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Colorado and federal rules to run a 501(c)(3) organization

The Articles of Incorporation for «Corporation» were filed with the Secretary of State on ______. Accordingly, the organization is in existence as of that date.

Whenever you have legal, tax, or accounting questions, please review this letter first.

Phone: 970-927-1200

If maintained, this binder will contain all of the historical legal and tax information you will need to keep over the years and provide for inspection by the public. I recommend that you place all correspondence from me behind the *Minutes* tab, and that you place all correspondence with the Secretary of State, including the corporate reports due every year, behind the *Sec. of State Correspondence* tab. I also recommend that you keep a copy of the three most recent annual nonprofit income tax returns in this binder behind the tab titled *IRS Form 990*.

Now that your business is incorporated, certain rules have to be followed. Below is a checklist of steps to be taken and rules to be followed:

- 1. <u>Nonprofit Meetings</u>. It is important that the nonprofit schedule an annual director meeting. At the director meeting, the Board of Directors and officers are elected. Matters that are not in the ordinary course of business, such as acquiring a major asset or borrowing a significant sum of money, should be voted on by the Board of Directors and recorded in the minute book. Also, if anything extraordinary happens during the year, a special director meeting should be held. The minutes of the meeting should be included in the nonprofit minute book. Enclosed behind the *Minutes* tab are blank forms for minutes for the annual and special meetings of shareholders and directors. Please call me for questions regarding what should be placed in the minutes.
- 2. <u>Identification Number</u>. The tax employer identification number is «Tax_ID_Number».
- 3. <u>Board Votes and Minutes</u>. Each Director vote should be on a single page, including the following information (see the sample form behind the *Minutes* tab). Only the following are required to be recorded in the minutes:
 - a. Who made and seconded the motion.
 - b. What the motion was, as amended.

- c. Whether a quorum was present and, if so, what the vote was.
- d. If a board member requests that his dissent and reasons therefor be recorded, then the minutes should reflect that as well.

Extensive meeting minutes regarding the board discussion (who said what) preceding the vote is often unnecessary. It may be counterproductive since it makes perusing old minutes very time consuming. However, on sensitive matters, such as a discussion about a board member's potential conflict of interest, the minutes should include more detail about the board discussions, and dissenting votes.

A useful practice is to keep all minutes in the same electronic file. If all minutes are kept in the same computer document, they are easily searched in the future.

The bylaws require that board members must disclose any conflict of interest they have with board activity; after disclosure, the board member cannot vote on the issue.

- 4. <u>Worker's Compensation</u>. The nonprofit is required to provide workers' compensation coverage for any employee you hire. You may contact the Nonprofit's insurer, your personal insurer or the State Compensation Insurance Authority at 303-368-5757 for information about workers compensation insurance.
- 5. <u>Unemployment Insurance: 501(c)(4) organizations</u>: Organizations exempt from income taxation under IRC § 501(c)(4) are required to pay federal unemployment tax (FUTA) unless their exemption letter states otherwise. They are always required to pay Colorado unemployment tax. Coverage should be obtained for the employees of the nonprofit at the following maximum rates; the unemployment insurance tax form which you complete will specify the rate you should pay per employee. The Colorado rate will gradually decrease if your employees make no unemployment claims over the years.

	Employee Wages Subject	Maximum Tax/	
	to Unemployment Tax	Tax Rate	Employee/Year
Federal	\$7,000	.8%	\$56
Colorado	\$10,000	3.0% - 11.2%	\$1,120

These forms will be sent to you if you notify the Colorado Department of Revenue that you have employees by completing form CR 100, *Colorado Business Registration*. If you have questions about Colorado unemployment insurance, contact the Colorado Department of Labor at 303-318-9055.

6. <u>Unemployment Insurance: 501(c)(3) organizations</u>: Organizations exempt from income tax under IRC § 501(c)(3) are also exempt from federal unemployment tax (FUTA). They must only pay Colorado unemployment tax if they have four or more employees employed for 20 weeks or more during the calendar year. This includes both part- and full-time employees. Colorado nonprofits can opt in and pay unemployment taxes to be covered by Colorado's unemployment tax system, or they can opt out and elect to provide their own coverage (known as a Reimbursable Employer,

since the nonprofit reimburses the Colorado Unemployment Department for unemployment benefits paid). These rules are reproduced below, but they only apply to you if you have at least 4 employees with salaries from which you withhold payroll taxes.

Reimbursable Employer. If the nonprofit chooses to self-insure, it does not have to pay any Colorado unemployment tax. This would make sense for a nonprofit that believes it is unlikely it will ever pay out a claim. But, the nonprofit must then pay the entire unemployment insurance benefit payable to laid-off employees for the first 26 weeks they are unemployed. The maximum amount due to an employee is 1/3 of the annual salary; this one-third-of-salary-amount is actually paid out over 26 weeks, so the actual amount paid equals 2/3 of the weekly salary, paid out for 26 weeks. For example, if the employee was receiving \$52,000 per year, or \$1,000 per week, the Reimbursable Employer would pay \$666.66 a week for 26 weeks to the laid off employee (\$17,333.33 total). If the employee is still unemployed, he can then obtain federal unemployment benefits for an additional 47 weeks; the nonprofit is not responsible to pay any of these federal unemployment benefits. If he is still unemployed after 73 weeks, the employee can come back and receive Colorado Unemployment income for 20 more weeks, and the nonprofit will again be liable for benefits paid.

The nonprofit must pay a bond to cover any potential unemployment liability to the Colorado Unemployment Department if it chooses to be a Reimbursable Employer. The bond is held by the Colorado Unemployment Department, and it is recalculated every 2 years. The nonprofit can elect to be a Reimbursable Employer by notifying the Colorado Unemployment Department within 30 days after it first registers as an employer with the Colorado Unemployment Department. If the nonprofit first opts to pay unemployment tax to the Colorado Unemployment Department, it can become a Reimbursable Employer 2 years later. After making this switch, the nonprofit is still liable for any unemployment benefits paid to employees for the next 3 years if they worked for the nonprofit while it was a Reimbursable Employer. The nonprofit must notify the Colorado Unemployment Department by December 1 each year if it wishes to switch its status from Taxed Employer to Reimbursable Employer, or vice versa. The switch will be effective 30 days later, on January 1.

8. Taxed Employer – i.e., opt for coverage under Colorado Unemployment Insurance. If employers opt in to be covered by Colorado Unemployment Insurance, the amount due depends on the rate set by the Colorado Department of Unemployment. The unemployment insurance tax rate depends on the prior rate paid by the employer, the number of employees who have made claims for unemployment insurance, the current economic climate and the Colorado unemployment rate. The Colorado rate will gradually decrease if your employees make no unemployment claims over the years. The table below indicates the maximum that can be paid per employee.

	Employee Wages Subject		Maximum Tax/	
	to Unemployment Tax	Tax Rate	Employee/Year	
Colorado	\$10,000	3.0% to 11.2%	\$1,120	

Unemployment insurance forms will be sent to you if you notify the Colorado Department of Revenue that you have employees by completing form CR 100, *Colorado Business Registration*. If you have questions about Colorado unemployment insurance, or wish to opt in for Reimbursable Coverage, contact the Colorado Department of Labor at 303-318-9055.

9. Periodic Report. A periodic report must be filed electronically with the Secretary of State (http://www.sos.state.co.us/pubs/business/businessHome.html) each year on the LLC anniversary date («AOI_Filing_Date»). The report may be filed anytime from 60 days before the anniversary date until the last day of the second month following the anniversary date for a \$10 fee. (i.e., the LLC must file its first annual report by ______ 30, 201____; the annual report must be filed by the end of ______ each year thereafter). If the report is filed after that date, but before the end of the fifth month following the anniversary date, the LLC is considered noncompliant and the fee increases to \$50. If the report is still not filed after the end of the fifth month following the anniversary date, the LLC becomes delinquent and is considered by the Secretary of State to be no longer in existence. If you have any questions, you can contact the Secretary of State at 700 Broadway, Suite 200, Denver, Colorado 80290; 303-894-2200.

Ken Ransford is not responsible for filing the Periodic Report with the Colorado Secretary of State each year. Please enter the renewal date on your calendar and sign up for email notifications at the Secretary of State website to ensure that your LLC stays in compliance. If you wish to have Ken Ransford file the periodic report, the charge will be \$100.

- 10. Officers' Salaries. Directors must establish officer salaries, and the officers and other employees must fill out Form W-4 authorizing the nonprofit to withhold taxes on wages. If you plan to pay a salary to any substantial contributor, please contact me first. IRS rules require that such salaries be reasonable. Bylaws Appendix A describes national compensation survey information (approximately \$100,000 for executive directors and \$65,000 for other officers such as development directors). If the nonprofit's salaries are below these amounts, they are deemed to be competitive.
- 11. <u>Nonprofit Expenses You Pay Personally</u>. If you pay for nonprofit expenses with your personal funds, and vice versa, you must account properly for these transactions. The correct accounting for these transactions is outlined below:

Whenever you pay a *nonprofit expense* with personal funds, the correct accounting entry to record this is:

Debit: Nonprofit expense account.

Credit: Due to officer account.

If the nonprofit ever pays for your *personal expenses* (not recommended), the correct accounting entry to record this is:

Debit: Due to officer account.

Credit: *Cash* account (or credit card payable).

If you are classified as a private foundation, the IRS has stiff penalties if the nonprofit pays personal expenses of its directors, officers, or employees, or if there are loans between them. For that reason, I recommend that this be done sparingly, and preferably not at all. The nonprofit is automatically deemed to be a public charity for the first 5 years of its existence, so it will not be a private foundation until year 6 at the earliest. The IRS will notify you before classifying you as a private foundation.

- 12. <u>Accounting</u>. I recommend that you purchase Quickbooks Pro, Premier Non-Profit Edition, for Windows to manage your accounting. I can recommend a consultant who can set up your initial accounts, and even do your monthly accounting if necessary. Most CPAs use this program, and can therefore load your account onto their computer for purposes of making year-end accounting entries to prepare your income tax returns. This program costs about \$400, or less if you purchase it on Ebay. You don't need to purchase the payroll tax module unless you plan to do your own payroll tax accounting.
- 13. <u>Insurance</u>. Notify all pertinent insurance agents so that insurance policies are issued in the name of the nonprofit.
- 14. <u>Collecting Sales Tax</u>. Colorado imposes a sales tax on all sales and purchases of tangible personal property. Your accountant can advise you of the Colorado and "Corporation_City" sales tax rules as they apply to you. **Unless you sell products, you are not currently liable to withhold sales taxes**. You may be liable for local use tax on products you purchase for or consume in your business if you haven't already paid sales tax on these items. Please call if you have any questions about this.
- 15. Exemption from Sales Tax. When the IRS issues you a determination letter setting forth that you are tax exempt, this determination letter may enable you to avoid paying Colorado or local sales and use tax on products you purchase if you file for a tax exemption with the appropriate authorities. It is not worthwhile to apply for this exemption unless you purchase a lot of products; in your case, it is not worth it to apply for this. The IRS determination letter alone will not exempt you from state or local sales taxes; you must take further steps to secure the exemption. To be considered for the exemption from sales tax within the state of Colorado, you must file Colorado form DR 0715. This form is available at https://www.colorado.gov/pacific/sites/default/files/DR0715.pdf After completing it, you need to attach a copy of your Certificate of Good Standing and Articles of Incorporation (which are filed behind the Articles of Incorporation tab in your binder), the IRS Determination Letter, and a copy of a current profit and loss statement and balance sheet. To be exempt from city or local sales taxes, you must complete a similar application provided by that city or locality. Your accountant or I can help you further with this if you have any questions.

- 16. Corporate Seal Not Required. A seal was once required for a corporation to transfer real estate in Colorado but this is no longer true. The seal is unnecessary for any purpose. The Nonprofit must record the Articles of Incorporation and any amendments thereto in any county where real estate owned by the Nonprofit is located if the Articles of Incorporation limit how the real estate can be used or conveyed, pursuant to Section 38-30-144(3), Colorado Revised Statutes.
- 17. Real Estate Property Tax Exemption. If the Nonprofit owns real estate and uses it for its exempt purpose, it should apply for a real estate tax exemption. The IRS determination letter alone will not exempt you from Colorado real estate property taxes; you file Colorado DOR Form 901-A to secure the exemption. This form is available at: https://www.colorado.gov/pacific/sites/default/files/atoms/files/Schools%20%26%20Cha ritable%20Application%20Form 0.pdf. The Nonprofit should send a copy of its articles of incorporation and a recent financial statement together with form 901-A to the local County Treasurer, who will then forward the application to the State of Colorado. In general, "property, real and personal, which is owned and used solely and exclusively for strictly charitable purposes and not for private gain or corporate profit" will qualify for a real property tax exemption; see CRS Section 39-3-109(a)(1) for residential properties, and CRS Section 39-3-116(1) for commercial properties. This is broad enough to include property owned by nearly every IRC Section 501(c)(3) organization. However, if the Nonprofit rents out space in a building that it owns, it generally cannot qualify for a real property tax exemption even if the tenant is a nonprofit; the only exception to this is if the rent is for \$1 plus the tenant's share of the building expenses. The Nonprofit will not qualify for a real property tax exemption if it requires the tenant to reimburse it for the cost of servicing loan principal on the property, or to reimburse it for depreciation on the building. See CRS Section 39-3-116(2)(c).
- 18. <u>Announcements</u>. The nonprofit should hold itself out to the public as a corporation, and the following should contain the nonprofit's full name:
 - a. Letterhead and statements.
 - b. Professional cards.
 - c. Telephone and similar listings.

Any officer or employee who signs a document on behalf of the nonprofit should indicate the signer's capacity as an officer or employee and that the document is signed on behalf of the nonprofit, as follows:

Signed: «President», President, «Corporation»

19. <u>Bank Account</u>. A bank account should be established in the nonprofit's name and signature cards should be signed by the appropriate nonprofit officials in their corporate capacities, i.e., «President», President. The bank will ask for the nonprofit's tax identification number and also a copy of the Certificate of Good Standing available from the Colorado Secretary of State's website before opening a nonprofit bank account.

20. Payroll Tax Reporting. If you hire employees you must file employee payroll tax returns. At least fifteen separate returns are required throughout the year; for this reason, I encourage you to contact Automatic Data Processing or Paychex, or another payroll accountant. These payroll tax processing services can process all of these tax returns for a single employee for about \$100 per month. Or, if your Quickbooks accountant is experienced, you can use Quickbooks payroll service to produce these reports and avoid this monthly expense.

21. Should nonprofit workers be classified as employees or independent contractors?

- a. The IRS generally favors employees over independent contractors, since that means payroll taxes will be withheld, while independent contractors may fail to pay their tax liabilities.
- b. Employee payroll tax reporting is complicated, and nearly 20 different forms must be filed each year to report withheld payroll taxes. It is also expensive Paychex and ADP charge about \$1,200 a year to file quarterly and annual payroll tax returns for a single employee.
- c. If an employer treats a person as an independent contractor and the IRS says they should have treated the person as an employee, the employer won't be penalized more than a de minimis amount if the employer sends the employee and the IRS a 1099-MISC statement to report the amount paid. This is required if total payments in a year are \$600 or more. So, even if the IRS disagrees with the practice of treating a person as an independent contractor, there's a minimal penalty for doing so as long as the 1099-MISC is sent out.
- d. An independent contractor who is injured on the job can claim that the employer should have considered the worker as an employee, and that the employer should have had workers compensation insurance. If the court agrees, the nonprofit would be liable for injuries incurred by the worker while on the job. It would probably be difficult to hold a volunteer director liable for the worker's injuries as long as the director did not cause the injury. However, the nonprofit could be held liable. Most lawsuits against nonprofits are by disgruntled employees.
 - To protect itself, the nonprofit should require that independent contractors purchase health insurance that covers them in the event they are injured while performing nonprofit business. The independent contractor should provide proof annually that the insurance is current.
- e. Ironically, if a nonprofit treats a worker as an employee, and if a volunteer director acts as a treasurer and signs the checks, the IRS can hold the treasurer personally liable if the withheld payroll taxes aren't paid to the IRS. So, there's a conflict between Colorado law, whose volunteer immunity statutes hold that volunteer directors are not liable for debts of the nonprofit, and IRS law, which holds that the person responsible for withholding payroll taxes is personally liable if the withheld taxes are not paid to the IRS. I don't know how this would turn out, but there's a

significant risk the IRS would win. This risk is avoided if independent contractors are used, since independent contractors are required to pay estimated taxes to the IRS.

- f. So, to summarize, by treating a worker as an independent contractor:
 - 1. There's a minimal IRS penalty if a 1099-MISC is sent to the IRS and the worker.
 - 2. The worker could claim s/he should have been covered by workers compensation if s/he is injured on the job.
 - 3. The director probably isn't liable, but the nonprofit would be if the worker convinces the court that s/he was really an employee.
 - 4. The nonprofit could protect itself by requiring the worker to prove that s/he has obtained workers compensation coverage so that s/he will be covered if injured while performing services for the nonprofit.
- g. To summarize treating a worker as an employee:
 - 1. The nonprofit must obtain workers compensation coverage or else the worker can sue the employer for injuries suffered on the job.
 - 2. A volunteer director can be liable for failure to pay over payroll taxes to the IRS.
- h. Whether a person is an independent contractor or an employee depends on about 15 different factors, but Colorado courts will likely honor an independent contractor characterization if the steps in the following paragraph are taken.
- 22. <u>Colorado statutory requirements for independent contractors</u>. Colorado courts will likely hold than an independent contractor relationship exists if the contract contains the following provisions, which are set forth in CRS 8-40-202(2).
 - a. Provisions demonstrating independent contractor status. Pursuant to CRS Section 8-40-202(2), the parties intend that an independent contractor relationship be established rather than an employment relationship. The Nonprofit agrees that the Contractor is free to determine the mode and manner of work performed under this contract. The Nonprofit agrees that the Contractor shall perform the services called for here according to the following rules.
 - b. <u>Freedom to contract for work elsewhere</u>. The Nonprofit may not require the Contractor to work exclusively for the Nonprofit, except that the Contractor may choose to work exclusively for the Nonprofit for a finite period of time.
 - c. <u>Establish a quality standard</u>. The Nonprofit may not establish a quality standard for the Contractor; except that the Nonprofit may provide plans and specifications regarding the work, provided that the Nonprofit does not oversee the actual work or instruct the Contractor as to how the work will be performed.
 - d. No salary. The Nonprofit shall pay a fixed or contract rate, which can be on an hourly basis. The Nonprofit shall not withhold payroll taxes.

- e. <u>Termination</u>. The Nonprofit may not terminate the work of the Contractor during the contract period unless the Contractor violates the terms of the contract or fails to produce a result that meets the specifications of the contract.
- f. <u>Training.</u> The Nonprofit shall not provide more than minimal training for the Contractor.
- g. <u>Provision of tools and equipment.</u> The Nonprofit shall not provide tools or benefits to the Contractor; except that materials and equipment may be supplied, and computer equipment at the Nonprofit's place of business may be supplied if that would be more efficient for the parties.
- h. <u>Dictate the time of performance</u>. The Nonprofit may not dictate the time of performance; except that a completion schedule and a range of negotiated and mutually agreeable work hours may be established.
- i. <u>Payment to independent contractor's business</u>. The Nonprofit shall make checks payable to the trade or business name established by the Contractor rather than paying the Contractor personally.
- j. <u>Combine businesses</u>. The Contractor may not combine its own business operations with those of the Nonprofit; rather, Contractor shall maintain all such operations separate and distinct.
- 23. <u>Volunteer Directors May Be Liable for Payroll Taxes</u>. The IRS holds that a volunteer member of the board of directors is liable for payroll taxes that were withheld from employees but not remitted to the IRS, if the volunteer director is in a position to control the disbursement of funds. The Seventh Circuit Court of Appeals agreed; see *Jefferson v. United States*, No. 06-4082 (7th Cir. 10/8/08).
- 24. <u>Internal Control</u>. In order to protect your finances, you should segregate the following activities so that they are handled by separate persons:
 - a. Writing checks,
 - b. Bookkeeping,
 - c. Reviewing bank statements, deposits and canceled checks.

If a single person performed all of these functions you would not know, for example, whether that person is writing checks to himself. Whenever possible, these activities should be handled by separate persons. If that is impractical, arrange to have your bank mail the canceled checks and bank statements directly to a person who is not responsible for writing checks or keeping the books. If a director who is not involved in bookkeeping or writing checks and making deposits reviews the canceled checks and statements monthly, the risk of embezzlement can be cut significantly.

Similarly, a single person should not be responsible for opening the mail, collecting contributions and making bank deposits. To the extent possible, those functions should be handled by separate persons.

This letter is not meant to take the place of an internal control analysis performed by a Certified Public Accountant, but is instead intended to alert you to potential problems which can arise if you place too much responsibility with a single person. Please contact me or another professional if you have any questions.

- 25. Charitable Contributions. The IRS requires that you send a written confirmation of any contribution over \$250 to the donor by April 15 of the year following the gift. If you give the donor any item of value over \$10 such as a meal, you must report the value of this to the donor. The IRS also requires that you keep track of individual contributions which exceed 2% of the total revenue of the Nonprofit for the current tax year and the four prior tax years. By accounting separately by donor for every contribution you receive in QuickBooks, you will capture the information necessary to make this determination. Once the IRS sends a determination letter setting forth that you are tax exempt, donors may safely claim tax deductions for contributions to you. This is retroactive to the date you incorporated, unless you incorporated more than 27 months before you mailed your 1023 application to the IRS; in that case, donors may only claim tax deductions for contributions made on or after the date you mailed your 1023 application to the IRS.
- 26. <u>Donor Acknowledgment</u>. You may use the following letter as a guide for your donor acknowledgment letter.

Dear Donor,

Thank you for your contribution of \$______. You received no items of value from the ABC Charity, so 100% of your gift is tax deductible.

Or: Thank you for your contribution of \$______. You received \$______ value from the ABC Charity, so you should not deduct this portion of your contribution. (The nonprofit must report any gifts to donors that exceed \$10 (such as a meal at a donor appreciation dinner) so the donor does not deduct this amount of the charitable contribution.)

The ABC Charity is a tax exempt public charity under IRC Section 501(c)(3). Donations to the organization are unrestricted, which means the ABC Charity may use the donation for its general purposes unless the donor restricts the use of the donation.

Thank you for your contribution.

Sincerely yours,

27. <u>Income Tax Filing Requirements</u>. The Nonprofit may have to file an annual income tax return, form 990, according to the following rules.

Executive Director

There are 3 separate IRS 990 forms; below is a table which indicates the form you should file.

Income under \$50,000	\$50,000 to \$200,000 income	Income over \$200,000
IRS Form 990-N	IRS Form 990-EZ	IRS Form 990

IRS Form 990-N: Income under \$50,000. If annual gross receipts are normally less than \$50,000, the Nonprofit may file form 990-N. Income is *normally less* than \$50,000 if in the first year the Nonprofit receives \$75,000 or if in the first two years it receives \$120,000. If the Nonprofit receives less than these amounts in the first 2 years, it can file form 990-N. Beginning in year 3, if the Nonprofit ever receives \$50,000 or more, it must file either form 990-EZ or form 990.

Additional schedules. If you are required to file either form 990-EZ or 990, you must also file Schedule A. If you receive more than \$5,000 from a single contributor, you must file Schedule B. You may also need to file the other schedules listed below:

Schedule A: Sources of income to determine public charity or private foundation status

Schedule B: Names and addresses of donors contributing \$5,000 or more

Schedule C: Political lobbying activities

Schedule E: School activities

Schedule G: Fundraising and gaming activities

Schedule L: Transactions with interested persons

Schedule N: Liquidation and dissolution of assets.

The tax returns are due May 15 for calendar year nonprofits, and may be extended on IRS Form 8868 until August 15, and for a second time until November 15. The return is mailed to the IRS, Ogden, UT 84201-0027.

<u>Colorado tax returns.</u> Unless income tax is due on Form 990 or Form 990T, the Nonprofit is not required to file a Colorado income tax return. Form 990T is used to report taxable income from a business that is regularly carried on and that is unrelated to the exempt organization's exempt purpose; very few nonprofits file this form. Private foundations, however, are required to file a copy of their 990-PF return with the Colorado Attorney General, 1525 Sherman, Fifth Floor, Attn: Library, Denver, CO 80203, telephone 303-866-4500.

Although Colorado *income tax returns* are not required for most nonprofits, the Nonprofit must still file an annual report online by May 15 every year with the Colorado Secretary of State as described below.

There are other tax forms which may need to be filed; consult a tax professional for the filing requirements for your specific organization.

28. <u>How to file IRS Form 990-N</u>. If the Nonprofit normally has under \$50,000 gross receipts, it still has to file IRS Form 990-N, which is a simple form that indicates the name and address of the organization and its principal officer, and also alerts the IRS that the

Nonprofit still exists. If the Nonprofit does not file this form, it will lose its tax exempt status, so the penalty is quite severe. To file this form, go to http://epostcard.form990.org. First, create a password; the user name will automatically be the federal tax EIN for the nonprofit. Then, follow the instructions and complete the information for form 990 N. Be sure to remember the password!

29. <u>Prohibited Acts for Private Foundations</u>. *Public charities* are organizations which receive at least one-third of their support from charitable contributions from the public or from grants from other public charities or the government, or from fees for admission or services rendered. *Private foundations*, on the other hand, tend to receive most of their income from a few individuals. The nonprofit will be treated as a private foundation after the first 5 years of its existence if over 90% of its income comes from a few individuals or private foundations.

If the nonprofit is deemed to be a private foundation, the following acts are prohibited:

- a. Private foundations cannot intervene in political campaigns at all, either for or against a candidate or an initiative. However, private foundations can make grants to public charities that lobby, as long as the private foundation's grants are less than the public charity's non-lobbying expenditures.
- b. Disqualified persons are prohibited from the following acts of self-dealing with the nonprofit (disqualified persons include founders, officers, and directors of the nonprofit, as well as donors who give more than \$5,000 to the nonprofit):
 - i. Loaning money, other than an interest-free loan from the donor to the nonprofit.
 - ii. The sale, exchange, or lease of property.
 - iii. The transfer of income or property to a donor for his benefit or the benefit of a disqualified person (i.e., the donor's spouse, parents, children, or related entities).
 - iv. Furnishing services to disqualified persons.
 - v. Paying compensation to a disqualified person, unless the amount is not excessive and the services are reasonable and necessary for carrying out the nonprofit's purposes.
 - vi. The transfer of mortgaged property to the nonprofit.

A very stiff penalty tax is imposed on the disqualified person and manager of the nonprofit for violating any of these provisions *if the nonprofit is deemed to be a private foundation*. The IRS will notify you if you are deemed to be a private foundation.

c. If you wish to make grants to individuals, other private foundations, or to foreign organizations, you must exercise expenditure responsibility, as explained further below.

- 30. Open Records Act. IRS rules require that you provide copies of your three most recent form 990 or 990-EZ income tax returns and your IRS form 1023 application at any time to the public upon reasonable request. Copies must be immediately available for inspection upon a request made in person, and copies must be mailed within 30 days of a written request. You may delete or black out sensitive information, such as officer salaries or the names and addresses of donors. Nonprofit corporations can charge a reasonable fee such as 25 cents a page for making copies. You are not obligated to provide this information if you believe the request is part of a concerted effort to harass you. The IRS defines harassment as repeated and multiple requests for the same information, such as by numerous members of an opposition group. If a person opposed to your organization requests information from you, you must provide it unless you are convinced the request is solely meant to slow you down or to prevent you from doing any meaningful work.
- Almost all charities that are required to file form 990 and 990-EZ and also solicit funds in Colorado are required to register annually with the Colorado Secretary of State. To register, click on this link: http://www.sos.state.co.us/ccsa/AcctCO.do . The annual registration fee is \$10. Charities are also required to file select information from their most recent IRS form 990 with the Secretary of State; to do so, please click on this link: http://efile.form990.org. The information is due at the same time IRS Form 990 is required to be filed (May 15 for the previous calendar year for organizations whose tax year ends December 31). If the charity extends the due date for filing form 990 or 990-EZ with the IRS, the charity must also extend the due date with the Secretary of State. Do not mail a copy of IRS Form 990 to the Secretary of State; rather, this information must be filed electronically.

Almost every charity must register. A charitable organization is defined broadly to include any person who in any manner makes a charitable appeal. The only charities excepted from this rule are religious organizations, certain educational institutions, political organizations, and charities that either (1) have under \$25,000 gross receipts in a year, excluding grants, or (2) receive contributions from fewer than 10 persons per year.

- 32. <u>Charitable Solicitation by Paid Solicitors</u>. If you plan to hire *paid* solicitors to raise money for your organization, Colorado Revised Statute § 6-16-104 requires that you file with the Secretary of State *prior to commencement of the campaign* a solicitation notice containing the information listed below. Paid solicitors do not include lawyers or financial professionals who advise a person to make a charitable contribution; a person whose sole responsibility is to print or mail fund-raising literature; a bona fide volunteer; or a director, officer or compensated employee of the Nonprofit, such as the development director. The following information must be sent to the Secretary of State:
 - a. A copy of the contract between the paid solicitor and your organization.
 - b. The full legal name and address of the paid solicitor who will conduct the campaign.

- c. The address where records and accounting information is kept.
- d. A description of the intended solicitation campaign, the means of communication used, the projected commencement and conclusion dates, and a description of any event that the solicitation campaign leads up to.
- e. A description of the charitable purpose which is being carried out.
- f. A statement certifying that the solicitation notice is true.
- g. Within 90 days after the campaign concludes, either you or the paid solicitor must file with the Secretary of State a financial report listing the gross proceeds raised and an itemization of all expenses. This statement must be signed by either the paid solicitor or the charitable organization and must include a statement certifying that the solicitation notice is true.
- 33. <u>Telephone Solicitation Rules</u>. Colorado Revised Statute § 6-16-105, effective July 1, 1997, requires *paid* solicitors who orally request contributions to provide prospective donors with the following information *prior to attempting to collect any contribution*:
 - a. The name, address and phone number of the paid solicitor, the paid solicitor's employer and of the charity.
 - b. A disclosure that the contribution is not tax deductible if it is not.
 - c. A disclosure that the solicitor is being paid to solicit the contribution.
 - d. The amount of the donor's expected monetary contribution.
 - e. Upon request, the percentage of the contribution which the solicitor will receive.
 - f. The donor has three (3) days to cancel the contribution.

The paid solicitor must send this information to the donor prior to collecting the contribution. If a paid solicitor fails to comply with these rules, the donor may cancel the contribution pledge at any time. If the paid solicitor complies with these rules and sends the donor the above information, the donor can cancel the pledge by midnight of the first business day after the day on which the contributor receives a written confirmation of the contribution. If the donor cancels the pledge, the paid solicitor must return the donor's contribution within 10 days. The last required disclosure, item (f) above, which requires notification that the donor has 3 days to cancel the contribution pledge, has been challenged on Constitutional grounds. Please contact me for an update on this court challenge if it affects you.

34. Open Meetings Law. Nonprofit corporations are not subject to the Colorado Sunshine Law, CRS § 24-6-401 et seq., unless a government has delegated governmental decision-making authority to the nonprofit corporation. Unless this delegation has been made,

- nonprofit corporations are not required to share their minutes or open their meetings to the public pursuant to CRS § 24-6-402.
- 35. <u>Liability of Directors, Officers, and Volunteers.</u> Directors, officers or volunteers who serve without compensation are exempt from liability for their acts (or failures to act) in their capacity as a director, officer, or volunteer of the nonprofit corporation, unless their act or omission to act was willful and wanton; § 13-21-115.5 and 116, Colorado Revised Statutes. This means that directors, officers or volunteers are exempt from liability for simple negligence; in laymen's terms, these statutes provide that as long as a person working on behalf of the nonprofit doesn't act in a manner which he or she knows is likely to cause tortious injury to a person, that person is exempt from legal liability. You need to decide whether to purchase insurance to protect your directors or officers from liability; I believe the cited statutes provide substantial protection and render insurance unnecessary in most cases. However, one reason to purchase coverage is to provide insurance to pay for the costs of defending against a lawsuit; you would need to check with an insurance carrier to determine the cost of this and whether it is warranted for your organization. This is discussed further below.

There are exceptions to this liability shield, however. Directors, officers, and volunteers can be liable for payroll taxes due to the IRS, or for injuring a person while driving an automobile while conducting nonprofit business, or for environmental contamination on properties owned by the nonprofit despite the Colorado statutes cited above. Contact me or another attorney if you have any questions about this.

- Sexpenditure Responsibility—grants to individuals, private foundations, and foreign charities. Private foundations may make gifts to other private foundations, individuals and foreign charities, and public charities may make grants to foreign organizations, as long as the nonprofit corporation exercises *expenditure responsibility*. This generally means that the nonprofit is required to see that the grant is spent solely for the purpose for which it is made; to obtain full and complete reports from the grantee on how the funds are spent; and to make report these expenditures to the IRS. The rules for this are detailed and haven't been included in the Articles of Incorporation and Bylaws (unless the nonprofit plans to make gifts to individuals, private foundations, or foreign charities. If the nonprofit decides to make grants to these parties in the future, be sure to see me or another attorney specializing in nonprofit corporations to revise your articles of incorporation and bylaws to add this language).
- 37. <u>Nonprofit Sponsorship Income</u>. The IRS issued regulations in 2000 to determine whether payments by nonprofit sponsors at nonprofit events would be taxable advertising income to nonprofits; see IRC § 513(i). Sponsorship payments are tax-free to nonprofits provided they comply with the following:
 - a. The sponsor is not granted an exclusive right to sell its products at the event. For instance, if a nonprofit told Coke that Pepsi could not be sold at an event, payments from Coke would be taxable income to the nonprofit.

- b. The nonprofit can acknowledge a sponsor's support through the use of its name, logo, or product line in connection with the nonprofit's activities. For instance, posting the sponsor's sign at an event is permissible.
- c. The nonprofit should notify the sponsor that the sponsor should not expect any substantial benefit other than the nonprofit acknowledging the sponsor or its products.
- d. The nonprofit should not advertise the sponsor's products or services, or endorse or offer inducements to members of the public to purchase or use the sponsor's products.
- e. The nonprofit may display sponsor logos and slogans, sponsor locations and phone numbers, and value-neutral descriptions, including pictures of products and displays of actual products at the applicant's events or in newspapers or other publications advertising the events. The nonprofit cannot say, for instance, that Coke is better than Pepsi.
- f. Either the nonprofit or the sponsor may distribute the sponsor's products at events, either free or for sale.
- g. Sponsors may be given complimentary tickets to nonprofit events or receptions for major donors.
- 38. <u>Director and Officer Liability Insurance</u>. I am frequently asked whether a nonprofit should obtain director and officer liability insurance. This raises the following issues.
 - a. Insurance generally costs \$1,500 to \$2,000 per year for a nonprofit, and it covers directors and officers in case they are sued in their personal capacity as a director or officer.
 - b. Federal regulations and Colorado statutes provide volunteer immunity to protect unpaid volunteers including officers and directors from liability for their actions on behalf of a nonprofit; see CRS §§ 13-21-115.7 and 13-21-116. These statutes provide that any director who is not compensated by the nonprofit shall be immune from civil liability for any act or omission which results in damage or injury if the director was acting within the scope of his or her official functions.
 - (1) These statutes do not protect the director from auto accidents; the director's own automobile insurance coverage generally will apply.
 - (2) These statutes also do not protect directors who intentionally harm others.
 - c. Since Colorado has a volunteer immunity statute, is there a need for director and officer liability insurance? In practice, the volunteer immunity statutes prevent most lawsuits against volunteer directors. However, if directors or officers are sued, D&O insurance will pay their legal costs to defend against the lawsuit. Some homeowner policies also supply limited coverage for volunteer activities;

- directors should consult with their homeowner insurance policy to determine if it covers their activities as nonprofit directors.
- d. Another relevant question is what acts are directors liable for. Nonprofit corporations are separate entities. This means that directors (like shareholders in for profit corporations) are not liable for the debts or liabilities of the corporation. If the corporation borrows money, directors and officers are not liable to repay the loan unless they personally guarantee it. However, listed below are exceptions to this liability shield; they rarely apply and are generally easily avoided.
- e. Directors or officers that control payroll disbursements are liable if payroll taxes are withheld from employees but are not then paid to the government.
- f. If a director or officer directs the dumping of hazardous wastes, they could be held personally liable.
- g. If you decide to get D&O insurance, and your board includes a director who is an attorney, ask the insurance company if the D&O insurance also covers the attorney. Some D&O insurance policies specifically exclude attorneys.
- h. If your board declines to get D&O insurance, and a director is concerned about potential liability, the director can apply for coverage through an umbrella insurance policy offered by his or her homeowner insurance company. Again, the director should verify that the umbrella coverage will cover actions performed as a nonprofit director, since some umbrella policies specifically exclude nonprofit directors.
- i. To be prudent, I recommend that you prepare a letter raising potential liability concerns specific to your organization, and that you mail this to your insurer and request a written response of whether the insurer will provide coverage for such concerns.

If you have any questions regarding these matters, I will be happy to discuss them with you.

Sincerely,

Ken Ransford Enclosures

Ken Rusford