” Nevertheless, unions may be able to avoid the limitations imposed by FECA by establishing union-affiliated political action committees, or PACs. This manual will not address PACs; however, it is important to note that this is a highly regulated and complex area of law. Locals interested in establishing a PAC should contact the IAFF Governmental Affairs Department for assistance.

Can a 501(c)(5) (labor organization) make political contributions to state or local candidates?

Possibly. Whether a 501(c)(5) organization can make political contributions to candidates for state and/or local office depends on the election campaign laws of the jurisdiction in which the election is being held. Therefore, before making a political contribution to candidates for state and/or local office, local affiliates should check the state and local election campaign code, and should consult with the IAFF Governmental Affairs Department to make sure that they are not running afoul of any election campaign laws.

What are benevolent funds?

Benevolent funds are funds that are created by locals to benefit their members and/or members’ families. The most common types of benevolent funds are “widows and orphans” and scholarship funds, but they are not limited to these purposes. These funds can be created within the locals themselves or as independent 501(c)(3) organizations.

In determining which option your local prefers, it is important to keep in mind the following considerations. If the local is interested in benefiting just its members and not soliciting donations outside of the membership, then establishing a fund within the local is probably the best option. On the other hand, if the local is looking to assist the fire protection services as a whole, and wants to raise money from the general public, establishing a 501(c)(3) organization might be better. This is mainly due to of the tax benefits that are provided to 501(c)(3) over 501(c)(5) organizations. If the fund is part of the local itself, then donations to the fund will not be tax deductible to the donor. However, if the local is qualified as a 501(c)(3) organization, then most donations will be tax deductible.

Other factors to consider in making this determination include the purpose of the fund, the administrative costs of creating, operating, and maintaining the fund, and how the fund will be governed.

Section 2

If my Local forms a 501(c)(3) non-profit organization, is it a separate legal entity from the Local?

Yes. However, the legal status of a 501(c)(3) non-profit will depend upon the law of the state it is created in, as well as the type of entity (trust, corporation, or association) the Local has chosen to establish. The Local should consult with local counsel in order to determine which entity type will work best for the type of non-profit the Local wants to form. In order to avoid confusion that the local and an associated 501(c)(3) are the same organization, and to avoid the possibility that the local could be held liable for the actions of the 501(c)(3) (and vice versa), it is essential that your Local and any associated 501(c)(3) operate independently. This means that each organization must abide by its own organizing documents and rules, establish and maintain its own accounting and recordkeeping policies, operate only for the purpose(s) for which it was created, and most importantly, ensure that the general public understands that the organizations, while associated, are independent and serve separate and distinct purposes.

Are the financial obligations/duties of a 501(c)(3) distinct from that of the local?

Yes. The financial obligations/duties of a 501(c)(3) non-profit are limited to carrying out the purpose(s) for which it was established.¹⁸ In order to maintain its exempt status, a 501(c)(3) must be organized and operated exclusively for the purpose(s) for which it was created.¹⁹ Under no circumstances should the funds of the local and an associated 501(c)(3) be commingled. In addition, it will be necessary for any local and an associated non-profit to establish and maintain independent procedures for recordkeeping and accounting. Failure to do so could result in a loss of 501(c)(3) status, and even loss of the 501(c)(5) status of the local.

Can the Local be held responsible for the financial obligations of the non-profit?

Possibly. The extent of a 501(c)(3)'s liability will depend upon how it is organized (i.e., as a corporation, association, or trust) and actually operated. If the 501(c)(3) is organized and operate solely for one or more of the purposes enumerated in section 501(c)(3),²⁰ it will be exempt from taxation and should only be responsible for those financial obligations associated with carrying out its purpose(s).²¹ However, if a local and an associated 501(c)(3) non-profit fail to operated independently, as discussed above, it is more likely that the Local could be liable for the misdeeds of the 501(c)(3) and vice versa.

¹⁸ See 26 C.F.R. § 1.501(c)(3)-1.

¹⁹ *Id.*

²⁰ See 26 U.S.C. § 501(c)(3) (a 501(c)(3) may be organized and operated exclusively for the following purposes: “religious, charitable, scientific testing for public safety, literacy, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals”)

²¹ See 26 C.F.R. § 1.501(c)(3)-1.

If my local forms a 501(c)(3) non-profit, can my local combine its general funds with that of the non-profit?

Absolutely not. As noted above, in order to maintain its exempt status, a 501(c)(3) non-profit must be operated exclusively for the exempt purpose for which it was created.²² The commingling of non-profit funds with those of the Local will likely cause the funds of the 501(c)(3) non-profit to be used in furtherance of a matter *other* than the 501(c)(3)'s exclusive purpose. This will result in a loss of the 501(c)(3)'s tax-exempt status.

Are the legal obligations/duties of a 501(c)(3) distinct from that of the local?

The legal obligations and duties of a 501(c)(3) non-profit in relation to that of the Local will depend upon the applicable state law as well as the way the non-profit is organized and operated. The Local should consult with local counsel in order to ensure that the 501(c)(3) non-profit and the Local have the desired level of autonomy.

Can the Local be sued for the illegal acts of the non-profit organization?

As discussed above, the Local's liability for any illegal acts of an associated 501(c)(3) non-profit will depend upon state law as well as the way the non-profit is organized and operated. The Local should consult with local counsel to determine its potential liability resulting from the acts of the non-profit.

Section 3 – Formation

Starting a non-profit can be a lengthy and complicated process. In fact, due to a backlog of applications from organizations requesting tax-exempt status, it will likely take the IRS at least 6 months before processing and responding to an application. As a result, it is highly recommended that local affiliates seek the assistance of an attorney familiar with non-profit law prior to beginning this process. That being said, below is an overview of the steps necessary to form a 501(c)(3) non-profit organization.

Step 1: Become Organized.

The first step in starting a non-profit is becoming “organized.” In order to become “organized,” the non-profit must be formed as a corporation, trust, or unincorporated association.²³ Because each organization type has its own benefits (and drawbacks), which will not be addressed in this manual due to the complexities and differences among state laws with regard to each, it will be necessary to thoroughly consider the type of organization that works best for the non-profit you are looking to start.

²² *Id.*

²³ U.S. Department of the Treasury, Internal Revenue Service, IRS Publication 4220, *Applying for 501(c)(3) Tax-Exempt Status* (Rev. 8-2009) at 2.

In addition, because there is no uniform or Federal law addressing how each type of organization must be formed, it will be important to understand the process required in your state. This typically involves the adoption of what are known as “organizing documents,” which establish the organization as a legal entity. For instance, a corporation’s organizing documents would typically include the articles of incorporation and by-laws (similar to those adopted by local affiliates).

Regardless of the organizational type, the “organizing documents” must: (1) limit the organization’s purpose to an exempt purpose (*i.e.*, charitable, scientific, or educational), (2) **not** expressly permit activities that do not further its exempt purpose, *i.e.* unrelated activities (as discussed below), and (3) permanently dedicate its assets to exempt purposes.²⁴

In addition, there are several other requirements an organization must meet to qualify for tax-exempt status, many of which can and must be addressed in the organizing documents. These are discussed more fully in Step 3.

Step 2: Obtain an Employee Identification Number (EIN).

An EIN is an account number with the Internal Revenue Service and is required for non-profits that wish to obtain 501(c)(3) tax-exempt status. This form is required regardless of whether the non-profit has employees. To obtain an EIN number, you must fill out form SS-4, *Application for Employer Identification Number*. This form is available for download on the IRS website at www.irs.gov. It is important for non-profits to include their EIN on all correspondence with the IRS.²⁵

Step 3: Complete and Submit Form 1023, *Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code.*

The most challenging step in obtaining 501(c)(3) status is completing Form 1023, a 26-page application made up of 11 parts. Below you will find a brief description of each part, along with some pointers on how to best answer the questions in each. It is important to keep in mind that this is a *general* overview of the requirements for obtaining tax-exempt status. Therefore, before applying for 501(c)(3) status, it is recommended that locals seek assistance from a local attorney that is familiar with in non-profit law.

- Part I (Identification of Application) – Part I requires basic information about the organization, including its name, address, EIN, authorized representative (if any), and date incorporated.
- Part II (Organizational Structure) – Part II asks you to identify the type of organization (*i.e.*, corporation, trust, or association) and to provide the organizational documents.
- Part III (Required Provisions in Your Organizing Document) – While short, Part III is the most important part of Form 1023. It asks whether the “organizing documents” state: (1) the exempt purpose of the organization (*i.e.*, charitable,

²⁴ *Id.* at 3.

²⁵ *Id.* at 10.

educational, or scientific) and (2) that, upon dissolution, the assets of the organization will be used exclusively for charitable, educational, or scientific purposes. As a result, it is necessary that the organizing documents include an adequate description of the purposes of the organization and a provision whereby, upon dissolution, all remaining assets will be used for charitable, scientific, or educational purposes. Without these, your application will be denied.

- Part IV (Narrative Description of Your Activities) – Part IV requires you to provide a narrative description of your organization’s activities. This part is also highly scrutinized by the IRS in making a determination of whether your organization qualifies for tax-exempt status. As a result, the answers to Part IV must be accurately and carefully crafted to ensure that the organization is properly classified as a 501(c)(3) non-profit. Failure to properly describe these activities could result in an improper designation of your organization by the IRS or denial of the application in full.
- Part V (Compensation and Other Financial Arrangements With Your Officers, Directors, Trustees, Employees, and Independent Contractors) – Part V asks you to list the name, title, address, and compensation of the organization’s officers, directors, trustees, employees, and independent contractors. In addition, this part requires you to disclose any family or business relationships between these individuals, to establish policies regarding business transactions between these individuals, to adopt a conflict of interest policy, and to set reasonable compensation levels.
- Part VI (Your Members and Other Individuals and Organizations That Receive Benefits from You) – Part VI asks whether the organization provides goods or services to individuals, and whether the individuals receiving these goods or services have a family or business relationship with the officers, directors, trustees, employees, and independent contractors of the organization. Part VI also asks whether there are limitations on who can receive these goods and services, such as members of a particular organization. Therefore, if your organization provides goods or services to any of the individuals listed above, or if your organization limits its benefits to members of a certain department, this limitation will have to be addressed in Part VI.
- Part VII (Your History) – Part VII asks whether your organization is taking over the activities of another organization.
- Part VIII (Your Specific Activities) – Part VIII asks questions relating to your organization’s activities, including whether your organization supports or opposes political campaigns, influences legislation, and operates bingo or gaming activities (*i.e.*, gambling, lotteries, raffles, etc.). If your organization participates in these activities, it must disclose them to the IRS. Because 501(c)(3) organizations are extremely limited in the type of political activities they may conduct, it will be necessary to carefully scrutinize any political action the organization wishes to undertake, as such activity may prevent the IRS from designating the organization as tax-exempt. In addition, Part VIII asks questions relating to the types of fundraising the organization anticipates undertaking, the economic development of the organization, anticipated or existing partnerships, any grant, loan, or scholarship programs your organization wishes to implement,

and if there are any “close connections” with other organizations. Depending on the affiliation between the local and organization applying for non-profit status, it may be necessary to disclose this relationship.

- Part IX (Financial Data) – Part IX requires detailed financial information regarding the organization, including a statement of revenue and expenses for the current tax year and two succeeding tax years (if the organization has been in existence less than a year). If the organization has been in existence longer than one year, it will need to provide this statement for the preceding year(s), and possibly, an anticipated budget for future years.
- Part X (Public Charity Status) – Part X is intended to classify your organization as a public charity or private foundation. Public charity status is a more favorable tax status than private foundation status. The primary distinction between the two is that a public charity generally has a broad base of support (*i.e.*, the general public), whereas a private foundation has very limited resources (*i.e.*, through membership).²⁶ Organizations qualifying for 501(c)(3) status are presumed to be private foundations unless they meet the qualification of a public charity, by receiving a substantial part of their financial support in the form of contributions from publicly supported organizations, governmental units, or the general public. If requested, the IRS will make this determination for you.
- Part XI (User Fee Information) – Part XI requires the organization to include a user fee, which varies depending on the annual gross receipts of the organization.

As noted above, once you’ve submitted your application, you probably won’t hear from the IRS for at least 6 months. If your application was complete and your organization qualifies for 501(c)(3) status, you will receive an IRS determination letter exempting you from Federal income tax. In addition, this letter will indicate whether the IRS has designated you as a public or private charity. If your application is incomplete, however, the IRS will require you to answer follow-up questions and assign a field agent to assist you. While this does not mean that you will not be qualified as a 501(c)(3) organization, it could extend the process of obtaining tax-exempt status for several months. Therefore, it is important to make sure that all questions are answered accurately and fully.

Step 4: Apply for State Income Tax Exemption(s).

Once you have received your IRS determination letter designating you as a 501(c)(3) tax-exempt organization, it is time to apply for your organization’s exemption from state income tax. These forms are much less complicated than Form 1023, and the process for obtaining a state income tax exemption is much faster. This is because most states rely on the IRS’s designation of your organization as a tax-exempt entity when granting the state income tax exemption. Nevertheless, some states may have additional requirements for organizations that wish to receive a state income tax exemption. As a result, it will be necessary to review applicable state law when setting up your non-profit.

In addition, many states provide other tax breaks for non-profits, such as state sales or property taxes. Because these laws tend to be complicated and vary from state to state, this

²⁶ *Id.* at 5.

Manual will not address state tax benefits or requirements. It is recommended that you seek the assistance of an attorney in your state to help you with this process.

Step 5: Apply for Appropriate Licenses to Conduct Business in the State.

Many states and municipalities require businesses, including non-profit organizations, to register with an administrative agency (*i.e.*, obtain a business license) before conducting business within their jurisdiction. This license, in most cases, is required in addition to the license to fundraise as described more fully below. Before conducting business in a particular state or jurisdiction, it will be necessary to check the appropriate state and local laws where the non-profit intends to operate. Failure to properly register with the appropriate state or local agency could result in fines, penalties, and restrictions on the organization's ability to operate.

Section 4 – Effective Date of 501(c)(3) status

When does a non-profit's tax-exempt status take effect?

As discussed above, in order to obtain tax-exempt status, an organization must complete and submit Form 1023 to the IRS. Assuming that the organization submits this form within 27 months of its initial organization the non-profit's 501(c)(3) status will become effective retroactively to the original date of organization.²⁷ If the organization does not submit its application within 27 months of its organization, the exemption will only be recognized from the date that the IRS receives it.²⁸

Section 5 – Maintaining a 501(c)(3)

How do I maintain my status as a 501(c)(3) tax-exempt organization?

Most 501(c)(3) organizations are required to file annual returns with the IRS either during, or shortly after the close of their fiscal year, which may include, among other forms: annual information returns, unrelated business income returns, employment tax returns, and donee information returns.²⁹ The most important of these is the annual information return, also known as the Form 990.

Every tax-exempt organization, regardless of its size, is required to submit Form 990. In lessening the burden on small and small to mid-size non-profits, the IRS created various versions of this form, including Form 990-N and Form 990-EZ. The total gross receipts of a tax-exempt organization typically determine which form it is required to submit.

Small tax-exempt organizations, *i.e.* those with annual gross receipts of \$50,000 or less, may file Form 990-N, also known as the “e-Postcard,” as opposed to the more lengthy and

²⁷ U.S. Department of the Treasury, Internal Revenue Service, IRS Publication 557, *Tax-Exempt Status for Your Organization* (Rev. 10-2011) at 24.

²⁸ *Id.*

²⁹ *Id.* at 10.

burdensome Form 990. The e-Postcard is a simple form that only requires: the organization's legal name and mailing address; any name under which it operates and does business; its internet website address (if any); its taxpayer identification number; the name and address of the principal officers; the organization's annual tax period; verification that the organization's annual gross receipts are normally \$50,000 or less; and notification if the organization has terminated.³⁰ This form is due by the 15th day of the fifth month after the close of the tax year (in most cases, May 15th).³¹

Small to mid-size tax-exempt organizations, *i.e.*, organizations with gross receipts of less than \$200,000 and total assets less than \$500,000, may also avoid submitting the longer Form 990 by instead submitting Form 990-EZ.³² If a non-profit does not meet the criteria for filing Form 990-N or 990-EZ, it must file the original Form 990.³³ Both Forms 990 and 990-EZ are due by the 15th day of the fifth month after the end of the organization's accounting period.³⁴

In addition to those requirements imposed by the IRS, states also have annual tax filing requirements. While most states depend on the IRS's determination of whether or not an organization remains tax-exempt, it is crucial that non-profit organizations keep up with mandatory state filing requirements. Failure to do so could result in the organization's loss of the state tax-exemption. It is highly recommended that non-profit organizations obtain a certified public accountant to assist them in filing both their Federal and state income tax returns.

Section 6

What precautions should charities take to avoid losing their 501(c)(3) tax-exempt status?

Non-profit organizations who are exempt under 501(c)(3) must ensure that they are organized and operated solely for one or more of the purposes listed in 501(c)(3).³⁵ An organization will not be considered organized or operated exclusively for a purpose listed in 501(c)(3) unless it serves a public rather than a private interest.³⁶ It is therefore necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.³⁷ A 501(c)(3) organization must also ensure that its activities do not involve substantially engaging in propaganda or attempts to influence legislation.³⁸ Furthermore, it must not participate in or intervene in any political campaign of (or in opposition to) any candidate for public office.³⁹

³⁰ *Id.* at 11.

³¹ *Id.*

³² *Id.* at 12.

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.* at § 1.501(c)(3)-1(d)(1)(ii).

³⁷ *Id.*

³⁸ 26 U.S.C. § 504(a). To determine whether an organization's attempts to influence legislations constitute a substantial part of its overall activities, the IRS will evaluate all of the pertinent facts and circumstances applicable

Tax-exempt non-profit organizations are required to file annual returns that provide information related to their income and expenditures.⁴⁰ This information includes: gross income for the year, any dues from members which are not included as gross income, expenses related to gross income, disbursements made towards its exempt purpose, a balance sheet of assets and liabilities, total contributions received during the year, the names and addresses of all organization officers and key employees, compensation amounts paid to organization officers and employees, as well as any lobbying expenditures made by the organization.⁴¹

Can the IRS revoke a non-profit's 501(c)(3) tax-exempt status?

Yes. The IRS can revoke the tax-exempt status of a 501(c)(3) non-profit in those situations where the organization is no longer organized or operated for the exempt purpose for which it was created.⁴² However, even in those situations where an organization continues to be organized and operated for its exempt purpose, the organization will automatically lose its tax-exempt status in the event that it fails to file its annual tax returns for three consecutive years.⁴³ (For a more in depth discussion of a non-profit's tax obligations, see Section 5 above). Once an organization has had its tax-exempt status revoked by the IRS, its state exemption will also likely be revoked. In the event that the IRS or a state revokes an organization's tax-exempt status, it is advised that the organization consult local counsel to determine how and if it can obtain tax-exempt status again.

Section 7

Are non-profits required to pay sales and use taxes?

An organization that receives federal tax-exempt status as a 501(c)(3) non-profit is not guaranteed or automatically made exempt from state taxes. In particular, a 501(c)(3) non-profit may be obligated to pay both sales and use taxes. Sales tax is a tax imposed by some states and local jurisdictions on purchases of goods within that jurisdiction. It is typically a percentage of the sale that varies from jurisdiction to jurisdiction. Similar to sales tax, a use tax is a tax which is imposed on goods that are going to be used in the respective jurisdiction. Use tax is often assessed at the same rate as a jurisdiction's sales tax and will typically only apply when sales tax

to each case. Internal Revenue Service, *Measuring Lobbying: Substantial Part Test*, <http://www.irs.gov/charities/article/0,,id=163393,00.html> (last viewed Apr. 25, 2012). Some of the factors considered include "the time devoted (by both compensated and volunteer workers) and the expenditures devoted by the organization to the activity" *Id.*

³⁹ 26 U.S.C. § 504(a).

⁴⁰ *See* 26 U.S.C. § 6033(a)(1).

⁴¹ 26 C.F.R. § 1.6033-2(a)(2)(ii).

⁴² *See* 26 C.F.R. § 1.501(c)(3)-1.

⁴³ 26 U.S.C. § 6033(j)(1). An organization that has had its tax exempt status revoked due to its failure to file annual returns for three consecutive years that wishes to obtain reinstatement of its exempt status must apply for reinstatement "regardless of whether such organization was originally required to make such an application." *Id.* at § 6033(j)(2). An organization applying for reinstatement may have its reinstatement made retroactive to the date of revocation in the event that it "can show to the satisfaction of the Secretary evidence of reasonable cause" for its failure to file annual returns. *Id.* at § 6033(j)(3).

does not. The application of use tax most frequently occurs in relation to purchases made in other jurisdictions—the use tax allows the jurisdiction to obtain tax monies that would have otherwise been obtained through sales tax had the purchase been made in the respective jurisdiction.

Even though state sales and use tax exemptions do not attach automatically when an organization obtains federal tax-exempt status, many states will grant exemptions to 501(c)(3) non-profits upon application.⁴⁴ A state or local jurisdiction that grants an exemption will typically provide the organization with a Certificate of Exemption to be provided to sellers at the time of purchase.⁴⁵ More information on the requirements that apply in your state can be found at <http://www.irs.gov/charities/article/0,,id=129028,00.html>. While the websites accessible via this link may provide access to useful information and forms, the non-profit organization is advised to consult local counsel to ensure that it satisfies all of the necessary state or local requirements to obtain exemption from sales and use tax.

Section 8

Are 501(c)(3) non-profits exempt from all types of income taxes?

Unfortunately, no. 501(c)(3) non-profits remain subject to taxes on unrelated business income for each tax year.⁴⁶ This tax is known as the unrelated business income tax, or UBIT. Unrelated business income is defined as “the gross income derived by any organizations from any unrelated trade or business . . . regularly carried on by it”⁴⁷ A non-profit’s income will be subject to UBIT if: (1) the income comes from a trade or business, (2) such trade or business is regularly carried on by the organization, and (3) the trade or business is not substantially related (other than through the production of funds) to the organization’s performance of its exempt functions.⁴⁸ These requirements will be discussed in turn.

An unrelated trade or business is one that is not substantially related to the exempt purpose of the organization.⁴⁹ It will generally include “any activity carried on for the production of income from the sale of goods or performance of services.”⁵⁰ However, an unrelated trade or business will not include a trade or business where the majority of the work done to conduct that business is performed for the organization without compensation, where the business is the sale of work-related items and food at members’ usual place of employment with sales being conducted by the organization to primarily benefits its members or employees, or where the business involves the selling of merchandise, the majority of which was “received by the organization as gifts or contributions.”⁵¹

⁴⁴ See Internal Revenue Service, *State Links*, <http://www.irs.gov/charities/article/0,,id=129028,00.html> (last viewed Apr. 25, 2012) (providing links to each state’s web pages related to tax filings).

⁴⁵ See *id.*

⁴⁶ 26 U.S.C. § 511(a)(1).

⁴⁷ *Id.* at § 512(a)(1).

⁴⁸ 26 C.F.R. § 1.513-1(a).

⁴⁹ 26 U.S.C. § 513(a).

⁵⁰ 26 C.F.R. § 1.513-1(b).

⁵¹ 26 U.S.C. § 513(a)(1)–(3).

To determine whether a trade or business is regularly carried on, it is necessary to consider the “frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued.”⁵² Part of this analysis will inevitably turn to how the organization’s activities compare with “commercial activities [that] are normally pursued by nonexempt organizations.”⁵³ Generally, “exempt organization business activities which are engaged in only discontinuously or periodically will not be considered regularly carried on if they are conducted without the competitive and promotional efforts typical of commercial endeavors.”⁵⁴

Finally, to determine whether a trade or business is substantially related to the organization’s exempt purpose requires “an examination of the relationship between the business activities which generate the particular income in question—the activities, that is, of producing or distributing the goods or performing the services involved—and the accomplishment of the organization’s exempt purposes.”⁵⁵ A trade or business will only be considered related to an exempt purpose when there is a substantial causal relationship between the business and the achievement of the exempt purpose.⁵⁶ In order for a substantial causal relationship to exist, “the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of [the exempt] purposes.”⁵⁷ It is important to note that “mere production of income to fund an exempt organization’s activities is insufficient to establish a substantial causal relationship between the trade or business and the exempt activity.”⁵⁸

Section 9 – Fundraising

What steps do non-profits need to take in order to fundraise?

Most states regulate non-profit fundraising through statutes called “solicitation laws” that are primarily concerned with regulating the solicitation of charitable contributions from the general public, and require some type of compliance reporting by the non-profit organization.⁵⁹ Compliance reporting under state solicitation laws is divided into two parts, registration and annual financial reporting. Registration “provides an initial base of data and information about an organization’s finances and governance.”⁶⁰ Annual financial reporting “keeps the states informed about the organization’s operations with an emphasis on fundraising results and

⁵² 26 C.F.R. § 1.513-1(c)(1).

⁵³ *Id.* at § 1.513-1(c)(2)(ii).

⁵⁴ *Id.*

⁵⁵ *Id.* at § 1.513-1(d)(1).

⁵⁶ *Id.* at § 1.513-1(d)(2).

⁵⁷ *Id.*

⁵⁸ *Educ. Athletic Ass’n, Inc. v. Comm’r of Internal Revenue*, 77 T.C.M. (CCH) 1525 (T.C. 1999).

⁵⁹ National Association of Attorneys General and the National Association of State Charity Officials, *Standardized Registration for Non-Profit Organizations Under State Charitable Solicitation Laws* (v. 4.01 May 2010).

⁶⁰ *Id.* at 1.

practices,” and generally requires an audit and the filing of certain tax forms with the state.⁶¹ Typically, states require both registration (at least initially) and annual financial reporting.⁶²

Any non-profit conducting a charitable solicitation within the borders of a state, *by any means* (e.g., a letter, phone call, or newspaper advertisement requesting financial support from a state’s residents), is subject to that state’s laws and may be required to register before soliciting contributions.⁶³ This may be true even if the fundraising is only among a local union’s members! However, there is little consistency with regard to the application of solicitation laws among the various states. For instance, some states require a one-time registration while others may require annual renewal of registration, submission of every common governance and financial document, or simply submission of an IRS 990 Form.⁶⁴ With approximately forty states regulating non-profits in this manner, these inconsistencies make it increasingly difficult for non-profit organizations to conduct fundraising activities on a multi-state or national level.⁶⁵

Because the initial registration and annual financial reporting requirements widely vary from state to state, an in-depth analysis of each state’s law will be required prior to fundraising in that state in order to ensure full compliance. By failing to fully comply with this process, a non-profit could forfeit its ability to solicit charitable contributions in a given state until registration has been completed.⁶⁶ Moreover, if the organization fails to adequately register, but nevertheless conducts fundraising activities, it may be subject to fines and/or penalties, and in the extreme case, the directors of each organization could be subject to criminal sanctions.⁶⁷ Therefore, to avoid fines and possible criminal sanctions, and to make certain that a non-profit can continue soliciting charitable contributions, non-profits must fully comply with the initial registration and annual financial reporting requirements.

In conjunction with the compliance reporting requirements, many states also charge initial registration fees. These fees vary from \$0 to \$325 per state depending, in many circumstances, upon the amount of revenues and/or contributions each organization receives or anticipates receiving. In addition, many states charge additional or “renewal” fees in coordination with the annual financial reporting requirements, which also vary greatly from state to state. While these fees are generally less than the initial registration fees, it is essential that non-profits maintain these registrations if they wish to continue the charitable efforts.⁶⁸

While the registration and renewal fees will likely place a large financial burden on the locals that wish to start a non-profit, it is also important to consider the administrative costs, *i.e.*, time and capital, which local affiliates will have to spend in order to initially register and maintain the registration of its non-profit.

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Id.* at 2.

⁶⁷ *Id.*

⁶⁸ *Id.*

What is the Uniform Registration Statement?

In order to help non-profit organizations cope with the complex and varied registration and filing burdens imposed on them by each state, the National Association of Attorneys General (NAAG) and the National Association of State Charities Officials (NASCO) collaborated with the Multi-State Filer Project to make it easier for non-profits to fundraise in multiple states. The result was the Uniform Registration Statement (URS), which is a single form accepted by most states from non-profits wishing to register and fundraise. This form can be found at the Multi-State Filer's website: www.multistatefiling.org. While most helpful for non-profits that are looking to fundraise on a regional or national level, it can also be used to for organizations that only fundraise within one state.

Although the URS greatly simplifies the process for this registration process, many states require supplemental information to be filed along with the URS. A summary of these additional requirements can also be found on the website listed above.

For non-profits in those states that do not accept the URS (a list of these states can also be found on the Multi-State Filer Project website), it will be necessary to review individual state law requirements to determine what steps must be taken before beginning to fundraise.

Section 10

Are there any limits on fundraising or the types of fundraising events a non-profit can hold?

One of the major issues that an organization must consider when taking part in or conducting fundraising events is how it will request funds from donors. An organization's request for funds constitutes solicitation, and in many states an organization is required to register with the state before it is able to solicit contributions from the state's citizens.⁶⁹ Beyond registration requirements, states may also require submission of financial statements in the event that an organization reaches certain financial benchmarks specific to the state.⁷⁰ As registration and financial reporting requirements vary from state to state, the non-profit is advised to consult local counsel to ensure that it is in compliance with all applicable state laws.

A 501(c)(3) non-profit is obligated to operate towards its exempt purpose.⁷¹ Fundraising that is not related to that exempt purpose has the potential to cause the organization to expose itself to tax liability⁷² or even loss of its tax-exempt status.⁷³

⁶⁹ See Karl E. Emerson, *State Charitable Solicitation Statutes*, available at <http://www.irs.gov/pub/irs-tege/eotopici01.pdf>.

⁷⁰ See *id.*

⁷¹ See 26 C.F.R. § 1.501(c)(3)-1.

⁷² See discussion *supra* section 7.

⁷³ See discussion *supra* section 5.

Can a non-profit fundraise for any purpose? (see above)

As discussed above, a 501(c)(3) non-profit is obligated to operate for the exempt purpose for which it was created.⁷⁴ An organization that elects to fundraise for a purpose other than the one for which the organization was created—and for which it received tax-exempt status—may cause itself to be subject to tax liability⁷⁵ or even lose its tax-exempt status.⁷⁶ This constraint also usually applies to *expenditures*: a 501(c)(3) non-profit is generally obligated to spend money it raises only for the lawful purposes for which it was created.

Can non-profits solicit funds online?

Solicitation of funds via the Internet is a very powerful fundraising tool. While it has the potential to be very beneficial to a non-profits fundraising efforts, it also has the potential to cause a non-profit to be in violation of the law. Internet solicitation is a currently developing area of law without uniform consensus.⁷⁷ Doing so may cause an organization to run afoul of state laws against solicitation in those states where the organization is not currently registered—even if the organization did not intend to reach the audience of that particular state.⁷⁸ Therefore, it is important for an organization to consider the potential reach of the methods it intends to use to advertise and promote its fundraising. For instance, simply maintaining a website that accepts donations for your non-profit will likely not run afoul of state solicitation laws; however, e-mails to individuals who live in states where the non-profit is unregistered likely would.

Can non-profits hold fundraisers where there is gambling, lotteries, or gaming?

Many non-profits can and do hold gaming events in order to raise funds for their organizations. However, it is important to note that though gaming “may generate funds to pay expenses associated with the conduct of exempt activities, gaming itself does **not** further the exempt purposes of most types of organizations.”⁷⁹ When it comes to 501(c)(3) non-profits, gaming is considered a recreational activity and a business.⁸⁰ Although a 501(c)(3) “may use the proceeds from gaming to pay expenses associated with its charitable programs, gaming itself does not further exempt purposes.”⁸¹

Because gaming will not be considered to further an exempt purpose for a 501(c)(3) non-profit, it may cause an organization to be subject to the unrelated business income tax (UBIT).⁸² The application of the tax will most likely depend upon the frequency with which gaming events

⁷⁴ See 26 C.F.R. § 1.501(c)(3)-1.

⁷⁵ See discussion *supra* section 7.

⁷⁶ See discussion *supra* section 5.

⁷⁷ Emerson, *supra* note 69.

⁷⁸ *Id.*

⁷⁹ Internal Revenue Service, *Tax Exempt Organizations and Gaming*, Publication 3079, ch.1, p.6, available at <http://www.irs.gov/pub/irs-pdf/p3079.pdf>.

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *Id.* at 9.

are conducted and the manner in which they are operated.⁸³ One way that an organization can help ensure that its gaming events will subject it to UBIT is to make sure that substantially all of the work involved in organizing and operating the gaming event is performed by uncompensated volunteers.⁸⁴ While “substantially all” is not a hard and fast number, an unofficial guideline is to have at least 85% of the work associated with a gaming event performed by volunteers.⁸⁵ An organization which intends to rely on the use of volunteer labor to prevent the application of UBIT is advised to maintain some record of the time spent on the event by both compensated and volunteer workers.⁸⁶

Organizations that hold gaming events “must maintain records of gross receipts from gaming, prize payouts, and other related disbursements to substantiate” their end of the year filing requirements.⁸⁷ Gaming events have the potential to alter an organization’s reporting requirements.⁸⁸ This is due in part to the fact that, for gaming events, “gross receipts includes **all** amounts wagered in games, not just the net proceeds after winning wagers have been paid out.”⁸⁹ As gaming events typically involve the use of cash, it is also important that the non-profit provide proper oversight and control “to ensure that funds are not diverted to private individuals or for private purposes.”⁹⁰

While an organization must be aware of how its gaming event is conducted to ensure that it does not subject itself to UBIT, it must also ensure that it makes proper withholdings from its employees and others that it compensates to work the event.⁹¹ Such withholdings include income, social security, and Medicare taxes.⁹² In addition to making all of the applicable withholdings, the organization must also provide the individuals with the appropriate tax forms and information returns.⁹³ A particular area of concern involves tips that event workers may receive. Tips, whether cash or non-cash, are taxable income and may also be considered wages and subject to employment taxes.⁹⁴ Receipt of tips can also have the potential to cause an event worker who is supposed to be a volunteer to become a compensated employee.⁹⁵ The same problem can occur in the event that the organization gives its volunteers a gift of more than nominal value as a thank you for their service at the event.⁹⁶

An organization’s withholding requirements are not limited to those it employs or compensates; they may even also apply to winners at the event.⁹⁷ For most wagering games, the rule is that if the amount paid to a winner is \$600 or more and at least 300 times the amount of

⁸³ *See id.*

⁸⁴ *Id.* at 11.

⁸⁵ *Id.*

⁸⁶ *Id.*

⁸⁷ *Id.* at 14.

⁸⁸ *Id.* at 15.

⁸⁹ *Id.*

⁹⁰ *Id.* at 14.

⁹¹ *See id.* at 17.

⁹² *Id.*

⁹³ *Id.* at p.18.

⁹⁴ *Id.* at 17.

⁹⁵ *Id.*

⁹⁶ *Id.* at 18.

⁹⁷ *See id.* at 22.

the wager, the winnings must be reported to the IRS.⁹⁸ In addition to reporting the winnings and providing both the IRS and the winner with the appropriate tax forms, the organization is required to “withhold income tax from a payment of winnings when the proceeds from the wager are more than \$5,000 and the wager was placed in: [a] sweepstakes, wagering pool, lottery, raffle, or poker tournament; or, [a]ny other wagering transaction, if such proceeds are at least 300 times the amount wagered.”⁹⁹ The organization must deduct and withhold 28% of “the difference between the amount of the winnings and the amount of the wager.”¹⁰⁰

It is important that an organization remember that each state or local jurisdiction may have its own policies and requirements related to conducting a gaming event within the jurisdiction. An organization should consult with local counsel to ensure that any gaming event satisfies all of the state or local jurisdiction’s applicable requirements.

Can non-profits have alcohol at fundraising events?

Non-profits can and quite often do serve alcohol at fundraising events. As the sale of alcohol is regulated by the states, it is essential that the non-profit ensure that it has satisfied all of the requirements of the particular state and local jurisdiction in which it intends to hold its event. Two issues that will likely need to be addressed in all fundraising events where alcohol is going to be served is licensing and liability coverage.

How does a non-profit obtain licensing to serve alcohol at a fundraiser?

There are a number of ways that a non-profit may obtain licensing to serve alcohol at a fundraiser. One of the easier ways would be to hire a caterer that has both a license as well as licensed employees to serve alcohol at the event. Alternatively, many states have procedures that will permit non-profit’s to obtain temporary or special event licenses that will permit them to serve alcohol at a fundraiser. It is important to note that a non-profit might also need to ensure that its employees or volunteers who will be serving the alcohol are properly licensed or trained to do so. The options available to a non-profit, as well as the requirements that will apply to obtaining a license, will depend greatly upon the state in which the non-profit seeks to obtain the license. It is advised that a non-profit seek the advice of local counsel to ensure that it has satisfied its jurisdiction’s requirements in obtaining a license for itself and its workers to serve alcohol at its event.

Does a non-profit open itself up to any liability by serving alcohol at a fundraiser?

Possibly. Just as the licensing requirements vary from state to state, so does the potential liability that a non-profit may face through serving alcohol at a fundraiser. By providing alcohol to event attendees, the possibility exists that, while under the influence of alcohol, an individual

⁹⁸ *See id.* For Keno games the reporting threshold occurs when the winnings are “\$1,500 or more after deducting the amount of the wager.” *Id.* For Bingo and Slot Machines an organization is required to report winnings “that are \$1,200 or more before deducting the amount of the wager.” *Id.* Poker tournaments winnings are required to be reported if the winnings are more “than \$5,000 after deducting the wager (i.e., the entry or ‘buy-in’ fee).” *Id.*

⁹⁹ *Id.* at 23.

¹⁰⁰ *Id.*

may cause harm to another or to him or her self. On the extremes, some states will hold the party serving the alcoholic beverage strictly liable for any harm caused by the person served, whereas other states may only hold the individual liable. The majority of states assign levels of responsibility between the server of alcohol and the individual who actually caused the harm. Before serving alcohol at a fundraiser, a non-profit should consult with local counsel to determine the level of liability that may attach in its state.

If a non-profit elects to have alcohol at an event it can take steps to help limit its exposure to liability. One such option is to transfer the risk by hiring a third party such as a caterer to serve the alcohol. Even when hiring a third party, a non-profit should always check to see that the third party has the proper insurance with adequate coverage limits. The non-profit should always request a copy of the third party's certificate of insurance, and although the third party may not be willing to do so, should request that the non-profit be added as an additional insured under the third party's insurance policies.

In the event that the non-profit elects to serve the alcohol itself, it will want to ensure that it has adequate insurance coverage. As many general liability policies have specific liquor liability exclusions, the non-profit will want to review its policy carefully and determine whether it will need to obtain any additional insurance coverage. Other precautions a non-profit should consider taking are to limit alcohol content, size and the number of drinks available to attendees. Provide attendees with food. End alcohol service prior to the end of the event. Put in place restrictions to ensure no alcohol is served to any minors, and make arrangements with a local transportation company, or volunteers, to provide rides for impaired attendees.

From whom can a non-profit solicit donations?

Limitations on the individuals from whom a non-profit may solicit donations will be found in the respective state's solicitation laws.¹⁰¹ It is important for non-profits to remember that registering in the non-profits home state does not guarantee that the non-profit may solicit donations from citizens of other states.¹⁰² As a result, non-profits should be cognizant of the potential reach of their solicitation efforts. Non-profits should consult with local counsel to ensure that they do not engage in activity that will cause them to violate applicable solicitation laws.

Another issue for non-profits to consider when making solicitations is where and when the solicitations are directed. For instance, in the Federal workplace the only authorized solicitation by charitable organizations is the Combined Federal Campaign.¹⁰³ However, this prohibition does not apply outside of the Federal workplace.¹⁰⁴ While the non-profit may be prohibited from reaching various individuals at certain times and in certain locations, it will not necessarily be prohibited from soliciting donations from these individuals altogether. Non-profits should check for similar state or local prohibitions prior to making solicitations.

¹⁰¹ See Internal Revenue Service, *Charitable Solicitation – State Requirements*, available at <http://www.irs.gov/charities/charitable/article/0,,id=123045,00.html> (last viewed Apr. 25, 2012).

¹⁰² See *id.*

¹⁰³ 5 C.F.R. § 950.102(a).

¹⁰⁴ *Id.* at § 950.102(b).

Can a Local's non-profit solicit donations from the Local's employer?

Yes, but it is generally not recommended. As discussed above, there may be limitations on when and where a Local's non-profit may solicit donations from the Local's employer. Most notably, locals should be aware that the Labor-Management Reporting and Disclosure Act (LMRDA) requires labor organizations, including their officers and employees, to report any loans and benefits received from, or certain financial interests in, employers whose employees their unions represent and businesses that deal with their unions.¹⁰⁵ This includes charities created and operated by local affiliates. The main purpose of these laws is to prohibit employers, as well as union officers and employees, from engaging in corrupt practices whereby either party can benefit, either financially or through some other means, at the expense of the local or its members (i.e., to prevent an employer from bribing a local officer in exchange for limiting members rights or benefits, and vice versa).

In addition, if a local non-profit decides to solicit donations from its employers (again, it is not recommended), it should make sure that doing so does not violate the governing documents and internal policies of the organization, and should also be sure that all local members are aware of the solicitation efforts and outcome.

Nevertheless, the LMRDA does not prohibit employers and locals from engaging in joint fundraising efforts that benefit outside charities (i.e., those not directly related to the local), such as the Muscular Dystrophy Association and the IAFF's Fill-the-Boot campaign. Therefore, it is perfectly legal for a department to allow its employees to utilize department equipment, even while on-duty, to fundraise for this very worthy cause. However, local's and their affiliated charities should make sure that any donations received while fundraising on behalf of an outside organization go directly to that organization, and are not passed through the coffers of the local or affiliated charity.

Finally, it is important to point out that many employers regularly contribute to non-profits in the form of a matching gift (i.e., where the employer matches a gift or a percentage of a gift made by an employee to a non-profit). Taking advantage of matching gifts is a way for donors to greatly increase the impact of their gift. Locals should determine whether their employers participate in any form of match to maximize contributions; however, they should be extremely weary of utilizing such programs with regard to a union affiliated non-profit to avoid any perception of impropriety by either party.

Can a non-profit solicit contributions for political campaigns? (see above)

As discussed above, 501(c)(3) non-profits are prohibited from participating or intervening in any political campaign.¹⁰⁶ A 501(c)(3) non-profit that fails to abide by this prohibition may lose its tax-exempt status.¹⁰⁷

¹⁰⁵ 29 U.S.C. 431 *et. seq.*

¹⁰⁶ 26 U.S.C. § 504(a).

¹⁰⁷ *See id.*

Section 11 – Tax Considerations

Can a non-profit organization receive tax-deductible charitable donations?

It depends. In order for a donation to be tax-deductible to the donor, it must be made to an organization qualified under Section 501(c)(3) of the Internal Revenue Code. If an organization is not qualified as a 501(c)(3) organization, donations made to it will not be tax deductible.

As discussed above, in order to be a qualified organization, it must be organized and operated **exclusively** for charitable, educational, or scientific purposes.¹⁰⁸ Thus, while a donation to a labor organization is **not** deductible to the donor (labor organizations are 501(c)(5), not 501(c)(3) organizations), a donation to a 501(c)(3) organization that benefits fire fighters who are injured or killed in the line of duty, that provides scholarships to the children of deceased fire fighters, that provides research and care for burn victims, or that provides disaster relief likely would be.

What types of donations are tax-deductible?

Generally speaking, donations of money or property to qualified 501(c)(3) organizations are tax-deductible.¹⁰⁹ However, a donor that has donated property may only deduct the *fair market value*¹¹⁰ of the property at the time of the donation. In addition, if a donor receives a benefit resulting from a donation to a qualified organization, he/she may only deduct the amount of the contribution that is **more** than the value of the benefit he/she receives.¹¹¹ For the excess amount to count as a donation, it must be made with the intent to make a charitable contribution.¹¹²

The IRS has provided the following examples to clarify these points:

Example 1. You pay \$65 for a ticket to a dinner-dance at a church.¹¹³ All the proceeds of the function go to the church. The ticket to the dinner-dance has a fair market value of \$25. When you buy your ticket, you know that its value is less than your payment. To figure the amount of your charitable contribution, you subtract the value of the benefit you receive (\$25) from your total payment (\$65). You can deduct \$40 as a charitable contribution to the church.¹¹⁴

¹⁰⁸ U.S. Department of the Treasury, Internal Revenue Service, IRS Publication 526, *Charitable Contributions* (2011) at 2.

¹⁰⁹ *Id.* at 3.

¹¹⁰ The fair market value “is the price at which property would change hands between a willing buyer and a willing seller, neither having to buy or sell, and both having reasonable knowledge of all relevant facts.” *Id.* at 10.

¹¹¹

¹¹² *Id.*

¹¹³ While the example the IRS gives is a donation to a church, this example would apply to all 501(c)(3) qualified organizations.

¹¹⁴ *Id.*

Example 2. At a fund-raising auction conducted by a charity, you pay \$600 for a week's stay at a beach house. The amount you pay is no more than the fair rental value. You have not made a deductible charitable contribution.¹¹⁵

These same principles apply to tickets sold for charity benefit events. If a donor pays a qualified 501(c)(3) organization more than fair market value for the right to attend a charity ball, banquet, show, sporting event, or other benefit, the donor can deduct only the amount that is more than the value of the privileges or other benefits he/she receives.¹¹⁶ Where there is an established charge for an event, the charge is the value of the benefit.¹¹⁷ Where there is no established charge, the donor's contribution is the amount the donor paid that is more than the reasonable value of the right to attend the event.¹¹⁸ Whether the donor uses the tickets has no impact on what he/she may deduct; however, if the donor returns the tickets to the organization for resale, he/she can deduct the entire amount of the ticket.¹¹⁹

If a donor only receives "token" items for his/her contribution to a qualified organization, he/she may still be able to deduct the entire contribution if the following are true: (1) the donor gets a small item or other benefit of "token" value, and (2) the qualified organization correctly determines that the value of the item or benefit received is not substantial and informs the donor that he/she can deduct the contribution in full.¹²⁰ The value of such goods or services will be considered "token" if their fair market value does not exceed 2% of the contribution or \$96, or, the contribution is at least \$48 and the only items provided bear the organizations name or logo (such as calendars, mugs, or posters) and the cost of these items is less than \$9.60.¹²¹

Are non-profits required to acknowledge donations?

A qualified organization must provide donors with a written statement if the donor makes a contribution that is more than \$75 and is partly a contribution and partly for goods or services.¹²² The statement must tell the donor that he/she can deduct only the amount of the contribution that is more than the value of the goods or services provided.¹²³ It must also provide a good faith estimate of those goods or services. The statement can be provided either when the qualified 501(c)(3) organization solicits the contribution, or when it receives it.¹²⁴ A penalty will

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.* The IRS has further stated, "[e]ven if the ticket or other evidence of payment indicates that the payment is a 'contribution,' this does not mean you [the donor] can deduct the entire amount. If the ticket shows the price of admission and the amount of the contribution, you can deduct the contribution amount. **Example.** You [the donor] pay \$40 to see a special showing of a movie for the benefit of a qualified organization. Printed on the ticket is 'Contribution - \$40.' If the regular price for the movie is \$8, your [the donor] contribution is \$32 (\$40 payment - \$8 regular price)." *Id.* at 4.

¹²⁰ *Id.*

¹²¹ U.S. Department of the Treasury, Internal Revenue Service, IRS Publication 1771, Charitable Contributions Substantiation and Disclosure Requirements (Rev. 9-2011) at 5.

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *Id.*

be imposed on charities that do not provide this written acknowledgement.¹²⁵ The penalty is \$10 per contribution, up to \$5000 per fundraising event or mailing.¹²⁶

It is important to keep in mind that a donor cannot claim a tax deduction for a single contribution (money, goods, or services) greater than \$250 unless the donor obtains a written acknowledgement of the contribution.¹²⁷ While it is the donor's responsibility to obtain this acknowledgement, the IRS recommends that non-profits readily assist donors by providing them with a timely, written statement including: (1) the name of the organization, (2) amount of cash contribution, (3) description (but not the value) of non-cash contributions, and either (4) a statement that no goods or services were provided by the organization in return for the contribution, or (5) a description and good faith estimate of the value of goods or services provided in return for the contribution.¹²⁸ This written acknowledgement should be provided by January 31 of the year following the donation.¹²⁹

What types of contributions are not tax-deductible?

Several types of contributions are not tax-deductible. These include: (1) contributions to specific individuals, (2) contributions to non-qualified organizations, (3) the part of a contribution from which the donor receives or expects to receive a benefit, (4) the value of a donor's time or services, (5) personal expenses, (6) a qualified charitable distribution from an IRA, (7) appraisal fees, (8) certain contributions to donor advised funds, and (9) certain contributions of partial interests in property.¹³⁰

Most relevant to organizations benefiting members of the fire service, contributions to individuals who are needy or worthy are not deductible.¹³¹ This includes contributions to a charity if the donor indicates that the contribution is for a specific purpose.¹³² However, a donor can deduct a contribution that helps needy or worthy individuals if the donor does not specify that the contribution is for a particular person.¹³³ For example, donors can deduct contributions for flood relief, hurricane relief, or other disaster relief to a non-profit; however, contributions earmarked for a particular family or individual are not tax-deductible.¹³⁴

In addition, special rules apply to contributions greater than \$5000, and to contributions of personal property (such as furniture, books, jewelry, paintings, and cars) that are unrelated to the exempt purpose or function of the charitable organization.¹³⁵

¹²⁵ *Id.* at 12.

¹²⁶ *Id.*

¹²⁷ *Id.* at 3.

¹²⁸ *Id.*

¹²⁹ *Id.* at 4.

¹³⁰ U.S. Department of the Treasury, Internal Revenue Service, IRS Publication 526, *Charitable Contributions* (2011) at 6.

¹³¹ *Id.*

¹³² *Id.*

¹³³ *Id.*

¹³⁴ *Id.*

¹³⁵ *Id.* at 12.

Section 12 – Insurance

Should my non-profit obtain insurance?

While it may not be required, it is recommended that non-profits obtain insurance to protect not only their assets and liabilities, but also the directors and officers of the organization. There are two main types of insurance that non-profits should consider: general liability insurance and directors and officers insurance. General liability insurance can, among other things, protect the organization against theft, loss, property damage, and lawsuits. Directors and officers insurance, on the other hand, adds an extra layer of protection for those individuals running the organization against lawsuits brought against them and the organization.

Section 13 – Dissolution

How are 501(c)(3)s dissolved?

As discussed above, 501(c)(3)s must make provisions for their dissolution in their organizing documents. As a result, in order to dissolve a non-profit, the procedures set forth in the non-profit's organizing documents must be followed. Regardless of the organizational type (*i.e.* corporation, trust, association), all remaining assets of the organization must be used exclusively for charitable, educational, or scientific purposes.