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Hooray! We Received Our IRS Determination Letter...Now What Do We Do? Compliance Tips for Virginia Nonprofit Organizations

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Once a nonprofit organization successfully completes IRS Form 1023 or 1024 and receives a determination letter from the IRS, the fun is just beginning from a corporate governance and compliance perspective. Here are a few compliance issues and tasks that nonprofit organizers, executives, and board members should always keep on the organizational “radar screen”.

1. Maintaining Corporate Status. If your organization was structured as a corporation under state law (as it should be under most circumstances), then it is subject to annual filing and fee requirements as a condition of maintaining its corporate existence and “good standing” under state law. Failure to timely comply with these requirements—as simple and straightforward as they may be—can result in late fees, penalties, and termination of corporate existence which, in turn, can lead to a variety of legal problems.

2. Obtaining Adequate Insurance. Any nonprofit organization that does not have basic insurance coverage (e.g., liability, D & O) is flirting with disaster. One could question whether the officers and directors of such an organization are fulfilling their fiduciary duties to the organization for such an oversight. While specific laws exist to shield nonprofit volunteers from certain types of liability under certain situations--and the corporate governance documents might include indemnity and limitation of liability provisions that offer additional protection--having adequate insurance coverage remains a very important part of any risk management strategy.

3. Complying with State Charitable Solicitation Laws. Most states regulate charitable fundraising to some degree. These laws impose a combination of registration, disclosure, and reporting requirements depending upon the type of organization and its activities. Charitable gaming (e.g., bingo and raffles) in particular is often heavily regulated at the state level. Some county and city governments also impose regulations on charitable solicitations.

4. Filing the Required Federal and State Tax Returns. Thousands of nonprofit organizations are on the verge of losing their tax-exempt status in 2010 as a result of their failure to file the applicable IRS Form 990 form for three consecutive years. Smaller nonprofits have gotten blindsided by a provision of the Pension Protection Act of 2006 which created a new filing requirement on Form 990-N (referred to as the e-postcard) and imposed the harshest of penalties—automatic loss of tax-exempt status—for any nonprofit organization that neglects to file the required Form 990 (Form 990, Form 990-EZ, or Form 990-N, as applicable) for three consecutive years. This underscores the importance of understanding what filing requirements apply to your organization and making sure those requirements are met in a timely fashion.

5. Observing Proper Corporate Formalities. When a nonprofit organization incorporates under state law, a new legal “person” is born. A nonprofit corporation can own property, enter into contracts, sue and be sued, and otherwise operate through its authorized representatives as a separate legal entity distinct from its individual officers, directors, members, employees, etc. To maintain this separate legal existence and enjoy the limited liability protection and other benefits of corporate status, the organization must faithfully observe proper corporate formalities, which includes: (i) using appropriate signature blocks when executing contracts, (ii) maintaining appropriate corporate documentation such as meeting minutes, resolutions, bylaws, and other documentation evidencing the separate legal existence of the organization, and (iii) abiding by the terms of your governing documents when authorizing and taking corporate action.

6. Complying with Applicable Disclosure Rules. The IRS imposes a variety of disclosure requirements on exempt organizations, and violating these rules can result in monetary penalties, negative publicity, and significant embarrassment to the organization and its leaders. Certain corporate and tax documents must be made publicly available, including an organization’s Form 1023 or 1024 filing, IRS determination letter, Form 990s, and formation documents such as Articles of Incorporation and Bylaws. Other disclosure requirements apply with respect to fundraising efforts and require certain information be provided to donors, particularly in situations where donors receive something of value in exchange for their donations. Other disclosure requirements are governed by state law and, therefore, will vary from state to state.

7. Managing Your Contractual Relationships. A nonprofit organization will enter into a wide variety of contractual relationships as it conducts activities in furtherance of its charitable mission, but all too often these contracts are forgotten about after they are signed. This neglect can lead to a variety of problems. Deadlines can be missed. Ongoing promises can be inadvertently breached. A simple strategy to minimize this risk is to create a one or two page “executive summary” of every significant contract to which your organization is a party outlining key obligations, deliverables, and deadlines. The summary should also assign responsibility for monitoring compliance with specific items.

8. Developing and Implementing the Right Policies and Procedures. Corporate governance has become a hot topic in both the for-profit and nonprofit communities in recent years in response to widely publicized cases of fraud, executive misconduct, and other white collar crimes. While nonprofit organizations are generally excluded from the scope of the Sarbanes-Oxley Act, the IRS and other authorities have indicated quite plainly that nonprofit organizations are expected to observe similar standards and “best practices” of corporate governance. To demonstrate this commitment to corporate governance in a transparent fashion, nonprofit organizations should adopt and carefully implement key policies and procedures. While there is no “one size fits all” list of policies that every nonprofit organization should have, several important policies that arguably will be relevant to most exempt organizations include: (i) conflict of interest policy, (ii) document retention policy, (iii) code of conduct, (iv)

whistleblower policy, (v) expense reimbursement policy, (vi) social media policy, (vii) compensation review policy, and (ix) Form 990 board review policy.

9. Promoting a “Race to the Top” Culture. All organizations are running one of two races—a “race to the top” or a “race to the bottom.” Your organization must candidly assess which race it is currently running and, if the latter, develop a strategy to get on the right track. It is all too easy for an organization to become complacent and careless in how it operates, particularly for volunteer-based organizations with limited resources. There are plenty of great resources available in your community and online to help figure out how to effectively run a race to the top and strengthen your organizational commitment to compliance. The trickle-down effect of such a commitment will benefit your organization in a multitude of ways.

10. Staying True to Your Mission. Tax-exempt organizations are required by law to be organized and operated for a legitimate exempt purpose. Unfortunately, it is not unusual for nonprofit organizations to lose focus of their charitable mission from time to time. Material deviations can result in significant problems, including unrelated business income tax liability, intermediate sanctions penalties, and loss of exempt status. Regular review of organizational documents, strategic plans, and mission statements; effective education and orientation training for new board members, staff, and volunteers; and diligent oversight of the organization’s activities are several ways a nonprofit organization can minimize the risk that it will steer off course during its existence.