THE EFFI BARRY
TRAINING INSTITUTE

# NON-PROFIT LEGAL BASICS

## PRIMER

DC | HEALTH
GOVERNMENT OF THE DISTRICT OF COLUMBIA

HealthHIV

# TABLE OF CONTENTS

# INTRODUCTION

## This Nonprofit Legal Basics Primer is intended to provide a summary of the key areas of law governing 501(c)(3) organizations, particularly those formed and operating in the District of Columbia.

Some laws may seem burdensome and difficult to understand, but organizations ignore them at their peril. Public trust is the most important asset that an organization has, and it takes one mishap to lose that trust - and the revenue that comes with it.

Most of these laws come with stiff penalties for compliance failure. A basic understanding and a commitment to compliance is key to an organization's long-term sustainability. This document is intended to alert you to some of the key issues to prompt you to ask the right questions, seek more information, and have more informed conversations with your organization's attorneys and advisors.

Primarily, this document will address:

- federal tax law requirements applicable to 501(c)(3) organizations;
- state nonprofit corporation law and state tax law (with a particular focus on D.C. law):
- federal and state laws related to fundraising and employment law; and,
- a few brief notes on other areas of legal risk for nonprofit organizations.

Please note that laws change. While this Primer contained current information as of the date of its publication, there may have been post-publication changes. Therefore, THIS PRIMER (AND ALL DOCUMENTS REFERENCED HEREIN) IS INTENDED FOR EDUCATIONAL PURPOSES ONLY AND IS NOT SPECIFIC TO THE FACTS OF ANY ORGANIZATION. YOU SHOULD NOT RELY ON THIS DOCUMENT, OR ANY PORTION THEREOF, FOR LEGAL COMPLIANCE PURPOSES WITHOUT THE ADVICE OF RETAINED LEGAL COUNSEL.

# PART I: FEDERAL TAX LAW REQUIREMENTS

## 1. Introduction

While a particular state's law designates a particular entity as a not-for-profit, federal tax law both guide and restrict the operations of nonprofit organizations, and 501(c)(3) status confers special benefits like exemption from federal income tax and other taxes, the ability to receive tax-deductible donations, and eligibility for grants. There are numerous other laws that directly impact an organization's day-to-day activities, but federal tax law provides the framework that has become familiar to nonprofits and ensures an organization operates for the benefit of the public and and not to the benefit of the private interests" or "and not to benefit the private of businesses or individuals.

Failure to adhere to federal laws has stiff penalties. If audited by the Internal Revenue Service (IRS), penalties will be the main concern. They cannot force your organization to dissolve or revoke your nonprofit status, but the IRS can revoke your 501(c)(3) status and levy monetary penalties. This will drastically tarnish your organization's reputation and ability to raise money.

Federal tax law is the primary driving force shaping the way nonprofits operate and provide crucial information on which state regulators, grantors, and other stakeholders rely. State laws supplement and mirror these requirements, which will be discussed in Part II.

# PART I: FEDERAL TAX LAW REQUIREMENTS

## 2. Internal Revenue Service (IRS) Form 990

**IRS Form 990 is the annual federal tax filing required of all nonprofit, tax-exempt organizations, and may be your organization's single most important document: it is used to ensure tax-exempt organizations are staying in legal compliance and is the primary vehicle for public transparency that is expected from nonprofit, tax-exempt organizations.**

It is crucial to ensure that Form 990 (including all relevant schedules) is fully and accurately completed and submitted on time. Failure to file on-time can result in steep penalties, so it is important to ensure it – or a request for extension – is submitted by your organization's particular deadline. Failure to file the applicable version of Form 990 for three (3) years consecutive years will result in an automatic revocation of tax-exempt status. It is highly recommended you add a completion/submission reminder to your organization's calendar.

There are different versions of Form 990 depending on the organization's level of revenue and assets:

- Form 990-N: Organizations that normally have $50,000 or less in annual revenue (based on average receipts over a 3-year period) may file this form online. The 990-N requires basic information about the organization including name, address, tax ID number, and the name of a Director or Officer.
- Form 990-EZ: Organizations with revenue exceeding the limits for Form 990-N but less than $200,000 in a year (and less than $500,000 in total assets) can use the 990-EZ.
- Form 990-PF: Organizations that have ever been classified as a private foundation (this concept is discussed further in the next section), are required to submit Form 990-PF.

Organizations with $1,000 or more in gross revenue that triggers the Unrelated Business Income Tax, are required to file Form 990-T in addition to whatever version of Form 990 is filed.

Form 990 is due 4 ½ months after the end of the organization's tax year, and the deadline for submission depends on which fiscal year-end the organization uses for tax purposes. The two most common are:

- May 15 for fiscal year-end coinciding with a calendar year (an ending of December 31)
- November 15 for fiscal year-end of June 30

To confirm your organization's year-end, refer to the letter from the IRS approving 501(c)(3) status or check a recently filed Form 990. It is possible to change your organization's tax year, but you should consult a professional before doing so. A 6-month extension is available for Forms 990 and 990-EZ. This extension is automatically granted when an organization submits a Form 8868 by the original deadline. No extension is available for the Form 990-N.

# PART I: FEDERAL TAX LAW REQUIREMENTS

## 2. Internal Revenue Service (IRS) Form 990

There are numerous schedules (additional forms) that must be filed with Form 990-EZ or Form 990. Whether or not a particular schedule applies depends on the organization's activities and finances. The more common schedules are:

- Schedule A: tracking the tests that establish public charity status
- Schedule B: disclosure of large donors
- Schedule C: tracking political and lobbying activity, discussed further below
- Schedule D: supplemental financial statements regarding certain special types of assets
- Schedule J: detailing compensation paid to Directors, Officers, and certain other employees
- Schedule L: disclosing certain conflict of interest transactions
- Schedule M: listing certain non-cash contributions

It is recommended that your organization hire a reputable CPA experienced in working with nonprofits to help prepare your tax filing documents, but the organization's staff and Board should be actively involved in gathering the relevant information, preparing detailed descriptions where required, and reviewing the forms before they are submitted.

Full and complete disclosure is a must as it is not only a legal requirement but can also impact charity watchdog ratings and public perception. For example, Part VI, Line 11 of Form 990 specifically asks whether the organization provided a complete copy of the form to all members of its Board prior to filing. You always want to truthfully check "Yes" to this question, as checking "No" can be a major red flag for the IRS, state charity regulators, and charity watchdog groups.

Charity watchdog sites like CharityWatch and Charity Navigator rely on Form 990 data for their rating systems, so your responses play a large role in their ratings. You are required to provide a copy of Form 990 to anyone from the public who requests it, and a copy of the latest Form 990 is a standard inclusion for grant applications. A copy is often required to be submitted to the state government in states where organizations solicit donations.

Your organization's Form 990 is viewable by the public on Guidestar (guidestar.org), the Candid free 990 Finder (candid.org/research-and-verify-nonprofits/990-finder) and on the IRS Tax Exempt Organization Search website (apps.irs.gov/app/eos).

# PART I: FEDERAL TAX LAW REQUIREMENTS

## 3. Public Charity vs. Private Foundation Status

Public charities and private foundations are both types of 501(c)(3) organizations with tax benefits. The main factor distinguishing their characterization is the source of funding.

**PUBLIC CHARITIES:**

- have more favorable tax treatment and less regulation
- must satisfy certain tests to keep its status as a public charity
- typically funded and run by a wider array of sources and individuals
- are given more leniency in how they carry out their charitable mission
- are often treated as "public" based on their activities (e.g. schools, hospitals, churches)
- must demonstrate receiving a wide range support from public financial sources and demonstrated through one of two different mathematical "support tests" calculated over a five-year period.

The first comes from sections 170(b)(1)(A)(vi) and 509(a)(1) of the Internal Revenue Code and is also known as the donative test. Designed for organizations that rely mainly on donations and grants for their funding, the donative test requires an organization to show that at least 1/3 of its total support comes from public support. Public support includes grants from the government, private foundations and other public charities, and donations from individuals.

These grants and donations are only counted from each source up to a limit of 2% of the organization's total support, with an important exception: grants from the government and other public charities are counted in full, not subject to any 2% limit. The 2% limit ensures that the organization's support is spread widely among different sources, not just a handful of donors.

**For example:** XYZ organization has a government grant of $50,000, and 5 grants of $10,000 each from 5 different private foundations. Their total support is $100,000. The $50,000 government grant fully counts toward public support, but the private foundation grants are only counted to 2% of their total support of $100,000, or $2,000 each. In total, $10,000 from the private foundations grants is counted as public support ($2,000 x 5). XYZ organization's public support is $60,000, or 60% of the $100,000. They are well above the 1/3 requirement.

"Fee-for-service" revenue, money paid in exchange for services that further the organization's charitable purposes, has a special treatment. This is called "exempt function revenue," and is excluded from the calculation, neither helping nor hurting the donative test.

# PART I: FEDERAL TAX LAW REQUIREMENTS

## 3. Public Charity vs. Private Foundation Status

If an organization cannot satisfy the 1/3 minimum, it can maintain public charity status with a public support percentage of 10%. To do so, it must satisfy the "facts and circumstances" test. This is a subjective measure of both financial and nonfinancial factors, such as maintaining a bona fide program to solicit donations from the general public on a continuous basis, having a Board of Directors that represents the broad interests of the public and making services broadly available to the general public. Some organizations rely on this 10% facts and circumstances test throughout their entire existence.

The second test comes from section 509(a)(2) of the Internal Revenue Code, commonly referred to as the service provider test. This test is designed for organizations whose main source of revenue is fee-for-service. The service provider test requires an organization to show that at least 1/3 of its total support comes from a combination of contributions, grants, membership fees, and gross receipts from activities that are related to the organization's exempt purposes (excluding all amounts from Board members, Officers, and other "disqualified persons"). The gross receipts are only counted with respect to each payor up to a limit of $5,000 or 1% of the organization's total support for the year (whichever is greater). No more than 1/3 of the organization's total support can come from gross investment income plus the excess of any unrelated business taxable income over the amount of tax imposed on that income.

**For example:** XYZ organization has $25,000 in donations from Board members, and $125,000 in fees collected from patients that it sees in its walk-in clinic. No patient pays more than $2,000 for the year. XYZ organization has no investment income or unrelated business taxable income.

XYZ organization's total support is $150,000. The limit on gross receipts from each payor is $5,000, because that is greater than 1% of XYZ organization's total support ($1,500). The patient fees are counted in full (no patient paid more than this $5,000 limit). However, the donations from Board members are not counted at all. Under this test, XYZ organization's public support is $125,000, or over 80% of $150,000. XYZ organization is well above the 1/3 requirement and easily passes the test.

The easiest way to understand the mechanics of these tests is to plug some numbers into Form 990, Schedule A. Part I, Line 7 on the Schedule A is the box you check for the donative test while Part I, Line 10 is the box you check for the service provider test. Part II of Schedule A is filled out to calculate public support under the donative test, and Part III of Schedule A is filled out to calculate public support under the service provider test.

# PART I: FEDERAL TAX LAW REQUIREMENTS

## 3. Public Charity vs. Private Foundation Status

Since these tests are calculated over a five-year period, one or two "bad" years is not likely to disrupt public charity status. There are provisions for excluding "unusual grants," so if a large grant opportunity unexpectedly arises, the organization does not necessarily need to turn it down.
Failing the test once does not automatically result in private foundation status. A public charity must fail the test for two years in a row to be reclassified as a private foundation.

**PRIVATE FOUNDATIONS:** are typically funded and run by wealthy individuals or businesses and sustained largely by the interest from endowments and other investment vehicles. Well known examples include the Bill & Melinda Gates Foundation, the Ford Foundation, and the Robert Wood Johnson Foundation. Private foundations are subject to more regulations and oversight to ensure they are not abused as a tax shelter or means of providing cushy jobs to the heirs of their founders. Many private foundations provide extraordinary and much-needed support to the charitable sector and the rules are designed to encourage this.

Private foundation regulations require they pay out a certain amount of their net assets in grants to public charities, more detailed reporting (Form 990-PF), and strict restrictions on dealings with insiders, ownership of businesses, provisions of scholarships, and lobbying and political activities.

# PART I: FEDERAL TAX LAW REQUIREMENTS

## 4. 501(c)(3) Purposes

**501(c)(3) status is granted based on a specific set of charitable activities that the IRS has deemed to have sufficient benefit to the public. Not every activity that a nonprofit organization could decide to pursue is consistent with 501(c)(3) purposes.**

When applying for 501(c)(3) status, organizations are required to submit their Articles of Incorporation (the governing document submitted to the state to establish the existence of a nonprofit corporation), which must state that the organization has a charitable mission, and in the event the organization dissolves its assets will be used only for proper charitable purposes. Most organizations are required to submit a narrative description of their charitable activities, upon which the IRS makes its determination whether the organization qualifies for 501(c)(3) status.

There are numerous different types of 501(c)(3) purposes that the IRS recognizes as proper, depending on the type of organization and activity. In addition to the traditional notion of providing support to the impoverished, charity also includes helping disabled, elderly, and mentally or physically ill people, as well as providing relief to the victims of disasters. The IRS also recognized certain missions and activities that are not charitable. These purposes include advancement of religion (churches, synagogues, mosques, and other religious organizations), advancement of science (academic research organizations), promotion of the arts (performance arts centers, theatre groups, and other arts organizations), education (schools and other organizations whose aim is to provide information or training to the public) and promotion of health (hospitals, health clinics, homes for the aged, medical research organizations, drug rescue centers, blood banks, halfway houses, and a variety of other types of organizations).

It is important to ensure that the community benefits from a 501(c)(3)'s services. For example, merely providing health services for a fee to those who can afford to pay will not necessarily qualify as a 501(c)(3) purpose. 501(c)(3) hospitals must adhere to a "community benefit standard" that requires hospitals to promote the health of a broad class of people to benefit the community and serve the public rather than private interests. While this requirement has a long and detailed history with respect to hospitals, analogous standards can apply to organizations and should be kept in mind when assessing your organization's programs.

# PART I: FEDERAL TAX LAW REQUIREMENTS

The community benefit standard and similar principles stem from a tax doctrine called the "private benefit rule," stating that the assets and activities of a 501(c)(3) organizations must not be used benefit the interests of a private individual, business, or non-charitable entity, except to the extent such benefit is incidental to the organization's 501(c)(3) purpose. In this context, the term incidental is meant in both a qualitative and quantitative sense. To be quantitatively incidental, the private benefit must be insubstantial, measured in the context of the overall benefit conferred upon the public. To be qualitatively incidental, private benefit must be inherent in the conduct of the activity and confer public benefit.

**For example:** a hypothetical health research organization conducting scientific research on health issues has an adequate 501(c)(3) purpose. However, if the research is only distributed to a single big pharmaceutical company, it would be considered an impermissible "private benefit." If the research is published in an academic journal that anyone could access, this would confer a substantial benefit upon the public. This is true even if the research were particularly helpful to the big pharmaceutical company, and the company used the results of the research in its own for-profit endeavors. In this case, the benefit to the big pharmaceutical company would be "incidental" to the organization's 501(c)(3) purpose, because everyone from the public is benefitting as well.

501(c)(3) organizations are not required to only engage in activities that further 501(c)(3) purposes. It is permissible for them to engage in a limited amount of activities that are unrelated to the organization's charitable purpose. The unrelated activities must be insubstantial as measured by the time and effort required by the organization's staff, and the overall portion of the organization's revenue and budget, among other factors. There is no clear threshold for determining whether an organization has crossed the line in pursuing non-charitable activities, but a general rule of thumb is that these activities should not exceed 15% of staff time and the organization's revenue and budget. Nonetheless, organizations should consult an attorney or advisor before embarking on major activities that do not further 501(c)(3) purposes.

Organizations are not necessarily restricted to the specific charitable mission and activities described in its initial application for 501(c)(3) status. An organization is permitted to evolve its mission and develop new programs, if the required focus remains on activities that are consistent with 501(c)(3) status. In theory, new missions and activities will not have the rock-solid protection provided in the IRS letter approving 501(c)(3) status, but these changes should not endanger an organization's tax-exemption provided they are disclosed in Form 990 (Part III and Schedule O) and are consistent with one or more recognized 501(c)(3) purposes.

# PART I: FEDERAL TAX LAW REQUIREMENTS

## 5. Conflict of Interest Rules

**One of the most important areas of federal tax law deals with transactions between an organization and its Board of Directors, Officers, and other high-level employees, as well as family members and businesses related to such persons. These transactions are regulated under the federal tax law through the "private inurement" rule, and the "intermediate sanctions" rules.**

The private inurement rule in the Internal Revenue Code prohibits those who create and run the organization ("insiders") from being paid excessive compensation or otherwise dealing with the organization so as to appropriate the use of its assets or profits in a manner not available to the general public. The penalty for violating the private inurement rule is revocation of 501(c)(3) status.

There are, however, intermediate sanctions rules enacted in 1996 as an "intermediate" step to correct violations, short of revocation of 501(c)(3) status (detailed in section 4958 of the Internal Revenue Code as well as the Treasury Regulations issued under this section). Prior to passage, the IRS was hesitant to use revocation to penalize improper dealings with insiders, because the organization itself would bear the brunt of the punishment rather than the insiders who benefitted from appropriating the organization's assets. The intermediate sanctions rules impose penalty excise taxes on: (1) insiders (called "disqualified persons") who receive more benefit from a transaction than does the charity; and (2) the organization managers who knowingly approve such transactions. Once discovered, any such transactions (called "excess benefit transactions") must be quickly undone or corrected by repaying the appropriate amount back to the charity, or the penalties skyrocket.

Determining who the disqualified persons are with respect to the organization is key as any transactions with disqualified persons are subject to scrutiny. Disqualified persons include those who have "substantial influence" over the organization, such as:

- Directors;
- Officers;
- High-level employees;
- Founders and substantial contributors;
- Family members of any of the above persons; and
- Businesses in which any of the above persons together hold more than a 35% ownership interest.

# PART I: FEDERAL TAX LAW REQUIREMENTS

## 5. Conflict of Interest Rules

Note: resigning from the Board or another high-level position with the organization does not immediately remove disqualified person status. A person will be considered a disqualified person if they were in this role at any time during the five (5) years that precede the transaction.

All financial dealings with disqualified persons must be closely scrutinized, including compensation for services, any sale or lease of assets (to or from the organization), loans (to or from the organization), provision of organization services or resources, and informal sharing of resources. However, contributions from disqualified persons to the organization are not subject to this scrutiny, so long as the contribution is purely donative.

Transactions with disqualified persons are not completely prohibited. Only "excess benefit transactions" are prohibited. If the organization pays fair market value to the disqualified person for what the organization receives in return, the transaction will not be an "excess benefit transaction" and is therefore allowed. Organizations must follow a process to show that the proper steps have been taken, including:

- Full disclosure of the conflict of interest (annually and when the conflict arises) and all relevant information;
- Review due diligence by the Board/committee to verify that the terms are reasonable based on fair market value;
- Approval of the transaction by the "disinterested" members of the Board/committee (without the presence of the disqualified person); and
- Documentation of the decision and the information relied upon (i.e. in the meeting minutes).

The intermediate sanctions rules are reflected in Part IV, Lines 25-28 of Form 990 (with further reporting required in Schedule L if there are "excess benefit transactions), and Part VI, Section B of Form 990 (which covers the organization's conflict of interest and compensation policies). Additionally, Schedule J requires additional reporting of compensation paid to Directors, Officers, and other high-level employees.

# PART I: FEDERAL TAX LAW REQUIREMENTS

## 6. Unrelated Business Income Tax

**Unrelated Business Income Tax (UBIT) rules (found in sections 511 through 514 of the Internal Revenue Code) were passed in 1950 in response to fears that nonprofits were using their tax-exemption to unfairly compete with for-profit businesses. Congress sought to level the playing field by imposing a tax (at regular corporate income tax rates) on revenue generated by a tax-exempt organization that is not related to the organization's tax-exempt purpose. UBIT applies to the gross income derived from any unrelated trade or business, regularly carried on by the organization, minus the deductions directly connected with the carrying on of such trade or business.**

**For example:** if an organization whose purpose is to teach music to inner city children decides to hold a charity car wash to raise money to buy instruments, the car wash is unrelated to its tax-exempt purpose. A car wash does not further a child's music education.

On the other hand, an organization whose purpose is to help mentally disabled individuals find employment has a related activity if it sets up a car wash as a way of providing employment for mentally disabled individuals. In this case, a car wash directly achieves the organization's mission goals.

Advertising revenue and income from unrelated debt-financed property (for example, a building that is mortgaged and rented out for unrelated purposes) are typically subject to UBIT. The Internal Revenue Code has provisions excluding from UBIT royalty income, rental income from real property (provided the unrelated debt-financed property rules don't apply), dividends, interest, capital gains, income from the sale of merchandise gifted to the organization, and income from businesses conducted by volunteers. It is important to research whether any UBIT rules apply before launching a fee-for-service activity, and if necessary, structure such arrangements properly to take advantage of any favorable Internal Revenue Code provisions.

When computing the tax on unrelated business income, organizations should deduct the expenses directly connected with the carrying on of the trade or business. Some expenses, such as overhead and staff time, can be allocated in part to exempt activities and in part to unrelated business activities. In this case, organizations should work with their accountants to find methods of distributing the expenses and stick to these methods consistently.

Unrelated business activities may require filing Form 990-T (as reflected in Part V, Line 3 of Form 990). Form 990-T breaks down all items of unrelated revenue and expenses in detail. This applies even to small organizations that file Form 990-N. Additionally, a breakdown of revenue allocated to unrelated businesses must be included as part of the Part VIII Statement of Revenue on Form 990.

The Internal Revenue Code has numerous special rules that each organization needs to consider. It is beyond the scope of this Primer to address all these special rules in depth. You should consult an attorney for application to your specific facts.

# PART I: FEDERAL TAX LAW REQUIREMENTS

## 7. Political Campaign Activities and Lobbying Activities

501(c)(3) organizations are prohibited from engaging in any amount of political campaign activities – the supporting or opposing any candidate for public office whether at the federal, state, or local level and from making statements that express a preference for a particular candidate – but are permitted to engage in a limited amount of lobbying activities. It is important to be aware of these restrictions and limitations because failure to comply could lead to penalty taxes being imposed on the organization, and revocation of 501(c)(3) status. Unfortunately, there are a lot of gray areas within these rules, so it can be to determine whether a particular activity is acceptable.

Organizations must be careful to distinguish between "issue advocacy" (which is allowed) and "campaign activities" (which are prohibited), as well as personal campaign activities of a nonprofit's leadership and staff (which are allowed) and the organization's campaign activities (which are prohibited).

501(c)(3) organizations are permitted to take positions on public policy matters and make statements advocating policy preferences. The risk is that an organization might imply a preference for a candidate (even if unnamed) and violate the rules. For example, an organization that is well-known for advocating on behalf of a single-payer, government run healthcare system should not issue a public statement before an election reminding readers to remember the importance of healthcare when voting. This is a hot button issue that clearly divides Democrats from Republicans, so this statement would clearly implicate favoring one party and one candidate over the other. The organization would **probably** be permitted to publish a position paper arguing for the societal benefits of "Medicare for all" with no mention of the election, the act of voting, or any party or candidate – especially if the piece is published significantly in advance of the election date. The IRS would look at all these factors to determine whether the communication was an implicit attempt to influence the election or a bona fide statement about a public policy issue.

The 501(c)(3) restrictions on campaign activities are not meant to restrict the free expression of an organization's leadership and staff on political matters in their own personal capacities. Any use of the organization's resources or implication that the individual is speaking on the organization's behalf **must** be avoided. When an organization's leadership or staff makes a statement supporting or opposing a candidate, they must make sure it is not during paid work hours, at organization events, or using the organization's website, email address, publications, office space, or computers. For example, an organization's Executive Director expressing her preference for a candidate on a listserv or discussion forum during work hours and/or using the organization's email address is prohibited. The Executive Director making a political statement at an event sponsored by a political party at her own expense and outside of working hours, especially if she is careful to state that she speaks for herself only and not on behalf of the organization, is permissible.

# PART I: FEDERAL TAX LAW REQUIREMENTS

## 7. Political Campaign Activities and Lobbying Activities

501(c)(3) organizations can engage in lobbying activities (i.e. "influencing legislation"), so long as lobbying is not a substantial part of the organization's activities. The two types of lobbying under the rules governing 501(c)(3) organizations are direct lobbying and grassroots lobbying.

Direct lobbying includes communications with a legislator or a legislator's staff that refer to a specific legislation or proposed legislation and reflect the organization's view of it. Grass roots lobbying includes communications with the public (made through press releases, publications, the organization's website, etc.) that refer to specific legislation, reflect the organization's view on the legislation, and encourage the readers to take action such as contacting their Senator or Representative with respect to the legislation (known as a "call to action").

There are numerous exceptions and nuances to these rules that are beyond the scope of this Primer. Many policy communications that fall outside these definitions of lobbying, most notably communications regarding administrative regulations and the enforcement of existing laws, both of which do not involve legislative proposals.

Lobbying is not entirely prohibited for 501(c)(3) organizations and can be an important aspect of an organization's mission goals. 501(c)(3) organizations that do (or may) engage in direct lobbying or grassroots lobbying are advised to file Form 5768 with the IRS to make the 501(h) election. This provides a clear expenditure-based test for staying within the allowable lobbying limits, as reported on Schedule C of Form 990 in contrast to the ambiguous "substantial part" limit.

The 501(h) expenditure test provides that 25% of the overall lobbying limit may be spent on grass-roots lobbying, and that a percentage of the organization's overall expenditures may be spent on lobbying (around 15-20% of the organization's total expenditures, though the exact percentage varies depending on the size of the organization). This test is usually favorable because lobbying communications often do not cost much money, aside from printing and travel costs, etc.

Bottom line: when it comes to political campaigns and lobbying activity, never jeopardize the organization's 501(c)(3) status and always consult an attorney for guidance on appropriate activities.

# PART II: STATE NONPROFIT CORPORATION AND TAX LAW

## 1. Introduction

Part II of this Primer focuses on state nonprofit corporation law and state tax law. Since most readers of this Primer are District of Columbia nonprofits, we will focus almost exclusively on D.C. law, with a few brief references to situations in which other state laws may be relevant. For readers that are not D.C. nonprofits, your state nonprofit corporation law likely addresses similar concepts, but may differ in the details.

While the 501(c)(3) tax exemption and federal Form 990 requirements get a lot of attention, nonprofits have increasingly been forced to face and address state law, due to state charity regulators becoming more aggressive and public in their enforcement efforts.

State law governs numerous key areas of nonprofit governance that are not directly addressed by federal tax law. In fact, state law determines your organization's nonprofit status and Federal tax law determines an organization's 501(c)(3) status. While the IRS can revoke an organization's tax-exempt status or levy penalties, only the state can revoke an organization's "nonprofit" status.

State nonprofit corporation law supplies the main rules regarding corporate governance: the way a nonprofit corporation is run by its Board of Directors and Officers, the decision-making process within an organization, and how corporate powers and authorities are delegated. This includes the fiduciary duties of an organization's Board members and Officers - their responsibility to be diligent and act in the organization's best interests.

State nonprofit corporation law determines when and how the people who run a nonprofit can be held liable for actions taken on behalf of the organization, and an organization's ability to carry out activities and raise money in the state.

States have their own tax laws, including income tax, sales tax, property tax, and employment-related taxes. 501(c)(3) organizations sometimes receive special treatment under state tax law by virtue of their federal tax-exempt status, but this is not always the case, and exemption at the state level is not always automatic.

# PART II: STATE NONPROFIT CORPORATION AND TAX LAW

## 2. Determining Which State's Laws Apply

Nonprofits are often subject to the laws of multiple states, as the organization may be incorporated in one, have offices, carries out activities, raises funds, or have employees in others.

Corporate governance laws, i.e. rules relating to governing documents, fiduciary duties, Board elections and meetings, and corporate limitations on liability, are almost always governed only by the laws of the state of **incorporation.** If your organization was incorporated in the District of Columbia, you should look to the D.C. Nonprofit Corporation Act to resolve questions regarding your organization's Articles of Incorporation and Bylaws, the manner of electing Board members, holding meetings, and making Board decisions, liability protections for Directors, Officers, employees, and volunteers, and similar corporate protections. To confirm your organization was incorporated in D.C., check your Articles of Incorporation or look up the organization on the website of the D.C. Department of Consumer and Regulatory Affairs (DCRA): corponline.dcra.dc.gov.

There are other matters that are governed where the organization is operating (or "doing business"). It is possible and common for an organization to incorporate in one state and operate in another or multiple states. An organization operating in one or more states that are different from its state of incorporation must comply with any applicable tax laws, business license laws, foreign corporation registration laws, charitable solicitation registration laws (discussed in Part III of this Primer), and employment laws (discussed in Part IV of this Primer) in the states where the organization is operating. There may be state laws that govern specific activities of your organization, such as health privacy laws, that would apply in the states where your organization is carrying out those activities.

For example, an organization that was incorporated in D.C. may decide to move its headquarters to Pennsylvania and have no further contact with D.C., carrying out all its fundraising and activities in Pennsylvania. Such an organization would be considered a "domestic corporation" in D.C. and a "foreign corporation" in Pennsylvania. The organization would be subject to D.C. law regarding corporate governance matters but must comply with Pennsylvania's tax laws and other laws governing its operations.

An organization that is incorporated in D.C., maintains its only office in D.C., and carries out all its fundraising and other activities only in D.C. would be governed entirely by D.C. law.

It is sometimes possible to move the state of incorporation, but this is inadvisable and should not be done without retaining a lawyer.

# PART II: STATE NONPROFIT CORPORATION AND TAX LAW

## 3. Corporate Governance Basics

Nonprofits are governed by their Board of Directors (sometimes called the Board of Trustees) in accordance with their Articles of Incorporation, Bylaws, and corporate policies. State nonprofit corporation law is important, but these laws provide organizations with a relatively high degree of freedom and flexibility to design their own governance structure and to operate as the Board of Directors sees fit in accordance with their governing documents.

The Articles of Incorporation bring the organization into existence and provide a basic framework for the organization's governance and must include provisions regarding:

- the organization's purposes and powers (it will suffice to include a statement that the organization is organized and operated exclusively for 501(c)(3) purposes, and has all the powers conferred upon nonprofit corporations under applicable law);
- whether or not the organization has "members" (i.e. individuals or organizations with rights to elect the Board of Directors or otherwise participate in the organization's governance);
- the general powers of the Board of Directors to manage and oversee the organization;
- the names of the "incorporator" (the person who signs the Articles to bring the organization into existence), the initial Board members, and the "registered agent" (a point of contact for the organization in the state, as discussed further below); and,
- the distribution of assets exclusively for 501(c)(3) purposes in the event the organization is dissolved. The Articles reign supreme over any decision of the Board of Directors or any provision of the Bylaws or corporate policies. Any amendments to the Articles must be duly approved (by the Board and, if applicable, the organization's members) and filed with the state where the organization is incorporated.

# PART II: STATE NONPROFIT CORPORATION AND TAX LAW

## 3. Corporate Governance Basics

Bylaws go into more detail about the organization's governance and operations and typically include provisions regarding:

- the term of office for Board members, the size of the Board, and the manner in which new Board members are nominated, elected, and removed
- how Board meetings are called and conducted, including how many Board members must be present to constitute a quorum allowing official business to be decided (usually a majority of Board members must be present to constitute a quorum);
- the roles and authority of committees of the Board and how they are appointed (which includes a specific description of any "standing committees," i.e. permanent committees like the finance committee, nominations committee, and/or executive committee);
- the roles and authority of different officers (usually a President/CEO/Executive Director, Secretary, and Treasurer) and how they are appointed;
- the fiscal year of the organization; and,
- how amendments to the Bylaws must be proposed and approved. The Bylaws cannot contradict any provision of the Articles of Incorporation. Amendments to the Bylaws must be duly approved by the Board and if applicable, the organization's members, but are not filed with the state.

# PART II: STATE NONPROFIT CORPORATION AND TAX LAW

## 3. Corporate Governance Basics

Many organizations adopt corporate policies that function very similarly to Bylaws which go into further detail in specific areas and are more easily amenable than Bylaws.   A wide range of policies exist that an organization may wish to adopt, depending on their activities and governance structure. The following four policies are ones that all organizations should have:

- **Code of Ethics:** outlines the fiduciary duties of the organization's Board members and Officers and includes a discussion of the organization's values and guiding principles. It is recommended to emphasize commitment to the mission, transparency, honesty, and compliance with applicable laws.

- **Conflict of Interest Policy:** describes the process of disclosing and addressing financial conflicts that may arise between an organization's Board members, Officers, high-level employees, and others in a position of power in the organization, as well as family members and businesses related to the above individuals. This policy should reflect the provisions of the intermediate sanctions rules discussed in Part I of this Primer and provide for review of any conflict of interest transaction by the disinterested members of the Board. It should include circulation of an annual conflict disclosure form, which must be updated throughout the year as conflicts arise. Form 990 specifically asks whether the organization has one, and you want to be able to check "yes."

- **Record Retention Policy:** provides rules for how long organization documents are retained and how and when they are destroyed. This policy should include language providing suspension of record destruction in the event of a lawsuit or investigation. Form 990 specifically asks whether the organization has one, and you want to be able to check "yes."

- **Whistle Blower Policy:** sets forth a process for employees and others inside the organization to report concerns about legal or ethical violations up the chain of command. The whistle blower policy typically provides for the investigation of such reports (when warranted) and provides some level of protection from retaliation against the reporting individual. Form 990 specifically asks whether the organization has one, and you want to be able to check "yes."

While not required by law, other policies to consider include an expense reimbursement policy, operating reserve policy, investment policy, gift acceptance policy, accounting policies and procedures, compensation policy, board fundraising (also known as "give or get") policy, confidentiality policy, and joint venture policy.

# PART II: STATE NONPROFIT CORPORATION AND TAX LAW

## 3. Corporate Governance Basics

With the governing documents in place, the main vehicle for carrying out an organization's governance responsibilities is Board of Directors meetings. It is essential to develop a smooth and systematic process for holding Board meetings and recording the results of these meeting minutes.

### Board Meeting Procedures

1. Provide adequate notice of the Board meeting and all relevant materials to Board members in advance (5-7 days' notice is sufficient, but this is dependent on the organization's Bylaws).

2. The Board needs to make sure a quorum is present before proceeding to official business. A quorum means a majority of the Board members are present at the meeting, but this depends on the Bylaws. A meeting can proceed without a quorum, but no official Board actions should be taken unless a quorum is present.

    a. Board meetings may be held by conference call or similar technology, and this counts the same as attendance in person (unless the Bylaws restrict this practice). Board voting by email or written correspondence is not considered a valid Board action unless the Board unanimously approves the particular action and each Board member signs a consent to this effect.

3. The first order of business at a Board meeting should be dealing with housekeeping items. Attendance should be taken to record whether a quorum is present, the minutes of the prior Board meeting should be reviewed and approved, and the agenda for the present meeting should be approved.

4. Formal parliamentary procedures (e.g. Robert's Rules of Order) are not necessary unless required by the organization's Bylaws. For clarity it is recommended that Board actions proceed with the following formality: (1) a Board member describe the proposed action and makes a "motion"; (2) another Board member "seconds" the motion; and (3) a Board vote is taken (making note of any dissenting votes). Without using this basic formality, it can be difficult to discern exactly what the Board has approved and whether the action had enough votes.

# PART II: STATE NONPROFIT CORPORATION AND TAX LAW

## 3. Corporate Governance Basics

### Board Meeting Procedures

5. The results of all Board meetings (as well as Committee meetings) must be reflected in official meeting minutes. Organizations are legally required to maintain meeting minutes in the corporate records, but the law is relatively silent on the detail required to be included in the meeting minutes. Following are some recommended best practices:

    a. Meeting minutes should show the date, time, and location of meeting (if meeting by conference call, the minutes should say so), along with who attended, and if anyone left early or didn't participate in a decision.

    b. Meeting minutes should not be too long or too short. There is no need to transcribe every statement or comment made. Meeting minutes should summarize the general gist of discussions and add additional details when necessary to protect the organization and Board, such as: (1) demonstrating due diligence and compliance with policies; (2) showing the Board used reasoned decision-making and relied on experts; and (3) detailing authority delegated to Officers and/or Committees.

    c. Meeting minutes should be reviewed and approved by the Board at a subsequent meeting (minutes should not be considered final and official until this happens). Once approved by the Board, the minutes should be signed by the organization's Secretary and the signed copy should be kept in the organization's corporate records.

# PART II: STATE NONPROFIT CORPORATION AND TAX LAW

## 4. Fiduciary Duties

Under traditional principles of nonprofit law, Board members and Officers owe two distinct fiduciary duties to the organization: the duty of care and the duty of loyalty. Some practitioners point to a third duty: the duty of obedience to the organization's mission, Articles of Incorporation and Bylaws, policies, and applicable laws, rules, and regulations. D.C. law recognizes these principles by statute.

Section 29-406.30(b) of the D.C. Code articulates the duty of care, stating that Board members "shall discharge their duties with the care that a person in a like position would reasonably believe appropriate under similar circumstances." A similar standard applies to Officers. This language essentially restates long standing requirements from court cases in D.C. that Directors and Officers of a nonprofit corporation "exercise ordinary and reasonable care in the performance of their duties, exhibiting honesty and good faith." Stern v. Lucy Webb Hayes Nat'l Training School for Deaconesses & Missionaries, 381 F. Supp. 1003, 1013 (D.D.C. 1974).

In practice, the duty of care requires Directors to: (1) attend Board and Committee meetings regularly; (2) stay adequately informed about the organization's activities and finances (particularly major transactions and potential liabilities), by means including reviewing corporate documents, meeting materials, and financial statements, and asking questions when appropriate; (3) make reasoned and deliberate decisions, consulting experts when necessary, and (4) adequately hire and supervise officers and management staff. Officers must be similarly attentive to their respective roles.

Section 29-406.30(a) of the D.C. Code articulates the duty of loyalty, stating that Board members shall discharge their duties: (1) "in good faith; and (2) in the manner the director reasonably believes to be in the best interests of the corporation." A similar standard applies to Officers. Directors and Officers owe an allegiance to the organization, and must make decisions in these roles based on what would best serve the organization rather than the individual's personal or financial interests, or those of the individual's family members, employer, or business associates.

# PART II: STATE NONPROFIT CORPORATION AND TAX LAW

## 4. Fiduciary Duties

The duty of loyalty requires that Directors and Officers avoid entering into transactions with the organization that contain terms that are more favorable to them than to the organization. This requirement is also enforced through the federal tax laws governing conflicts of interest. Transactions that raise conflicts of interest are not prohibited per se, but must follow processes that ensure the organization is fully informed of all relevant facts, due diligence is performed to ensure the terms are fair to the organization, and the transaction is approved by disinterested members of the Board or a Committee of the Board (i.e. Board members who do not stand to benefit directly or indirectly from the deal).

The duty of loyalty requires that Directors avoid diverting to themselves opportunities which in fairness ought to belong to the corporation (such as leasing or purchase of property, funding opportunities, mission-based activities, or other business opportunities that could be advantageous to the organization). This is known as the "corporate opportunity" doctrine. The application of this doctrine is complex and sometimes contentious, making transparency and open communication key. Directors and Officers should fully disclose to the Board any opportunities that could arguably be within the scope of this doctrine before pursuing them personally.

The duty of loyalty carries with it a requirement that Directors fully disclose to Board members all information that is relevant to the Board's decision-making or oversight functions. See D.C. Code § 29-406.30(c). It is traditionally interpreted to require Directors and Officers to maintain the confidentiality of information the person knows or has reason to know is confidential (such as strategic plans, donor lists, and sensitive operational and employment matters), especially if failure to maintain confidentiality could disadvantage the organization, personally benefit the Director or Officer, or manipulate the outcome of a Board action.

The duty of loyalty is traditionally viewed as including a duty of obedience to the organization's mission, Articles of Incorporation and Bylaws, policies, as well as applicable laws, rules, and regulations. The duty of obedience stems from the unique role of nonprofit leadership in overseeing funds that have been entrusted and provided tax-exempt status for a specific charitable mission.

# PART II: STATE NONPROFIT CORPORATION AND TAX LAW

## 5. Limitations on Liability

A primary benefit of being organized as a nonprofit corporation is the strong liability protections provided under state law for the Board, Officers, and other organization personnel and volunteers.

Section 29-406.90 of the D.C. Code sets forth a "volunteer immunity" rule, which protects Board members, Officers, and other persons who perform services for the organization from civil liability so long as they receive no compensation from the organization except for reimbursement of expenses for those services. This immunity has conditions and limitations that the organization should be aware of.

A key condition to the volunteer immunity rule is that the organization must maintain liability insurance with a minimum coverage level of $200,000 per individual claim and $500,000 per total claims arising from the same occurrence. Depending on their activities, organizations may want to maintain higher levels of insurance than this minimum.

Volunteer immunity is limited in that it does not apply if the injury or damage was the result of: (1) the willful misconduct of the volunteer; (2) a crime, unless the volunteer had reasonable cause to believe that the act was lawful; (3) a transaction that resulted in an improper personal benefit of money, property, or service to the volunteer; or (4) an act or omission that is not in good faith and is beyond the scope of the organization's authority under D.C. law and the organization's Articles of Incorporation.

Section 29-406.90 of the D.C. Code provides a similar, but less expansive, immunity to employees of the organization. Employees of D.C. nonprofit corporations are exempt from civil liability for amounts that exceed the compensation received by the employee during the 12 months preceding the act or omission giving rise to the liability. The same limitations that apply under the volunteer immunity rule apply to the immunity for employees.

The D.C. Code provides for protections to nonprofit Directors and Officers in the form of "indemnification." Indemnification is the reimbursing of Directors and Officers for the costs of lawsuits involving actions taken in their official capacity on behalf of the organization. Under D.C. law, a nonprofit corporation must indemnify a Director or Officer's reasonable expenses to the extent the Director or Officer is successful in defending himself/herself in a lawsuit or other proceeding involving corporate acts or omissions. The organization may indemnify in other cases if there is a judgment that fiduciary duties were breached.

Organizations typically obligate themselves in their governing documents to indemnify Directors and Officers to the fullest extent permitted under the law, and this indemnification is typically funded by Directors and Officers Insurance (or D&O insurance) maintained by the organization. It is recommended that all organizations maintain D&O insurance.

These protections do not apply to unpaid payroll taxes, federal excise taxes, and certain other government penalties, for which nonprofit Directors may be held personally liable.

# PART II: STATE NONPROFIT CORPORATION AND TAX LAW

## 6. Corporate Registrations

Every nonprofit corporation incorporated in D.C., as well "foreign corporations" incorporated outside of D.C. that "do business" here, must submit a registration form every two (2) years (starting with the first year following the year of incorporation) to maintain the corporation's good standing in the District of Columbia. This registration form is called the BRA-25, and it can be submitted online at the D.C. Department of Consumer and Regulatory Affairs website at corp.dcra.dc.gov.

The form requires basic information such as the organization's name, address, registered agent, list of Directors and Officers, and a brief statement of activities conducted in the District of Columbia. Failure to submit the BRA-25 will result in lack of good standing, and eventually revocation of the organization's nonprofit corporation status in D.C., including all the protections that nonprofit corporation status entails. Reinstatement is possible, but is costly, a hassle, and leaves the organization's volunteers and employees at risk of personal liability for the period in which the organization's nonprofit corporation status was revoked.

If an organization does business outside of D.C., it will need to file "foreign corporation" registration in these states and keep these registrations updated.

As part of this registration process, organizations are required to maintain a "registered agent" in their state of incorporation and in any states where the organization is registered as foreign corporation. The registered agent is a point of contact in the state where the state government can send important notices and communications to the organization, and where "service of process" can be delivered to the organization in the event of a lawsuit. If the organization has an actual office in the state, the registered agent can be an employee or officer of the organization. Otherwise, the organization will need to hire a "commercial registered agent," a company that offers this service to businesses and organizations for an annual fee. These fees run between $200 and $500 per year, depending on the company.

Nonprofit organizations that are based in D.C. and nonprofits that conduct charitable fundraising in D.C. are required to maintain a "charitable solicitation" license in D.C., a topic that is covered in Part III of this Primer.

# PART II: STATE NONPROFIT CORPORATION AND TAX LAW

## 7. State Tax Law

An organization that has its 501(c)(3) status approved by the IRS is exempt from federal income tax and is eligible for the other benefits that federal 501(c)(3) status provides. 501(c)(3) status does not mean the organization is automatically exempt from corporate income tax and other taxes applied at the state level. Organizations must take steps to review and understand the tax rules in all states in which they do business (e.g. holding conferences and events in a particular state, having employees do work in that state, and fundraising in the state). The amount and type of activities in a state that could potentially trigger tax liability varies.

Fortunately, it is an easy process in most states for 501(c)(3) organizations to obtain a state level income tax exemption. Most states rely heavily on the IRS determination of 501(c)(3) status, with application processes that usually grant state level income tax exemption based on a copy of the 501(c)(3) approval letter and answers to some additional questions. Some states bestow state level income tax exemption on 501(c)(3) organizations automatically, with no additional action required. It is recommended you seek the guidance of an attorney or CPA for more information on what states require.

D.C. is one of the jurisdictions that requires a specific registration and application process to become tax-exempt. In D.C. there are three different taxes to take notice of: (1) the Corporation Franchise Tax (the income tax that applies to corporations); (2) the Sales and Use Tax ( the tax on the sale or rental of goods and certain services, as well as the tax on the "use" of goods and certain services in D.C., if purchased or rented elsewhere); and (3) the Personal Property Tax (the tax on equipment, furniture, and other types of personal property used in D.C.).

# PART II: STATE NONPROFIT CORPORATION AND TAX LAW

## 7. State Tax Law

**Obtaining and Maintaining Tax Exemption in D.C.**

1. Set up an account for the organization at MyTax.DC.gov, the District's online portal for all tax matters.

2. Submit the FR-500 combined registration application for new businesses through the portal. You will be able to tell whether the organization is registered once the MyTax.DC.gov account is set up.

3. Submit the FR-164, an application for tax exemption through the portal. The D.C. Office of Tax and Revenue is now requiring all organizations to submit the FR-164 to renew their D.C. tax exemptions every 5 years. Unlike federal 501(c)(3) status (which is valid until revoked by the IRS), tax-exempt status in D.C. only lasts for 5 years, and then must be renewed with a new application.

    a. The FR-164 application provides a means of obtaining exemption from the District's Corporation Franchise Tax, Sales and Use Tax, and Personal Property Tax. Only 501(c)(3) organizations physically located in D.C. qualify for exemption from the Sales and Use Tax and Personal Property Tax. These are referred to as "semi-public institutions." Organizations located outside of D.C. may only qualify for the exemption from the Corporation Franchise Tax. This is like the sales and use tax rules in other states, which only provide exemptions to organizations physically located in the state.

    b. To seek exemption from the Sales and Use Tax and Personal Property Tax, you must include a copy of your office lease with the FR-164 to prove the organization is physically located in the District of Columbia.

    c. All FR-164 applications must include a copy of the tax-exemption approval letter from the IRS, a copy of the organization's Articles of Incorporation, and (if incorporated outside of D.C.) a copy of the foreign corporation registration certificate from the D.C. Department of Consumer and Regulatory Affairs.

    DI. Exemption from D.C.'s Corporation Franchise Tax does not apply to revenue from activities that trigger the "unrelated business income tax" under federal law.

4. 501(c)(3) organizations that own real property in D.C. may seek exemption using the form FP-300 for all or a portion of the D.C. real property tax. The real property tax exemption is narrowly construed, and only available to certain types of organizations. Not all 501(c)(3) organizations qualify, and real property tax may still apply to portions of the property that are used for purposes outside of the organization's 501(c)(3) purposes. More information about the real property tax exemption can be found at otr.cfo.dc.gov/publication/fp-300-exemption-dc-real-property-tax-instructions.

# PART III: FUNDRAISING LAWS

## 1. Introduction

Part III covers the key areas applicable to all nonprofit 501(c)(3) organizations, including donor restrictions, donor acknowledgment requirements, and state charitable solicitation registration laws. If your organization receives funds from the federal government or state/local governmental entities, there will be other laws and rules that apply. As compliance with government grants is a subject beyond the scope of this Primer, it is recommended to take special care in researching your organization's responsibilities when accepting funds from the federal or state government.

## 2. Donor Restrictions

One of the most important and complicated aspects of operating a nonprofit involves distinguishing "restricted" funds (funds with donor-imposed restrictions and cannot be diverted for other purposes such as supporting a specific program) from "unrestricted" funds which have no donor-imposed restrictions. Similarly, funds received for purposes of creating or adding to an endowment (i.e. an investment fund meant to sustain the organization in perpetuity) generally cannot be spent at all (except, in most cases, for the interest generated by the investments). This is true whether the funds come from grants or donations.

Maintaining the distinction between "restricted" and "unrestricted" funds is essential to maintaining accurate financial statements. An organization with $500,000 of cash in the bank may not be as healthy as it appears if the entire amount is restricted for a single program. Diverting restricted funds for purposes outside of the restrictions is a serious problem that is sure to be flagged during an organization's audit.

Improperly diverting restricted funds raises legal issues. Virtually every state in the country (including D.C.) has enacted a version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA), legislation that provides rules extending beyond what is suggested by its title. In addition to setting forth rules and standards regarding the management of endowments, UPMIFA provides that any donor-imposed restrictions must be obeyed unless: (1) the donor consents to the change; or (2) the court approves a modification to the restriction (subject to stringent standards and following notification of the Attorney General). See D.C. Code § 44-1635.

# PART III: FUNDRAISING LAWS

## 2. Donor Restrictions

Additionally, diverting restricted funds is likely a breach of contract, a violation of the grant agreement or an informal promise to the donor, that could lead to a lawsuit brought by the grantor or donor. If the grantor is a governmental entity, the consequences can be even more serious.

It is important to understand when funds are restricted and the nature of the restriction. Some funds may be restricted as to a purpose (i.e. how the funds can be spent), other funds may be restricted as to timing (i.e. when the funds can be spent), and some funds may be restricted as to both purpose and timing. Similarly, some funds are considered "temporarily" restricted, which means the restriction is lifted when funds are spent for purposes of the program. Other funds are "permanently" restricted, which is typical of endowments, where the "corpus" (or "principal") often must remain perpetually invested and only the interest is available for spending.

The most common type of restriction is of "purpose," which can arise in different ways. Restrictions can be expressed by the donor or grantor by including explicit instructions regarding the intended purpose of the donation, or when a grant is provided in response to a grant proposal with a budget and/or an accompanying grant agreement. Restrictions can be created by an organization's fundraising materials when the request for funding explicitly or implicitly says that the funds raised will only be used for one program. Due to the risk of inadvertently creating this type of restriction, fundraising materials should be closely scrutinized to determine whether a restriction has been created. When possible, fundraising materials should mention a couple of different programs at minimum and leave the door open to multiple uses with language such as "Donations will benefit programs such as …".

Your organization will need to work closely with an accounting professional to fully understand the nature of restricted funds and how to set up recordkeeping systems that enable your organization to comply.

# PART III: FUNDRAISING LAWS

## 3. Donor Acknowledgements

Donor acknowledgements refer to providing written notification to your donors confirming that a donation has been made. This requirement comes from federal tax law but is from a different part of the Internal Revenue Service Code in that it comes from the rules regarding the tax-deductibility of charitable donations. These rules are not a condition of the organization's tax-exempt status, but donors will not be able to use the charitable deduction unless the rules are followed. Failure to follow these rules will generally not lead to revocation of tax-exempt status, but fines could apply in some cases. Most importantly, you want to make sure that your donors can use every tax benefit available to them, so they continue to give!

There are two key rules underpinning the donor acknowledgment requirements: (1) donors who give more than $250 cannot claim the charitable deduction without receiving a written acknowledgment from the organization; and (2) organizations are generally required to provide a written acknowledgment for contributions that exceed $75 if the contribution includes a payment for goods or services, called "quid pro quo" contributions.

The content required in the acknowledgment varies depending on the circumstances. There are 4 different scenarios:

1. A donation of cash, with no goods or services provided by the organization in return
2. A donation of cash, with some goods or services provided by the organization in return
3. A non-cash donation (e.g. property, unreimbursed expenses, in-kind services, etc.), with no goods or services provided by the organization in return
4. A non-cash donation, with some goods or services provided by the organization in return

For all scenarios, the acknowledgement must include the name of the organization and the date of the contribution. Although not legally required, you want to show appreciation and tell the donor about the impact of the gift. Donors must receive acknowledgements no later than the date they file their tax returns (generally April 15), however, organizations should aim to send all acknowledgments by January 31 of the year following the donation. Organizations can choose whether to send individual acknowledgments for each donation, or a summary of all contributions from the donor during the year. Emailed or auto-generated acknowledgments are permitted so long as all the required information is included.

# PART III: FUNDRAISING LAWS

## 3. Donor Acknowledgements

For donations of cash, the acknowledgment must include the amount of the cash.

For non-cash donations, the acknowledgment must include a description of what was donated but should not provide the value of the donation – this valuation is the responsibility of the donor! For example, if a donor contributes shares of stock, the acknowledgement will say something like "Thank you for your donation of 100 shares of ABC Corp. stock."

When there is a quid pro quo contribution, the acknowledgment must include an estimate of the value of the goods or services provided by the organization in return for the contribution. Only the amount of the donation that exceeds the value of the goods or services received by the donor is eligible for the charitable deduction. Unlike goods or services received by the organization (which are the responsibility of the donor to value), it is the organization's responsibility to state a valuation of the goods or services provided by the organization to the donor.

For example, if a donor is invited to a fundraising dinner with a ticket price of $150 and the dinner is valued at $50, the acknowledgment should state that the donor received a dinner valued at $50 and that the donation portion equals $100.

There are some exceptions to the obligation to state the value of goods or services provided to the donor, such as for low-cost goods or services with insubstantial value. These exceptions and an overview of the rules in general are discussed in IRS Publication 1771: https://www.irs.gov/pub/irs-pdf/p1771.pdf.

The value of personal services provided by a donor is not eligible for the charitable deduction (e.g. a lawyer who normally charges $500 per hour and donates 10 hours of pro bono legal services cannot deduct $5,000 as the value of her time). This is widely misunderstood, and your organization should not lead donors to believe this type of donation comes with a tax deduction. However, this shouldn't stop you from keeping track of the contribution and thanking the donor for the valuable help!

# PART III: FUNDRAISING LAWS

## 4. Charitable Solicitation Registration Laws

Approximately 40 states (including the District of Columbia) require nonprofit organizations to file a "charitable solicitation" registration prior to raising money for charitable purposes in the state. This requirement is separate and distinct from other requirements that may apply to activities in a state, such as registering as a foreign corporation, applying for tax-exempt status, or paying state unemployment insurance taxes for employees in the state. The charitable solicitation registration requirement is a consumer protection law to ensure residents of these states can confirm the charities asking for money are not a scam.

The requirement is triggered by fundraising conducted in the state, so registering in the state where the organization is incorporated and/or has its office headquarters may not be sufficient. There are exemptions in each state that have the charitable solicitation registration law, but they are narrow (such as churches and/or small organizations with low amounts of revenue). The requirements and the exceptions vary widely by state, so it is important to be careful and thorough in assessing the states in which your organization must register and get professional guidance whenever possible. There are numerous filing and registration companies that specialize in charitable solicitation registration and can help nonprofit organizations on a cost-effective basis.

Charitable solicitation registrations must be renewed every year (D.C. is an exception). Renewing these registrations can become burdensome; states vary in the information and supplemental documents that must be included. Failure to register can result in significant penalties, especially if an organization uses a large mailing list to solicit contributions.

State charitable solicitation registration laws often require organizations with over a certain amount of revenue ($300,000-$1,000,000/year, depending on the state) to include audited financial statements with the registration. For organizations that are not required to have an audit pursuant to their grant agreements, this can be the first time they are required to have their financial statements audited by a CPA. This process typically costs a minimum of $10,000.

State charitable solicitation registration law is triggered by making any direct or indirect plea or request in the state to be used for any charitable purpose. This includes oral or written requests, posting or circulating advertisements or publications that request funds, or requesting funds through an announcement to the press or over the television or radio airwaves, or any other means of fundraising in the state. The key concept is soliciting in the state, with a heavy focus on active fundraising efforts. For example, asking for money at an event or meeting in the state, sending emails to state residents, calling state residents on the phone, and sending fundraising materials in the mail are examples of active fundraising efforts.

# PART III: FUNDRAISING LAWS

## 4. Charitable Solicitation Registration Laws

One of the most difficult questions faced by charity regulators in the nonprofit community is how the rules apply to fundraising through websites and social media. This question does not have a universally definitive answer, but a good rule of thumb is provided by the "Charleston Principles," a practical set of advisory guidelines developed by the National Association of State Charity Officials (NASCO) at one of their meetings in Charleston, South Carolina in 2001.

Under the Charleston Principles, organizations should register in:

1. States where the organization has its headquarters or other offices;

2. States where its non-internet activities would require registration (e.g. through mail or telephone campaigns);

3. States where the organization's internet activities specifically target persons physically located in a state (e.g. through language that references the state, or through emails or targeted advertising if the organization knows or reasonably should know the recipient is physically located in the state – meaning you should do analysis of the geographic info you have for your organization's email lists); and

4. Other states from which the organization receives contributions on a "repeated and ongoing basis" or a "substantial basis" through its website (meaning you should analyze where your contributions are actually coming from and register in states based on this data).

The Charleston Principles have not been enacted as law except in a few states, so organizations should carefully assess the possibility of charitable solicitation registration obligations in other states (again, preferably with the help of a filing and registration company or a legal professional). As a practical matter, all D.C. nonprofits must register to make charitable solicitations in D.C. Fortunately, D.C. has a charitable solicitation registration process that is easier than many other states. All businesses and organizations in D.C. are required to have a "Basic Business License" (BBL). Some types of organizations may require a more specialized type of license, depending on their activities. In D.C., the charitable solicitation registration is a particular category of BBL. By completing the charitable solicitation registration through the D.C. Department of Consumer and Regulatory Affairs, an organization can satisfy its requirement to obtain a BBL. The application and other instructions and resources can be found at business.dc.gov.

# PART III: FUNDRAISING LAWS

## 4. Charitable Solicitation Registration Laws

D.C. does not require submission of Form 990 or any other financial statement upon registration or renewal or require an audit as part of its charitable solicitation registration or renewal process. However, there are several unique documents required by D.C. as part of its charitable solicitation registration process:

- The organization must make sure that it is properly registered as a corporation in D.C. (a domestic corporation if incorporated in D.C., or a foreign corporation if incorporated elsewhere) and submits its FR-500 and FR-164 tax registrations. Various supporting documents must be submitted with the application.

- The organization must file a "BBL" or "BBL-EZ" application form, including a "clean hands self-certification" that states the organization does not owe outstanding debts to the District of Columbia. A copy of the 501(c)(3) approval letter must be provided and, unique to D.C., a resolution authorizing submission of the application with the notarized signature of a corporate officer, along with a copy of the occupancy permit from the building where the organization has its office (you should be available to get a copy of this document from the building owner or management company).

- If your organization is run from someone's home instead of an office building, you will need to obtain a "home occupation permit" from the D.C. Department of Consumer and Regulatory Affairs.

In D.C. the charitable solicitation license can be obtained for 2 years or 4 years (with different fee levels). This contrasts with most other jurisdictions, where charitable solicitation registrations must be renewed annually.

# PART IV: EMPLOYMENT LAW BASICS

## 1. Introduction

Employment law is not just a critical part of managing an organization's staff, it is the most common source of lawsuits and legal liability, comprises a combination of federal and state laws, and is (mostly) not unique to nonprofits. With a small handful of exceptions where nonprofits enjoy special treatment, employment law applies equally to for-profits and nonprofits alike.

Employment law is especially complicated, fact-specific, and frequently changing. It is impossible to thoroughly explain all the intricacies of employment law in a short summary like this one. As with the other topics covered in this Primer, you should use this as a starting point for further research and consult an attorney to get personalized help to implement and apply these laws to your specific facts.

# PART IV: EMPLOYMENT LAW BASICS

## 2. Employee vs. Independent Contractor

Whether a worker is an employee or an independent contractor is the largest consideration when an organization is assessing its employment law responsibilities. There is a strong temptation to treat workers as independent contractors: an organization does not have to pay payroll taxes on, or withhold taxes from, an independent contractor's compensation; Independent contractors do not accrue paid sick leave or vacation time; and are not covered by workers' compensation, unemployment, or most employee benefit plans. And independent contractors can be terminated with little risk of liability for employment discrimination.

There are strict guidelines regarding when it is permissible to treat a worker as an independent contractor, and organizations must resist the temptation to treat a worker as an independent contractor merely because it is convenient (even if the worker prefers that treatment). The independent contractor test is applied in numerous contexts under federal and state law, and the precise language of the test varies depending on the context. But most versions of the test focus heavily on the amount of control that the employer exercises or could exercise over how the worker carries out the work.

The test (known as the common law "master and servant" test) is traditionally articulated as follows: if an employer has the right to control the manner and means by which the work is performed, the worker is an employee. An independent contractor works independently, free from control over how the work gets done. A worker is considered an employee if the employer has the "right" to control how the work gets done, even if this right is not exercised.

The IRS has articulated 20 factors it considers when applying the test. Factors that tend to indicate employee status include:

- whether the worker must follow instructions as to when, where, and how he or she is to work;
- whether the services must be rendered personally and cannot be delegated by the worker to assistants;
- whether the worker must work according to hours, e.g. from 9am to 5pm on weekdays;
- whether the worker must devote substantially full time to performing the services; and,
- whether the worker is provided with the tools, materials, and equipment needed to perform the work.

# PART IV: EMPLOYMENT LAW BASICS

## 2. Employee vs. Independent Contractor

If the worker makes his or her services available to the general public on a regular and consistent basis, this tends to indicate independent contractor status.

Independent contractor status should be reserved for situations where it is quite clear that the worker is indeed independent. For example, when you hire a CPA to prepare the organization's Form 990, the CPA does the work on his/her own schedule, finding time to prepare your organization's Form 990 when he/she is not busy with other clients. The CPA uses his/her own resources to aid in preparing Form 990 and figures out answers to tricky questions, and the CPA is free to hire assistants to help him/her get the work done. Your organization truly does not care how the CPA gets the work done – only that it gets done well and on time. While many independent contractor relationships are not as clear as this one, all independent contractor roles should have elements like this example. Otherwise, there is risk that the worker should instead be considered an employee.

DC law follows the common law test. Some states apply a more rigid version of the test with a stronger presumption of employee status. This more rigid version of the test (often called the "ABC test") requires that: (A) the worker is free from the control and direction of the hiring entity; (B) the worker performs work that is outside of the usual course of the hiring entity's business; and (C) that the worker is customarily engaged in an independently established business for himself/herself to perform this work, and takes steps to offer these services to the public. California is a notable example of a jurisdiction that takes this more rigid approach, and the trend among other states is heading in this direction. Organizations should be wary of this trend when hiring workers on an independent contractor basis.

# PART IV: EMPLOYMENT LAW BASICS

## 3. New Employee Onboarding

Once it is determined that a worker is an employee rather than an independent contractor, numerous requirements are triggered. New employees must:

- sign and return Form W-4 (the employee tax withholding certificate to determine how much tax to withhold from the employee's paycheck);
- sign and return the applicable state tax withholding worksheet (Form D-4 in D.C.);
- sign and return Form I-9 (an immigration form to verify employment eligibility) along with the required documentation (some employers are required to verify eligibility using the E-Verify website at www.e-verify.gov);
- fill out a direct deposit authorization form (if applicable); and,
- fill out enrollment forms for employee benefit plans maintained by the organization.

All employers must comply with applicable state new hire reporting laws with respect to newly hired employees, which are intended to assist states in enforcing child support orders. In D.C. this is called the "District of Columbia Directory of New Hires," and the reports can be filed online at dc-newhire.com. D.C. requires reporting within 20 days of a new employee's hire date.

Employers are required to maintain workers' compensation coverage, and make sure that all new employees are covered.

While not required by law, organizations should have new employees sign an acknowledgement that they have received the employee handbook, fill out emergency contact forms, any non-disclosure agreements, employment agreements, or other employment-related contracts that the organization uses. This paperwork is in contrast with the relatively simple process for onboarding independent contractors, which usually requires only a signed Form

W-9. Contracts with independent contractors, often called "independent contractor agreements," "work for hire agreements," or "service provider agreements," are highly recommended.

# PART IV: EMPLOYMENT LAW BASICS

## 4. FLSA Exempt vs. Non-Exempt

Organizations must determine whether its employees are "exempt" or "non-exempt" under the federal Fair Labor Standards Act (FLSA). This classification determines whether an employee must be paid a minimum hourly wage as opposed to a flat salary, and whether an employee is eligible for increased overtime pay for hours worked in excess of 40 hours per week. Non-exempt employees are paid the minimum hourly wage and must be paid overtime.

If the employee's salary and duties fit within one or more of the categories of exempt employees under the FLSA, the employee is exempt, generally makes a flat salary and is not eligible to receive overtime. A job title is not sufficient to establish the exempt status of an employee. The employee's actual duties must match the parameters of the relevant category in order to be considered FLSA exempt.

Exempt categories are typically reserved for higher-level, more educated employees for whom the protections of the wage and hour laws are deemed less necessary. These higher-level employees are often expected to work more hours as necessary to get their work done and are often paid commensurate with their responsibilities. The FLSA exemptions are intended to respect these expectations.

There are three exemption categories that are relevant to nonprofits: (1) Executive Employees; (2) Administrative Employees; and (3) Professional Employees. There is potential overlap between these categories, but an organization only needs to be confident that at least one category applies to treat an employee as exempt from minimum wage and overtime requirements.

- **Executive Employees:** Exemption generally applies to employees: (1) whose primary duty is management of the organization or a particular department or division thereof; (2) who customarily and regularly direct the work of two or more other employees; and (3) who have authority to hire or fire other employees (or whose recommendations as to hiring, firing, advancement, promotion or change of status are given particular weight). See 29 CFR § 541.100. This category includes the Executive Director and could include other high-level positions like the Chief Operations Officer.

# PART IV: EMPLOYMENT LAW BASICS

## 4. FLSA Exempt vs. Non-Exempt

- **Administrative Employees:** Exemption applies to employees: (1) whose primary duty is the performance of office or non-manual work directly related to the management or general business operations of the employer; and (2) whose primary duty includes the exercise of discretion and independent judgment with respect to matters of significance. See 29 CFR § 541.200. "Discretion and independent judgment" are key factors for this category, implying that "the employee has authority to make an independent choice, free from immediate direction or supervision," although the required level of judgment can still exist even though the decisions are subject to review by higher level employees. See 29 CFR § 541.202. Human Resource managers would be a good example of this category.

- **Professional Employees:** Exemption applies to employees whose primary duty is the performance of work: (1) Requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction; or (2) Requiring invention, imagination, originality or talent in a recognized field of artistic or creative endeavor. See 29 CFR § 541.300. This category would include staff nurses or physicians, subject matter experts who teach, train, or write papers, and similarly skilled individuals.

All three categories must satisfy salary requirements to be considered FLSA exempt. These employees must be paid a flat salary that does not vary depending on the number of hours worked, and that salary currently must be a minimum of $684 per week ($35,568 annually). If the employees are not paid a flat salary of at least this minimum amount, they cannot be considered exempt and will be entitled to overtime pay for hours worked in excess of 40 hours per week - even if their duties otherwise fit the exemption category.

For clarification on which nonprofit organizations are subject to the federal FLSA, see "Fact Sheet #14A: Non-Profit Organizations and the Fair Labor Standards Act" on the Department of Labor website: https://www.dol.gov/agencies/whd/fact-sheets/14a-flsa-non-profits. State law generally adopts the federal FLSA framework in determining which employees are entitled to minimum hourly wages and overtime pay. This is in fact the case in D.C. (see D.C. Code § 32-1004).

At $15/hour, the minimum wage in D.C. is significantly higher than under federal law and is subject to increase every year in proportion to the increase in the Consumer Price Index. Overtime pay (i.e. hours worked by non-exempt employees in a work week in excess of 40 hours) must be paid at 1.5x the regular rate at which the employee is employed, pursuant to both the FLSA and D.C. law.

# PART IV: EMPLOYMENT LAW BASICS

## 5. Payroll, Withholding, and Reporting Requirements

Once new employees are onboarded, employers are subject to various payroll, tax withholding and reporting requirements. This is true regardless of the number of employees. The importance of complying with these requirements cannot be overstated: failure to remit payroll taxes or withhold taxes from the paychecks of employees can lead to massive penalties for which an organization's directors and officers can be held personally liable. Federal and state authorities are exceptionally aggressive in enforcing these rules.

Steps for Payroll, Withholding, and Reporting Requirements:

- Set up a payroll schedule, either generating physical paychecks or depositing payments directly into the employee's bank account. State laws have requirements about how frequently employees must be paid. Most states, including D.C., require employees to be paid at least twice per month (either every 2 weeks, or mid-month and at the end of the month).

- Employers are required to withhold from employees' wages income taxes owed by employees as well as the employee share of Social Security and Medicare taxes. Employers are responsible for paying the employer's share of Social Security and Medicare taxes, and in some cases, state unemployment insurance taxes. (501(c)(3) organizations are exempt from federal unemployment insurance taxes and have the option of opting out of the state unemployment insurance system. This reimburses the state for actual unemployment claims, which can potentially save money for organizations with little turnover in employees. However, some organizations opt for the stability of simply paying the state unemployment taxes.

- D.C. employers are required to pay an additional payroll tax to fund the District of Columbia Universal Paid Leave Act. This tax took effect on July 1, 2019 and requires employers to pay 0.62% of the wages of each of their covered employees.

- Withheld taxes and payroll taxes must be remitted to the government immediately after each payroll. Form 941 must be submitted to the federal government on a quarterly basis. Form UC-30 wage reports must be submitted to the D.C. government on a quarterly basis to report unemployment tax payments and Universal Paid Leave Act payments. Employers must report all wages paid during the previous year using Form W-2 (which is provided to each employee) and Form W-3 (which is provided to the IRS) no later than January 31 each year. These forms must also be submitted to the D.C. government.

# PART IV: EMPLOYMENT LAW BASICS

## 5. Payroll, Withholding, and Reporting Requirements

This summary is provided to give you a sense of the different payroll, withholding, and reporting requirements, but under no circumstances should an organization attempt to handle these payments and filings by itself. There are plenty of options for third-party payroll administration companies that have automated systems for paying employer payroll taxes, withholding employee taxes, and sending all required payroll reports. The organization is responsible for making sure information is reported accurately, payroll is run on time, and that there are sufficient funds to pay employees. A reputable payroll administration company can carry most of the burden and do so with fewer errors.

# PART IV: EMPLOYMENT LAW BASICS

## 6. Anti-Discrimination and Other Restrictions

Employers have discretion to make hiring, firing, promotion, compensation and other employment decisions as they see fit. There is a strong presumption of "at will" employment, which means that employees can quit or be fired at any time, for any reason or no reason at all. However, due to myriad anti-discrimination rules and other restricted practices under federal and state law make the general principle of employer discretion and at will employment much more complicated in practice.

It is more accurate to say that employers are free to make employment decisions based on any reason so long as that reason is not prohibited by law. It is illegal to take an adverse employment action against an employee or prospective employee based on characteristics or activities that are protected under the law, called "disparate treatment." There is a complex theory called "disparate impact" under which an otherwise neutral employment policy or practice can be challenged if it has a disproportionate negative impact on members of a protected class, but this subject is beyond the scope of this Primer. "Adverse employment actions" include termination, failure to hire or promote, subjecting employees to harassment or a "hostile work environment," or otherwise materially changing the terms or conditions of employment in a negative way.

Employers are prohibited from retaliating against an employee or prospective employee for asserting their rights to be free from employment discrimination, including harassment, or for talking with co-workers about pay and working conditions (the latter is called "concerted activity" under Section 7 of the National Labor Relations Act).

Under federal law, the protected characteristics are **race, color, national origin, religion, age, sex** (including gender, sexual orientation, and pregnancy), **genetic information**, and **physical or mental disability**. The relevant federal statutes include Title VII of the Civil Rights Act of 1964, the Age Discrimination in Employment Act of 1967 (as amended by the Older Workers Benefit Protection Act), the Equal Pay Act of 1963, the Americans with Disabilities Act of 1990, and the Genetic Information Nondiscrimination Act of 2008.

Under D.C. law, the protected characteristics are **race, color, national origin or ancestry, religion, age, sex, marital status, personal appearance, sexual orientation, gender identity or expression, family responsibilities, political affiliation, disability, genetic information, physical or mental disability, credit information, unemployment status, matriculation** (i.e. enrollment in a college, university or some type of secondary school), **tobacco use**, and **status as a victim or family member of a victim of domestic violence, a sexual offense, or stalking**. D.C. law also has restrictions regarding when it is permissible to inquire into a job applicant's criminal history.

# PART IV: EMPLOYMENT LAW BASICS

## 6. Anti-Discrimination and Other Restrictions

In practice, organizations must be vigilant in teaching its leadership, managers, and supervisors the anti-discrimination rules, scrutinizing employment applications and interview questions, and avoiding statements that could be construed as bias toward a protected group. Because the risk of discrimination claims is significant even if these practices are followed, organizations with employees should carry employment practices liability insurance and use carefully drafted severance agreements as part of their employee termination process (when appropriate).

The aspects of anti-discrimination laws that warrant special discussion include anti-harassment policies and disability discrimination.

- **Anti-Harassment Policies:** Harassment includes unwelcome conduct that is based on protected characteristics. Sexual harassment is perhaps the most frequent and notable example, but harassment based on any type of protected characteristic is prohibited. Harassment becomes unlawful when: (1) enduring the offensive conduct becomes a condition of continued employment; or (2) the conduct is severe or pervasive enough to create a work environment that a reasonable person would consider intimidating, hostile, or abusive. An organization must have and follow an anti-harassment policy in order to avoid being liable for the harassing behavior of its supervisors and managers. Employers will in all cases be liable if the harassment leads to a tangible employment action, such as hiring, firing or failure to promote.

An anti-harassment policy must include, at a minimum: (1) a clear explanation of the prohibited conduct; (2) an assurance that employees who make complaints will not be subject to retaliation; (3) a clear process that provides an accessible way for employees to make complaints; (4) assurance that the employer will protect the confidentiality of harassment complaints (to the extent possible with the need to conduct an investigation); (5) a complaint process that provides a prompt, thorough, and impartial investigation; and (6) assurance that the employee will take immediate and appropriate corrective action when it determines that harassment has occurred. An employer must always follow its anti-harassment policy in practice.

Some states require that employers periodically provide mandatory harassment training to their employees. D.C. currently requires harassment training only for employers with "tipped employees," but this area of law changes frequently and should be monitored closely.

# PART IV: EMPLOYMENT LAW BASICS

## 6. Anti-Discrimination and Other Restrictions

- **Disability Discrimination:** Organizations must be aware of the unique and complex responsibilities that arise under disability discrimination laws, such as the Americans with Disabilities Act and applicable state law. An employer cannot discriminate against an employee or prospective employee with a disability who is qualified to perform the essential functions or duties of the job, with or without "reasonable accommodation." The law protects individuals who have a disability, as well as individuals whom the employer believes to have a disability, even if they aren't disabled.

A disability is a substantial impairment that significantly limits or restricts a major life activity such as hearing, seeing, speaking, walking, breathing, performing manual tasks, caring for oneself, learning or working. This concept includes not only obvious impairments such as major illnesses, blindness, deafness, and inability to walk, but also increasingly pervasive problems such as mental illness and alcohol or drug addiction.

Employers are required to provide a reasonable accommodation to disabled employees who inform the employer that the accommodation is needed, except when such accommodation would cause an "undue hardship" to the employer. A reasonable accommodation could include modifying workspaces or restrooms to make them accessible, job restructuring or reassignment, part-time or modified work schedules, obtaining special equipment, and finding the appropriate accommodation for the circumstances that requires an interactive process between the employer and the employee. Undue hardship refers to accommodations that would be extremely costly to the employer, unduly extensive, substantial, or disruptive, or those that would fundamentally alter the nature or operation of the employer's business.

Navigating the questions of whether an employee has a disability, whether the employee is otherwise qualified to perform the essential functions of the job, what kind of reasonable accommodation might be required, and when it may be permissible to terminate an employee whose work performance may be related to a disability are the most challenging aspects of employment law and dealing with staff. Employers must be careful before inquiring whether an employee has a disability or requesting a medical examination or other proof of the disability, as such inquiries are only permitted in limited circumstances. Similarly, disclosure by an employer of an employee's disability, medical information, or reasonable accommodation is prohibited except in limited circumstances.

# PART IV: EMPLOYMENT LAW BASICS

## 7. Federal and State Leave Laws

Navigating the patchwork of paid leave and unpaid leave required under federal and state law (as well as an employer's own voluntary vacation and sick leave programs) is another challenging aspect of employment law.

- **Vacation Leave:** Employers have the most flexibility with paid vacation policies. There is no requirement under federal or state law to provide paid vacation time to employees (i.e. taking time off from work for rest and leisure without giving up pay). But most employers have a paid vacation policy, in recognition that vacations are necessary for employee morale and productivity.

Employers can design vacation leave in any manner they want, provided that vacation leave is not administered in a way that violates anti-discrimination laws, the employer follows its own policies, and the value of any vacation leave accrued by an employee that is unused at the time of the employee's termination is paid to the employee in his or her final paycheck. Vacation leave is treated as a form of wages and cannot be taken away after it is accrued, but employers can limit the amount of vacation leave that accrues or carries over from year to year through carefully drafted policies.

It is up to the employer to design a process for awarding specific amounts of vacation leave per year, specifying how much advance notice an employee must provide, and how many days an employee may be away on vacation at one time. Some employers combine paid vacation time with paid sick days into one bank of accrued leave days called "paid time off." A growing number of employers are experimenting with "unlimited" vacation days, relying on trust among its staff to get their work done responsibly and not abuse the system.

- **Sick Leave:** Employers have some discretion in designing paid sick leave programs for their employees, though this is an area that is increasingly regulated at the state level. Paid sick leave differs from vacation leave in that sick leave is not permitted to be used for leisure activities, but for when the employee is ill, caring for an ill family member, or otherwise dealing with a personal emergency of some sort. However, when an employer has a combined "paid time off" program, the reason for using the leave is irrelevant.

Many states have passed laws requiring employers to provide a minimum amount of paid sick leave to their employees, and D.C. is no exception. Employers with 1 to 24 employees must provide employees who work in D.C. with a minimum of 1 hour of paid leave for every 87 hours worked, up to a maximum required amount of 3 days per calendar year.  The employer is free to provide more sick leave, if desired. Employers with 25 or more employees are required to provide a more generous amount of leave at levels that vary depending on the number of employees. Employees must begin accruing sick leave immediately upon commencing employment, but employers are permitted to make employees wait up to 90 days after beginning employment before using their paid sick leave.

# PART IV: EMPLOYMENT LAW BASICS

## 7. Federal and State Leave Laws

In D.C., employees must be able to use their paid sick leave for a variety of reasons including:

- their own physical or mental illness, injury, or medical condition or that of a family member;
- seeking a medical diagnosis or preventive care for themselves or a family member; and,
- needs relating to themselves or a family member being a victim of stalking, domestic violence, or sexual abuse.

Employers in D.C. are permitted to ask for a doctor's note or other proof that the employee's reason for using the paid sick leave is valid, but only if the employee uses 3 or more consecutive days of paid sick leave.

Your organization may be required to comply with the minimum sick leave (and other employment laws) of other states if you have employees who work in them.

- **Family and Medical Leave:** The federal Family and Medical Leave Act (FMLA) is one of the few federal laws mandating leave for employees. However, the FMLA only applies to employers with 50 or more employees. D.C. (and most other state jurisdictions) has their own family and medical leave laws that apply to smaller employers. D.C.'s family and medical leave applies to employers with 20 or more employees. D.C. organizations with less than 20 employees are generally not subject to these laws (unless they have employees who work in a jurisdiction with more widely applicable protections).

FMLA gives certain employees the right to take certain amounts of unpaid, job-protected leave for specified family and medical reasons without interruption of their health care coverage during this period. Employees need not be paid for this leave, but the employees must be able to take the leave and return to their jobs without being terminated. FMLA requires employers with 50 or more employees to provide up to 12 work weeks of unpaid leave during a 12-month period for the following reasons:

- The birth of a child and to care for the newborn child within one year of birth;
- The placement with the employee of a child for adoption or foster care and to care for

  the newly placed child within one year of placement;
- To care for the employee's spouse, child, or parent who has a serious health condition; and/or,
- A serious health condition that makes the employee unable to perform the essential functions of his or her job.

# PART IV: EMPLOYMENT LAW BASICS

## 7. Federal and State Leave Laws

FMLA leave may be taken in large or small increments. An employee may take a couple hours or a half-day of leave, referred to as intermittent leave, rather than entire days or weeks.

To be eligible for FMLA rights, an employee must have worked for the employer for at least 12 months (the 12 months do not have to be consecutive) and worked for the employer for at least 1,250 hours during the 12 months immediately before the beginning of the FMLA leave.

Recent amendments to the FMLA require employers with 50 or more employees to provide up to 26 work weeks of unpaid leave during a 12-month period to care for family members who are or were in the military under certain circumstances.

D.C.'s family and medical leave law grants similar but more generous rights, requiring employers with 20 or more employees to provide up to 16 work weeks of unpaid "family leave" during any 24-month period, and up to 16 work weeks of unpaid "medical leave" during any 24-month period (for a total of up to 32 work weeks of unpaid leave during any 24-month period. Like FMLA, D.C.'s medical leave may be used for a serious health condition that makes the employee unable to perform the essential functions of his or her job, and D.C.'s family leave may be used for the following reasons:

- the birth of a child of the employee (within 12 months of the birth);
- the placement with the employee of a child for adoption or foster care (within 12 months of the placement);
- the placement of a child with the employee for whom the employee permanently assumes and discharges parental responsibility (within 12 months of the placement); and,
- to care for a family member of the employee who has a serious health condition.

As under federal law, D.C.'s medical and family leave may be used intermittently. To be eligible for D.C. family and medical leave rights, an employee must have: (1) worked for the employer for at least one (1) year without a break in service (except for regular holiday, sick, or personal leave); and, (2) worked for the employer for at least 1,000 hours during the 12 months immediately before the request for family or medical leave.

# PART IV: EMPLOYMENT LAW BASICS

## 7. Federal and State Leave Laws

- **D.C. Universal Paid Leave Act:** The District of Columbia Universal Paid Leave Act requires that employers pay a payroll tax in the amount of 0.62% of the wages of each of their covered employees, starting July 1, 2019. This tax gets paid into the Universal Paid Leave Implementation Fund, and qualifying employees are eligible to file claims for benefits to the D.C. Office of Paid Family Leave effective July 1, 2020. This system should function like unemployment benefits, is intended to supplement the paid sick leave benefits required under D.C. law, and provide a source of income for employees in circumstances that would entitle them to unpaid leave under D.C.'s family and medical leave law.

Like the D.C. family and medical leave law, employees can claim benefits for the following events:

- The birth of a child of an eligible individual;
- The placement of a child with an eligible individual for adoption or foster care;
- The placement of a child with an eligible individual for whom the eligible individual legally assumes and discharges parental responsibility;
- The diagnosis or occurrence of a serious health condition of an eligible individual; and
- The diagnosis or occurrence of a serious health condition of a family member of an eligible individual.

Benefits are calculated based on the employee's average weekly wage, up to a maximum benefit of $1,000 per week. Employees can receive 2 weeks of benefits for their own medical leave, 6 weeks of benefits to provide care for family leave, and 8 weeks of benefits for parental leave.

The program is administered by the D.C. government. The employer's responsibility includes paying the tax into the Universal Paid Leave Implementation Fund, submitting quarterly wage reports, and providing notice to employees regarding the program. More information about the program and the notice requirement can be found on the D.C. Department of Employment Services website: does.dc.gov/page/dc-paid-family-leave.

# PART IV: EMPLOYMENT LAW BASICS

## 7. Federal and State Leave Laws

- **Other Forms of Leave:** In D.C., employers must allow an employee who is a parent a total of 24 hours of unpaid leave during any 12-month period to attend or participate in a school-related event for his or her child. In D.C., an employee is entitled to take an unpaid day off on April 16th, the District of Columbia Emancipation Day. Both forms of leave require the employee to provide 10 days advance notice. However, the employee does not need to provide notice to take leave to attend a school event if the need for the leave cannot be reasonably foreseen. As these leave laws do not require the employee to be paid, the employee may choose to use an applicable form of paid leave if provided by the employer.

Employers must allow D.C. employees to take unpaid leave to respond to a jury summons or serve on a jury.

In D.C., an employer is required to provide reasonable daily unpaid break-time, as required by an employee so she may express breast milk for her child. The employer must make reasonable efforts to provide a sanitary room or other location close to the work area where the employee can express breast milk, other than a bathroom or toilet stall. This break time can run concurrently with another break time already provided to the employee.

Under a federal law called the Uniformed Services Employment and Reemployment Rights Act (USERRA), employers are required to provide unpaid leave of up to 5 cumulative years for military training and extended military service.

# PART IV: EMPLOYMENT LAW BASICS

## 8. Essential Elements of the Employee Handbook

Employment law is complicated, driven largely by having required policies in place, and closely following those policies in a non-discriminatory way. A well-drafted employee handbook is an essential document for any nonprofit that is not entirely operated by volunteers, especially if the organization has more than one or two employees.

The employee handbook should be tailored to fit your organization. Template documents are helpful, but it is crucial that each provision reflects the reality of how your organization operates. An organization's leadership and management must know the organization's employment policies inside and out, and make sure they are always operating in compliance with the employee handbook. Failure to follow the employee handbook is a recipe for disaster, especially in an area that presents as much litigation risk as employment law.

Key subjects that must be addressed in any employee handbook include:

- **A clear statement of at will employment:** the employee handbook must define at will employment. An employee can quit or be fired at any time, for any reason or no reason at all, unless there is a written employment agreement of some kind setting forth other terms for the particular employee. Without this clear statement, it can be much more difficult to terminate an employee who is not a good fit for the organization.

- **Vacation and sick leave policies consistent with applicable law:** the employee handbook must provide a clear and detailed explanation of the organization's paid and unpaid leave policies. It should address how vacation and sick leave is accrued, how much leave employees can use, the process for requesting leave, and how much unused leave carries over from year to year. This is especially important regarding vacation leave, which is considered a form of wages and must be paid out in cash to employees upon termination. Sick leave policies must provide at least the minimum paid leave required by law, and all forms of unpaid leave required by law must be described in a manner consistent with the applicable statutes.

- **A non-discrimination policy:** the employee handbook should state that the organization does not discriminate against employees and prospective employees based on the characteristics protected by law, and the handbook should list all of the protected characteristics under federal and applicable state law.

# PART IV: EMPLOYMENT LAW BASICS

## 8. Essential Elements of the Employee Handbook

- **An anti-harassment policy:** the employee handbook should include the key elements discussed earlier in the Primer. An anti-harassment policy provides the best possibility of avoiding liability for the harassing conduct of an organization's supervisors and managers.

- **A signature page acknowledging receipt of the handbook:** an employee handbook is useless if the employees are not made aware of it and the organization has no documentation showing that it was distributed to employees. All employee handbooks should have a page for each employee to sign, with language acknowledging that they have received a copy, that they have been given an opportunity to ask questions about the handbook, and that it is their responsibility to be familiar with its terms.

Most employee handbooks contain more than the key subjects listed above. Typically at least 20 pages, many are 50 to 100 pages or more, even for small organizations. The following are other provisions that are found in employee handbooks:

- **Code of conduct:** this section discusses the priorities of the organization in terms of ethics, punctuality, dress code, avoiding personal activities while at work, etc. It should reflect the actual priorities and expectations of the organization, and state that violations may result in disciplinary action, up to and including termination from employment.

- **Employee classification:** this section details the parameters for what is considered "full-time," "part-time," and (if applicable) "temporary" employment and discusses what effect this classification will have regarding eligibility for certain leave accrual and employee benefits. This section should also cover the distinction between exempt and non-exempt employees.

- **Expense reimbursement policies:** if the organization reimburses employees for properly incurred organization expenses, this section details the policy defining what types of expenses are reimbursable and under what circumstances, noting any limits (such as stating that first class air fare will not be reimbursed), and the process for submitting requests for reimbursement (i.e. including a requirement that the employee submit receipts, invoices, and other necessary substantiation).

# PART IV: EMPLOYMENT LAW BASICS

## 8. Essential Elements of the Employee Handbook

- **Work schedules and overtime:** this section addresses when the work week begins and ends (which is necessary for figuring out when a non-exempt employee must be paid for overtime), when employees are expected to show up and go home, the process for authorizing overtime work (for non-exempt employees), and any policies regarding working from home (i.e. who is allowed to do it, how working from home is authorized, and what is expected from employees who work from home.)

- **Confidentiality:** this section defines any non-disclosure policy for sensitive information of the organization, although it is preferable (and more enforceable) to address this in a separate contract signed by the employee and employer.

- **Social media:** this section defines the use of social media by employees both inside and outside the office. While there is a delicate balance between respecting an employee's personal activities and ensuring the protection of an employer's reputation and sensitive information, most social media policies remind employees that they cannot use social media to engage in prohibited harassment, disclose confidential or sensitive information of the employer, speak on behalf of the employer without proper authorization, or use personal social media during work hours. These policies also address the proper use of the employer's official social media accounts.

# PART V: OTHER RISK MANAGEMENT CONSIDERATIONS

## 1. Introduction

This Primer has covered basic tax rules governing 501(c)(3) organizations, state nonprofit corporations and tax rules, fundraising rules, and employment law. These areas represent core principles and rules that comprise the field of nonprofit law and are basics with which all nonprofit organizations should have familiarity.

There are many more legal issues and risks that nonprofits will confront during their day-to-day operations. While this Primer cannot cover all these areas in depth, this final section will briefly highlight a few areas that warrant further study and consideration.

## 2. Insurance Coverage

No organization is perfect. Mistakes, internal disagreements and bad luck can happen. There is no educational resource or expert legal advice that can protect your organization from every risk of financial loss or legal liability - which is why insurance is such an important part of risk management and financial sustainability.

In most cases, an organization should have comprehensive general liability insurance policy and a directors & officers (D&O) insurance policy. The general liability policy covers personal injury, property damage and other liability risks, and the D&O policy protects organization leaders for actions taken in their official capacity on behalf of the organization. If an organization has employees, it should have employment practices liability insurance that covers employment actions such as employee terminations. Health organizations may need more specialized types of insurance, such as errors & omissions (E&O) insurance and information security and privacy insurance. "Umbrella" insurance provides extra liability coverage that goes beyond the limits of your other insurance policies.

There is a form of insurance coverage for every type of nonprofit or business activity. The organization must balance the risk and cost and choose the amount of coverage that makes the most sense. A good insurance broker can be immensely helpful in assessing your needs and finding the right policies and coverage level for your organization, as well as being an excellent source of free, practical advice when questions and issues arise. Organizations should consider scheduling annual insurance review meetings with their broker to discuss potential changes to operations and the risk environment.

# PART V: OTHER RISK MANAGEMENT CONSIDERATIONS

## 3. Liability Waivers

Organizations that use volunteers and/or interact frequently with the general public to provide their services should use liability waivers, also known as "releases," whenever possible. A liability waiver is a contract that states the individual is participating with the organization (as a volunteer or a service recipient, as applicable) willingly and with informed consent as to the risks, and thereby releases the organization from liability for personal injury or property damage in exchange for this participation. Volunteer agreements can also state that the individual understands and agrees that he/she is serving in a volunteer capacity only with no expectation of compensation.

Organizations that film and/or photograph their activities or events should similarly obtain a signed consent to be filmed and/or photographed, and a release from liability for posting or publishing the individual's name and "likeness" on the organization's website and other materials.

These can be one-page agreements, although the precise language and content will vary based on the circumstances. Depending on the organization's activities and services, the law may not provide the total protection envisioned by these liability waivers but having signed liability waivers on file is better than not. You should seek legal counsel if your organization engages in inherently risky activities.

# PART V: OTHER RISK MANAGEMENT CONSIDERATIONS

## 4. Intellectual Property

Intellectual property law is complicated, so an organization needs to make sure: (1) that it is not using another person or organization's creative works (writing, photography, video, etc.) and trademarks (name, logo, etc.) without their permission; and (2) that the organization is adequately protecting its ownership of its own creative works and trademarks.

Organizations must be careful not to use photos, artwork, videos, found on the internet unless there is a "license" for such use (i.e. an email granting permission can suffice in many cases, though a formal license agreement is preferable when possible). Doing so without a license can be copyright infringement. There are numerous resources online for legally obtaining and using stock photos, artwork, and videos, often for no charge. However, you should always make sure that your use of these materials is consistent with the scope of the license provided.

The same considerations apply when using the name or logo of another organization or business. Doing so without permission to use these trademarks can result in trademark infringement, even if the trademark is not registered.

Regarding an organization's own copyrights and trademarks, there are a couple main areas of focus including:

- Having properly established that it owns the copyrights to work that the organization has created (or paid someone to create for it). The confusion most often arises in an independent contractor context. Organizations should execute "work for hire" agreements with independent contractors who are hired to provide written work, photos, video, or other creative work to the organization. These agreements should be executed prior to the commencement of the work. If the independent contractor will not agree to standard "work for hire" language, the organization should at least obtain an unrestricted license to use the work product for all purposes of the organization.

- Take steps to protect organizations' own name, logo, and other trademarks. You should consult an intellectual property attorney to discuss whether your organization should file a trademark registration for its name and logo, and get help navigating this process. Once registered, an organization has a responsibility to actively protect its trademarks, by keeping an eye out for unauthorized use and seeking to stop any unauthorized use when it is found.

# PART V: OTHER RISK MANAGEMENT CONSIDERATIONS

## 5. Privacy

Privacy law is another complex and rapidly evolving area of the law. It deals with how an organization obtains and uses the personally identifiable information of individuals (names, email addresses, location information, phone numbers, health information, etc.).

Health organizations may be subject to the Health Insurance Portability and Accountability Act (HIPAA) and state medical privacy laws. These laws are strict and require confidentiality of health and medical information with disclosure permitted in extremely limited circumstances. You should seek legal counsel if your organization may be subject to these laws.

Outside of HIPAA and state medical privacy laws, there are currently limited privacy protections under federal law in the U.S., with much of the law currently being driven by the states (California, in particular). These laws are aimed at personally identifiable information that is collected over the internet (for example, through an organization's website, email and donor lists, social media accounts, etc.). This area of law changes frequently, and organizations should keep an eye on updates that could affect how the organization collects and uses personally identifiable information.

The most significant legislation currently includes the federal Children's Online Privacy Protection Act (COPPA) and the California Consumer Privacy Act (CCPA). COPPA prohibits the collection of personal information on the internet from minors under age 13 without parental consent. CCPA grants individuals a right to request or delete personal information that has been collected, as well as a right to opt out of having their personal information sold to another company or organization, among other protections. Other states have recently enacted legislation like California's, and because internet communications can be accessed across the entire country, organizations must make sure they are compliant with the most protective state privacy law.

Organizations that interact online with people in the European Union must take steps to ensure that they comply with the E.U.'s General Data Protection Regulation (GDPR), which is currently the most expansive data privacy law worldwide.

The first and most basic step to complying with these privacy laws is to post a "privacy policy" and/or "terms of use" page on your organization's website, with language that complies with the applicable privacy laws. Examples of privacy policies and terms of use are abundant, as these can be viewed on the websites of virtually every major organization and company. However, it is highly recommended to seek legal counsel to make sure your privacy policy and terms of use are up to date and aligned with your organization's actual practices.

## THE EFFI BARRY TRAINING INSTITUTE

The Effi Barry Training Institute provides trainings and technical assistance to support current and prospective HAHSTA grantees and community-based organizations in the Fee-for-Service business process; basic HIV service competencies; advanced skills in health care systems, data and health informatics; high-impact prevention programs, including biomedical; and emerging evidence-based or informed approaches through a series of group-level trainings, boot camps, community forums, and individual consultation.

Rooted in the idea of holistic, integrated, patient-centered care, HealthHIV capacity building efforts help develop an organization's ability to improve patient outcomes and increase efficiencies, while remaining organizationally sustainable. The agency's unique approach involves structuring sustainable systems and services that span the HIV care continuum. HealthHIV's ability to diagnose and address multisystem challenges is enhanced by a comprehensive team of expert consultants and focuses on achieving measurable outcomes. By remaining data and outcomes driven, HealthHIV employs state-of-the-art, and state-of-the-sciences approaches to improve health care delivery.

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