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OUTLINE FOR NATIONAL BUSINESS INSTITUTE SEMINAR APRIL 25, 2008

HOW TO KEEP TAX EXEMPT ORGANIZATIONS IN COMPLIANCE

REVISED 09/16/11

INTRODUCTION TO TAX EXEMPT ORGANIZATIONS

By Katherine B. Miller, Esquire

A. Advantages of Incorporation vs. Unincorporated Entities.

Incorporation as a not-for-profit corporation in New Hampshire provides multiple benefits. Generally, we recommend that all of our clients who do any amounts of not-for-profit work incorporate. The reasons for this are as follows:

1. Limitations on Liability For Those Involved in the Operations of the Organization:

The corporate structure provides limitation from liability for the officers and directors of the organization. Generally, the officers and directors are not exposed to liabilities or obligations of the corporation. By contrast, the liabilities and obligations of the activities of an unincorporated association of individuals may attach to those individuals.

2. New Hampshire Voluntary Corporation and Association Law, RSA 292: New Hampshire has a statute specifically dealing with charitable and other non-profit corporations, RSA Chapter 292. The specific provisions of the statute are discussed further below, at B (2), but the statute itself provides a useful structure for organizations and their operations. In addition, any provisions not explicitly covered in the statute pertaining to not-for-profit organizations are covered in the General Business Corporation Act, RSA Chapter 293-A. Reference to that chapter provides additional guidance on operation of organizations. Given the straightforward procedures of a corporation, it is often the easiest entity for managing a not-for-profit organization.

3. Contrasts with Trusts:

Another option for a not-for-profit organization is a trust. The benefits of a trust include flexibility and no set structure beyond the Board of Trustees. In New Hampshire, we have the Uniform Trust Code, RSA Chapter 564-B. The IRS requires that any trust

applying for tax exempt status be funded. However, the very flexibility of trusts often proves to be the undoing of charitable organizations structured as a trust. Without some guidance with regard to operating mechanisms, the looseness of a trust can sometimes prove to be too loose. Some organizations without a clear idea of how to operate flounder as trusts. In addition, the IRS subjects trusts to much greater scrutiny, in part because of their looseness.

4. Limited Liability Company: LLC:

Another option for the form of your entity is as a limited liability company or “LLC.” LLC’s are really designed for for-profit businesses, as they provide for the limitations on personal liability of a corporation, but the option for passing through taxation to the individual members, like a partnership. For tax exempt organizations there are few taxes, if any, so tax considerations are generally less important. Similar to a trust, the LLC is not required to have as formal a structure as a corporation. Again, this can lead to trouble, especially because the LLC arrangement is generally geared toward for-profit businesses. Finally, to be recognized as tax exempt by the IRS, an LLC can only be made up of tax exempt entities (corporations, trusts, etc.), limiting the usefulness of this structure for most groups.

5. IRS Requirements.

The IRS will only accept a corporation, an unincorporated association, an appropriate LLC or a trust as a tax exempt entity under Internal Revenue Code (IRC) 501(c)(3). Sole proprietorships, partnerships or loosely affiliated groups of individuals are not eligible for tax exempt status.

B. Form of Organization and Governing Instruments.

1. Corporation or Trust?

In choosing the form of the organization, individuals wishing to create a not-for-profit, charitable organization need to be looking at three sets of regulations and laws simultaneously in order to make sure that they meet all of the applicable requirements. First, not-for-profit charitable corporations are covered by the New Hampshire Voluntary Corporation and Association Law, RSA Chapter 292, and are subject to regulation by the Secretary of State in New Hampshire. In the case of a trust, the entity is subject to the Uniform Trust Code, RSA Ch. 564-B. Trusts are more lightly regulated by the State of New Hampshire, as described below at B(13-14).

2. Filings for Corporations:

The incorporators of not-for-profit corporations file their Articles of Agreement with the Secretary of State's Office and with the Town Clerk in which the principal place of business is located, and are required to file reports with the Secretary of State every five years to maintain their corporate existence.

3. RSA 292:4 provides:

Record of Articles of Agreement; Effect.

The articles of agreement shall be recorded in the office of the secretary of state. When so recorded, the signers thereof shall be a corporation, and such corporation, its officers, and members shall have all the rights and powers and be subject to all the duties and liabilities of other similar corporations incorporated under this chapter, their officers, and members, except so far as they are limited or enlarged by this chapter. Subsequent to filing with the secretary of state a copy shall be filed in the office of the clerk of the town in which the mailing address of the corporation is located.

4. Filing with Secretary of State and Recording by Municipal Clerk:

It is the recording of the Articles of Agreement in the office of the Secretary of State that creates the corporation. When the Articles are so recorded, the officers and members of the organization and the corporation will have all the rights and powers and be subject to all the duties and liabilities of similar corporations incorporated under this New Hampshire chapter. The law was amended recently to clarify the sequence of filing: the Articles of Agreement should be filed first with the Secretary of State's Office, and then sent to the Town or City Clerk's office in the municipality where the activities of the corporation is carried on.

5. Secretary of State Oversight:

The New Hampshire Secretary of State's Office has a helpful website with preprinted forms and a fee schedule attached: www.sos.nh.gov/corporate/nonprofitforms. The Secretary of State's Office also provides forms for an amendment to the Articles of Agreement, as well as for dissolution. Once an application has been submitted to the IRS, and forever thereafter, the IRS must receive a copy of any amendments to the Articles of Association.

6. New Hampshire Secretary of State Forms Do Not Meet IRS Standards: **Please note the disclaimer at the bottom of the first page of the Secretary of State's Office website.**

If you intend to apply for IRS federal tax exemption as a charitable organization, your articles of incorporation must contain a required purposed clause and a dissolution of assets provision. Valuable information on 501(c)(3) qualification is on the IRS website, www.irs.gov. It includes sample articles of the incorporation. Click the "Charities and Nonprofits" link and then the [Life Cycle of a Public Charity](#) link.

This introduces the second layer of regulation: the IRS.

7. IRS Sample Language for Articles:

Although the Secretary of State's Office does not provide the magic language needed, the links to the Internal Revenue Service website do provide the key language that is required by the IRS for an entity to be considered for tax exempt status as a charity. In Publication 557, available on the IRS website (www.irs.gov) at pages 17-20, the IRS provides the language that must appear in the Articles of Agreement. The categories of information are: the charitable purposes of the organization, the powers of the organization including limitations on lobbying and the prohibition on private inurement, and the requirements for disposition of its assets upon dissolution. Specifically, the Articles need to include language substantially as follows:

“Said corporation is organized exclusively for charitable, religious, educational and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under § 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future federal tax code.

No part of the net earnings of the corporation shall inure to the benefit of, or be distributable to its members, trustees, officers, or other private persons, except that the corporation shall be authorized and empowered to pay reasonable compensation for services rendered and to make payments and distributions in furtherance of the purposes set forth in Article [_____] hereof.

No substantial part of the activities of the corporation shall be the carrying on of propaganda, or otherwise attempting to influence legislation, and the corporation shall not participate in, or intervene in (including the publishing or distribution of statements) any political campaign on behalf, or in opposition to, any candidate for public office.

Notwithstanding any other provision of these Articles, the corporation shall not carry on any other activities not permitted to be carried on (a) by a corporation exempt from federal income tax under § 501(c)(3) of the Internal Revenue Code

or the corresponding section of any future federal tax code, or (b) by a corporation, contributions to which are deductible under § 170(c)(2) of the Internal Revenue Code or the corresponding section of any future federal tax code.

Upon the dissolution of the corporation, assets shall be distributed for one or more exempt purposes within the meaning of § 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future federal tax code, or shall be distributed to the federal government, or to a state or local government for a public purpose. Any such assets not so disposed of shall be disposed of by a court of competent jurisdiction of the county in which the principal office of the corporation is then located, exclusively for such purposes, or to such organization or organizations as such court shall determine, which are organized and operated exclusively for such purposes.”

These requirements may be modified for other tax exempt entities that are not charities, such as § 501(c)(4) (social welfare organizations) § 501(c)(6) (business leagues) or § 501(c)(7) (social clubs).

8. Blending New Hampshire and IRS Requirements for Corporations:

This is language taken directly from the sample Articles of Organization in Publication 557 that appears at page 20 of that document. It is important for organizations to follow the guidelines provided by the IRS in its Instructions for the Application for Recognition of Exemption, Form 1023, and in its Publication 557¹. More will be discussed later in this presentation about the application form for tax exempt status, Form 1023. In general, if the IRS provides model language, organizations are well advised to use that language and to adapt it as little as possible to fit their specific needs. In the case of New Hampshire law, organizations need to meld the requirements of RSA Chapter 292, the requirements for charitable organizations and the other sections of the RSAs pertaining to property tax exemptions, limitations on liability and indemnity for directors and officers (RSA 292-2,V), as well as the Attorney General’s other regulations in RSA Chapter 7 discussed below. Bringing all of these various branches of regulation

¹ Organizations seeking recognition under other subsections of IRC § 501(c) use IRS Form 1024 and its Instructions. For instance, social welfare organizations (§ 501(c)(4)), business leagues (§ 501(c)(6)) and social clubs (§ 501(c)(7)) would use that form, which is less complex.

together into one document will provide something that will pass muster, both with the Attorney General's Office and Secretary of State's Office here in New Hampshire, as well as satisfy the Internal Revenue Service and possibly your municipality for tax exemption qualification.

9. Secretary of State Reports on the "Fives" and "O's":

Charitable corporations must file reports every 5 years to the Secretary of State's Office. RSA 292:25. This means on years ending in fives and zeros, not on the 5 year anniversary of incorporation. Any organization that fails to file will be administratively dissolved. As with some of the other forms provided in New Hampshire, the standard form does not provide space for all the information that is needed. The form for the every 5 year renewal has space for only 3 directors on the form, although New Hampshire law requires at least 5 unrelated directors for a public charity. Additional information should be submitted on a separate sheet of paper. Organizations should not be lulled into thinking that the forms alone will be sufficient.

10. Corporate Bylaws:

In addition to the Articles of Agreement, which are generally very standard and have little creative writing involved, the organization will need to create Bylaws, which are the working document that describes how the organization actually operates. Whereas I recommend using standard language that is previously approved by the IRS for Articles of Agreement, adapted to meet New Hampshire' requirements, I recommend that organizations develop Bylaws based on a general framework but customized to meet their needs. Organizations should feel that the Bylaws are theirs to use, to understand and to change as necessary, as long as they do not run afoul of any the statutory or regulatory requirements for tax exempt organizations.

There is a wonderful resource on the New Hampshire Attorney General's <http://doj.nh.gov/charitable>. In the section of "quick links" marked "Publications," there is a link to several excellent resources written by the New Hampshire Charitable Trust Unit as well as links to other publications. One of the best, in my opinion, is "Incorporation and Tax Exemption for New Hampshire Arts and Other Organizations: An Introductory Guide." This is published by the New Hampshire Business Committee for the Arts and is available on their website. It was last updated in 2002, so it should not be relied on for all statutory and regulatory references because there have been some changes. However, it provides an excellent guide for those starting this process and provides not only sample Articles but also sample Bylaws. Their website is www.nhbca.com. The website, in general, has a host of useful resources for not-for-profit organizations.

11. Recommended Provisions in Bylaws:

I generally recommend that organizations begin with a set of Bylaws based on or similar to the general outlines provided below:

- Name: The name of the organization.
- Office Address: The office in which it is located.
- Initial Meeting: If there is a meeting of the incorporators needed to appoint the initial board of directors, then requirements for that meeting.
- Business Meetings: Meeting notices for subsequent meetings. The meetings of the board of directors should be spelled out specifically with regard to how frequently they are. Generally I recommend monthly so that the organizations do not slide off track, with the meetings preset so

they do not need to be noticed. A monthly meeting, say on the first Monday of each month, makes for a standard practice, is easy to follow, and requires the minimum of organization for the group to maintain.

- **Membership:** I often counsel the organizations I represent that if membership is not key to their functioning, they should consider not having formal members, although many individuals may contribute to the organization. Members, generally, are entitled to a membership meeting which can provide an additional level of organizational complexity that is challenging for some charities to handle.
- **Annual meetings:** Annual meetings at which trustees or directors are elected, officers appointed, etc.,
- **Board:** Board of directors or trustees including description of the numbers (I generally recommend between 5 and 8, 5 being the minimum required by New Hampshire law for a public charity, RSA 292:6-a, which requires that there be “at least 5 voting members, who are not of the same immediate family or related by blood or marriage.”) Additionally, the initial board of directors must adopt the Bylaws by a 2/3 vote (RSA 292:6). Subsequent to that, a mere majority is required to amend the Bylaws, which is all that I recommend requiring.
- **Committees:** Committees should be provided for and may be appointed by the board of directors or trustees and/or the President.
- **Removal:** There should be a provision for the removal of members of the board by a 2/3 majority vote of the disinterested members of the board,

after notification and an opportunity for the affected individual to address the board in person, if he or she wishes.

- Vacancies/Resignations: There should be a section for filling vacancies on the board and for the process for resignation.
- Compensation: Compensation should be addressed: If officers and directors receive no compensation, they are provided with this statutory liability limitation. I strongly recommend that not-for-profit charitable organizations not compensate their boards of directors, except for reasonable compensation for any officers who sit on the board of directors, such as a CEO or executive. (All compensation of officers, directors and key employees must be reasonable and based on arms-length negotiations, with reference to comparable salaries of similar organizations in the area in order to pass muster with the IRS. This is more fully discussed later in the program in the section on Intermediate Sanctions.)
- Officers: Officers should be specified and those generally include a President, a Secretary and a Treasurer, although a Vice President may also be added. I recommend saying away from Co-Presidents and similar less orthodox creations initially, although that may be employed later (after getting tax exempt status from the IRS), if necessary. The powers of each officer should be specified as are the provisions for removal, resignation and filling vacancies.
- Indemnity: I recommend strongly that the incorporation indemnify its board of directors and officers for any of the actions for which RSA 292:2,V-a provides limitations.

(a) The articles of agreement may contain a provision eliminating or limiting the personal liability of a director, an officer, or both, to the corporation or its shareholders for monetary damages for breach of fiduciary duty as a director, an officer, or both, except with respect to:

(1) Any breach of the director's or officer's duty of loyalty to the corporation or its shareholders.

(2) Acts or omissions which are not in good faith or which involve intentional misconduct or a knowing violation of law.

(3) Any transaction from which the director, officer, or both, derived an improper personal benefit.

(b) This paragraph shall not be construed to eliminate or limit the liability of a director, an officer, or both, for any act or omission occurring before January 1, 1992.

RSA 292:2,V-a. Again, in the interest of attracting the best possible directors and officers, I recommend including this provisions on indemnification permitted by New Hampshire law in both the Articles and the Bylaws.

- Conflict of Interest: I recommend a section referencing a separate document that tracks the IRS and New Hampshire state law requirements for any transactions that involve a possible conflict of interest between the organization and a member of the board, an officer or an employee of the entity. Those limitations are in RSA 7:19-a, and are described more fully in the section involving a conflict of interest policy. Although organizations that are not charitable trusts as defined by New Hampshire law are not required by law to have such policies, they are strongly recommended to do so.

- Dissolution: There should be a section dealing with dissolution that tracks the language noted above in the Articles of Agreement section that meets IRS requirements.
- Date: I recommend that the Bylaws contain at the end the date on which they were initially adopted and the fact that it was by a 2/3 majority of the initial board. Any subsequent amendments to the Bylaws should be dated so that the development of the Bylaws can be tracked.

12. Bylaws: A Practice Guide for the Organization:

All directors and officers should have a copy of the Bylaws and they should consider this to be their roadmap for how to operate the organization. Meetings should be scheduled and conducted in compliance with the requirements in the Bylaws. If the organization wishes to use telephonic conferences, this is fine as long as it is permitted by the Bylaws, and if they wish to try to meet via skype, they can do so, so long as it is permitted by the Bylaws. They may not “meet” by email. As noted above, not-for-profit charitable organizations are using the public’s money to conduct charitable purposes and must be able to demonstrate that all of their activities are furthering those charitable purposes and not for any private benefit. The Bylaws should not be so complex or difficult to understand that those responsible for running the organization cannot comprehend them. On the other hand, they must be sufficiently comprehensive to cover the basis components outlined above.

13. Limited Liability Companies:

An LLC may file its own 501(c)(3) exemption application, but only under certain circumstances: it will be treated as a corporation rather than a partnership, and all the members of the LLC must be 501(c)(3) organizations. This most often arises when one

or more charities want to hold an asset (such as real estate) in a separate entity, such as when they share facilities. The LLC's organizing document is its "Articles of Organization," and its "Operating Agreement," if adopted, is also part of its organizing document. If an LLC wants to be treated as a disregarded entity by its tax exempt member, then it should not file its own exemption agreement. New Hampshire LLC's may not be non-profit corporations in New Hampshire.

14. Trusts: Requirements for Trust Documents:

A sample trust declaration is included in IRS Publication 557, at ¶¶ 20-21. While that does not sound very long, it is four columns of extremely small type, so it is not reproduced in these materials, but it is available to download from the IRS website. Care must be taken to meld the IRS's model language with the New Hampshire Uniform Trust Code Requirements at RSA Chapter 564-B. As noted above with regard to corporations, the requirements of New Hampshire law and the Federal Tax Exemption Law and IRS regulations must be combined in order to provide a document that will satisfy review by both groups. As with the corporations discussed above, the New Hampshire Attorney General's Office also reviews charitable trusts, and their regulations, found at RSA Chapter 7, must also be met.

15. Trusts: Describe Procedures for Operating Trust:

A trust can be very flexible, but that flexibility can come with the costs of disorganization. If an entity wishes to organize itself as a trust, care must be taken to map out operating procedures very carefully.

16. Registration with New Hampshire Attorney General Charitable Trust Unit:

As noted above, once the organization has been formed, within 6 months the organization needs to register with the New Hampshire Department of Justice, Charitable Trust Unit. They have an outstanding web page with information including forms and resources at www.nh.gov/nhdoj/charitable. All the forms are available there or will be mailed upon a request by telephone (603-271-3591). The staff is exceptionally knowledgeable and friendly.

17. Annual Reports to New Hampshire Attorney General Charitable Trust Unit:

In addition to the initial registration, organizations are required to file a report with the New Hampshire Attorney General's Office on an annual basis. The annual form is also available on that website. Organizations with annual revenue of less than \$10,000 a year may apply for exemption from the annual filing requirement after they have filed their first report. Organizations may use their IRS Form 990 to meet most of the requirements of the report, but if the organization's gross receipts are less than \$25,000, the Attorney General's Office will still require the submission of the annual report, which is NHCT-2A on their website. Additional information regarding conflicts of interest and potential pecuniary benefit transactions must also be submitted. This is an appendix to the annual report which is also found on the Attorney General's Charitable Trust Unit website. Finally, organizations that are fortunate enough to have revenue of \$500,000 to \$1,000,000 must file with the Charitable Trust Unit, the organization's latest financial statement prepared in accordance with generally accepted accounting principles and any organization with revenue in excess of \$1,000,000 annually must file an audited financial statement prepared in accordance with generally accepted accounting principles, effective August 10, 2004.

18. Conflict of Interest Policy: New Hampshire Requirements:

The last document that I am going to cover here, while not traditionally understood as an organizational or governing document, is the Conflict of Interest Policy. Both charitable trusts and corporations must have one. As noted above, RSA 7:19-a has very specific requirements for any potential pecuniary benefit involving an officer, director or trustee. Basically, the requirements include that for any transaction that involves a pecuniary benefit to the director, officer or trustee, that is more than \$500 in the aggregate over the course of a year on an aggregate basis, exceeding \$500, requires an affirmative vote of at least a 2/3 majority of all the disinterested members of the governing board, after full disclosure of the material facts, without any participation, voting or even presence, of any of the affected directors, officers or trustees with a financial interest, and a record must be kept of the meeting and the vote. RSA 7:19-a. If the transaction is over \$5,000, all of the above requirements apply plus the organization must publish notice of the transaction in a newspaper of general circulation in the community in which the organization is located, and provide written notice to the Director of Charitable Trusts at the Attorney General's Office and include that on their annual report to the Attorney General as well.

19. Conflict of Interest Policy: IRS Requirements:

The IRS also has a separate set of extremely specific requirements for any transactions that have a potential conflict of interest. For this reason, I recommend that organizations adopt a Conflict of Interest Policy that blends both the specific requirements of the New Hampshire law in RSA 7:19-a with the policy included in the instructions to Form 1023, which appear at Appendix A starting at page 25 in the current version of the Instructions for Form 1023.

20. Importance of Conflict of Interest Policy:

Although Conflict of Interest Policies that incorporate all these requirements tend to be longer than the Articles of Agreement and often the Bylaws as well, it is critically important that all of those involved with not-for-profit tax exempt charitable organizations understand the importance of these conflict of interest requirements. They really go to the heart of the purpose of the organization, which is charitable to benefit the public or a substantial segment of the public, and are necessary to meet the requirements of the New Hampshire Charitable Trust Unit, and the IRS. A Conflict of Interest Policy is now required and questions are asked on the Form 1023 and on the 990 Return to the IRS, and in the Annual Report to the Attorney General's Office, as well.

21. Rule: No Self-Dealing:

We simplify the rules for our clients to be: "Just Don't"; Don't pay your board; don't have financial dealings between the organization and members of the board, officers or key employees, other than salaries with reasonable compensation for officers and employees.

22. Other Documents:

The Sarbanes Oxley law imposed many requirements on for-profit corporations and a law on not-for-profit corporations as well, including (1) adoption of a document retention/destruction policy and (2) a whistle-blower protection policy.

C. Categories of Tax Exempt Organizations: Private Foundations vs. Public Charities.

1. The two basic types of not-for-profit charitable organizations recognized by the IRS are private foundations and public charities. The vast majority of not-for-profit charitable organizations in New Hampshire are public charities, meaning that they either are a specifically listed type of public charity, or they receive a substantial part of their financial support in the form of contributions from the general public, or other publicly supported organizations or a governmental unit (Internal Revenue Code § 509(a)(1) and § 170(b)(1)(A)(vi), or they are organizations that receive no more than 1/3 of their financial support from their own investment income and receive at least 1/3 of their financial support from membership fees and contributions (Internal Revenue Code § 509(a)(2)). Public charities have a more favorable tax status than private foundations and are subject to many fewer requirements. On the other hand, private foundations allow donors a greater degree of control over the organization than a public charity is allowed to have. Private foundations are organizations that do not qualify as public charities under Internal Revenue Code § 509(a)(1)(2)(3) or (4), because either they are self-sustaining (with an endowment) or are sustained by a very limited number of individuals.

2. Although most not-for-profit charitable organizations are public charities rather than private foundations, the IRS presumes the opposite: An organization is presumed to be a private foundation under § 501(c)(3) unless it falls into one of the categories specifically excluded from the definition, as described above, or is one of the other statutorily exempt entities, such as a school. In addition, the organization must notify the IRS that it is not a private foundation. This requirement does not end with filing the application for recognition of exemption, Form 1023, with the IRS. Organizations who ask for an advanced ruling will need to follow-up with documentation of their finances in order to avoid being classified as a private foundation. This is discussed more, later in the panel.

3. An organization needs to file notice that it is a public charity within 15 months within the end of the month in which it was organized. An extension of time may be granted if an initial request is timely. The date on when an organization came into existence is essentially the date on which the Articles of Agreement were recorded at the New Hampshire Secretary of State's Office.

4. There are two key differences between public charities and private foundations: excise taxes and the requirement for the Articles and Bylaws. Excise taxes are required to be paid on the net investment income of most domestic private foundations. Form 990-PF includes that report, and the taxes must be paid annually at the time of filing that return, or in quarterly estimated tax payments if the total tax for the year is going to be \$500 or more.

5. There are also additional restrictions on dealings between the private foundation and their substantial contributors and other "disqualified persons," a requirement that the foundation distribute at least part of its income for charitable purposes, and limitations on holdings in private businesses. In general, the requirements are designed to assure that expenditures further the organization's exempt purposes, because of the greater involvement by family members, founders and donors in private foundations.

6. In the Articles of Agreement, a private foundation must include certain specific language in its governing documents in order to qualify as tax exempt. IRS Publication 557 provides an example of those requirements. They include:

- a) The corporation will distribute its income for each tax year at a time and in a manner as not to become subject to the tax on undistributed income imposed by § 4942 of the Internal Revenue Code, or the corresponding section of any future federal tax code.

b) The corporation will not engage in any active self-dealing as defined in § 4941(d) of the Internal Revenue Code, or the corresponding section of any future federal tax code.

c) The corporation will not retain any excess business holdings as defined in § 4943(c) of the Internal Revenue Code, or the corresponding section of any future federal tax code.

d) The corporation will not make any investments in a manner as to subject it to tax under § 509 of the Internal Revenue Code, or the corresponding section of any future federal tax code.

e) The corporation will not make any taxable expenditures as defined in § 4945(d) of the Internal Revenue Code, or the corresponding section of any future federal tax code.

IRS Publication 557, p. 27. These requirements are also outlined in New Hampshire law in the Voluntary Corporations statute, RSA 292:2-a:

RSA 292:2-a Charitable Corporations; Required Provisions.

Every charitable corporation established under this chapter which is a private foundation as defined in § 509(a) of the United States Internal Revenue Code of 1954, and which is in existence on the effective date of this section, or which is thereafter established, is subject to the following provisions, whether they are set forth in the articles of agreement or not:

I. A corporation which is a "private foundation" as defined in § 509(a) of the Internal Revenue Code of 1954, shall not:

(a) Engage in any act of "self-dealing" (as defined in § 4941(d) of the Internal Revenue Code of 1954), which would give rise to any liability for the tax imposed by § 4941(a) of the Internal Revenue Code of 1954;

(b) Retain any "excess business holdings" (as defined in § 4943(c) of the Internal Revenue Code of 1954), which would give rise to any liability for the tax imposed by § 4943(a) of the Internal Revenue Code of 1954; nor

(c) Make any investment which would jeopardize the carrying out of any of its exempt purposes, within the meaning of § 4944 of the Internal Revenue Code of 1954, so as to give rise to any liability for the tax imposed by § 4944(a) of the Internal Revenue Code of 1954; nor

(d) Make any "taxable expenditures" (as defined in § 4945(d) of the Internal Revenue Code of 1954) which would give rise to any liability for the tax imposed by § 4945(a) of the Internal Revenue Code of 1954.

II. Each corporation which is a "private foundation" as defined in § 509 of the Internal Revenue Code of 1954 shall distribute, for the purposes specified in its articles of organization, for each taxable year, amounts at least sufficient to avoid liability for the tax imposed by § 4942(a) of the Internal Revenue Code of 1954.

III. The provisions of paragraphs I and II shall apply to any corporation except to the extent that a court of competent jurisdiction determines that to apply these provisions would be contrary to the terms of the articles of agreement or other instrument governing the corporation or the administration of charitable funds held by it, and that the articles or the other instrument cannot properly be changed to conform to these provisions.

IV. Nothing in this section impairs the rights and powers of the courts or of the attorney general with respect to any corporation.

V. All references to sections of the Internal Revenue Code of 1954 include amendments to those sections which are made after the effective date of this section, and include all corresponding provisions of any United States Internal Revenue laws which replace the Internal Revenue Code of 1954.

D. Protecting Directors, Officers and Nonprofit Executives from Potential Liability.

1. The potential for liability can be reduced significantly as discussed above by the use of the corporate structure. As a practical matter, officers and directors of a corporation are protected by the corporate entity's existence from being personally liable on contracts and other claims against the organization. Thus, the corporate structure for a not-for-profit charity provides the same benefits as it would for a business: the limitation on personal liability of the individuals involved.

2. As noted above, New Hampshire law provides limitations on the liability volunteer directors or trustees of charitable organizations pursuant to RSA 292:2,V-a. A

provision incorporating this limitation should be included in the Articles of Agreement and repeated in the Bylaws.

3. In promoting voluntary organizations with charitable purposes, the Legislature has also created a limitation on the personal liability of directors and officers who serve without compensation on the board of a charitable organization, organized or having a principal place of business in the State of New Hampshire. Note that the definition of charitable organization is tied back into that definition of “charitable” for the real property tax exemption at RSA 72:23-1.

RSA 508:16 Directors and Officers of Charitable Organizations or Societies;
Liability Limited.

I. For the purposes of this section:

(a) "Director" means a person who serves without compensation on the board of trustees or board of directors of a charitable organization or society organized or incorporated in this state or having a principal place of business in this state.

(b) "Officer" means a person who serves without compensation as an officer of such an organization or society.

(c) "Compensation" does not include reimbursement for expenses actually incurred.

(d) "Charitable organization or society" means an organization or society which is "charitable" as defined in RSA 72:23-1.

II. Directors and officers shall not be liable for damages for bodily injury, personal injury, or property damage if the claim for such damages arises from an act committed in good faith and without willful or wanton negligence in the course of an activity carried on to accomplish the charitable purposes of the organization or society.

4. Thus, volunteer officers and directors are not liable for damages for bodily injury, personal injury or property damage so long as the claim arises from an act committed in good faith without willful or wanton negligence, and in the course of an activity carried on to accomplish a charitable purpose of the organization. Therefore, officers and directors are protected only when carrying out the mission of the organization and acting in good faith. Nevertheless, this provides an important layer of protection to officers and directors. Organizations are always looking for highly qualified and energetic individuals to serve on their boards of directors and as officers. Being able to provide this statutory level of liability limitation is an important incentive. It is important to note that volunteers of non-profit and governmental organizations are also provided with a degree of immunity from civil liability, pursuant to RSA 508:17. The requirements for an organization to take advantage of that limitation are quite specific and should be carefully followed.

5. Additionally, Directors' and Officers' insurance is an excellent investment for any organization that has a substantial amount of revenue. For the very smallest organizations, it may not be required, but for those with hundreds of thousands of dollars in assets or revenue, I would certainly recommend it.

6. Officers and Directors should be familiar with, and should make sure they comply with, the Uniform Management of Institutional Funds Act, RSA Chapter 292-B, recently replaced by the Uniform Prudent Management of Institutional Funds Act, also RSA Ch. 292-B, effective July 1, 2008 (HB 1382).

7. Finally, scrupulous compliance with the Conflict of Interest Policy will protect both the officers and directors, and the organization.

E. How to Become Tax-Exempt.

1. Federal taxation is the primary reason most non-profit organizations seek tax-exempt status. New Hampshire has no income tax, but it does have a Business Profits Tax, a Business Enterprise Tax, and property taxes.

2. Not-for-profit charitable organizations may be exempt from all those taxes. They are not required to pay the Business Profits Tax if they are not operated for business. If they meet the IRS requirements for 501(c)(3) status, they are exempt from the business Enterprise Tax. If they meet the requirements of a charitable organization under RSA 72:23-1, they may apply to their local taxing authority for an exemption or apply for an abatement if taxes are assessed, but the requirements are more narrow than IRS requirements for tax exempt status.

3. The most significant tax exemption is at the federal level. The main event towards which all of these other procedures have essentially been leading is the Application for Recognition of Tax Exempt Status with the IRS, Form 1023. In addition to the Publication 557, which is very useful in a general way, the IRS has also provided a number of other useful documents for this process, including a Form 1023 checklist, revised June 2006, a Form 1023 itself, also revised June 2006 to match a slight increase in the application fees, and revised Instructions for Form 1023, also revised June 2006 to reflect the fee increase. There is now an Addendum, with additional revisions and fee increases. Basically, the application should be filled out following very closely with the instructions for Form 1023. The IRS has been very clear in terms of what it is looking for and how it is evaluating the answers. Where the form provides information with regard to the types of language it is looking for, organizations are well advised to follow that language in their organizing documents or Bylaws, as discussed above.

4. Organizations should all know that their 1023 forms must be made available for public inspection if the IRS approves their exempt status under Internal Revenue Code § 501(c)(3). In addition, some donors may wish to see the exemption letter from the IRS in order to verify the exempt status. All of these documents should be kept in a file available for public inspection. These documents provide an opportunity to “market your organization,” as well as providing information to the IRS for its evaluation. All of the information should be put in the form with an eye towards the ultimate viewers, namely, not just the IRS, but also potential donors and the public.

5. The specific items in the 1023 application include:

- Name of organization, as it appears on the organizing documents (Articles of Agreement).
- Mailing address: where you want correspondence to be sent. Make sure that if the contact person changes the IRS is informed. I have had several clients who have had people leave their boards, move and information from the IRS has gone astray.
- You may execute a Power of Attorney form (IRS Form 2848) to authorize another person, whether an attorney at law or another individual, to represent the organization for the purposes of speaking with the IRS. Form 2848 can be submitted to the IRS either at the same time as the application is filed or separately.
- EIN: The Tax I.D. Number which the organization must obtain in advance.

- Organization's website: The IRS asks if the organization has a website. This is to be able to view additional information and also, not insignificantly, to be able to see if the organization's actions really live up to its purposes clause and its claims on the Form 1023. Organizations should scrub their website carefully at all times, to make sure that they only include information that is consistent with their charitable purpose. This is especially important when the application is pending, but should be continued throughout the life of the organization.
- Date legally created: This is date on which the organization was incorporated. If an organization has been around for a while but was not legally incorporated until a certain point, it is that magic date that should be entered here for the purposes of the application.
- Certificate of Filing: You should get a certified copy of your Articles of Agreement to be able to show to the IRS that it was in fact filed and recorded at the Secretary of State's Office. Although they will sometimes stamp a document, I also recommend getting a Certificate of Existence from the Secretary of State's Office. This will also usually be required in order to open a bank account with many banks.
- Bylaws: The IRS asks about copies of Bylaws. If they exist, they should be submitted. If they do not exist, they do not need to be created for that purpose, although I strongly recommend that all organizations have Bylaws at the point of being created. Again, just as with the websites, the Bylaws must be reviewed carefully to make sure that they contain nothing that would compromise the application to the IRS. All the Bylaws must be consistent with the purposes of the organization and must include any magic language discussed above.

- **Required Provisions:** To make its life easier, the IRS requires that you point them to where in your organizing documents certain magic language is included, specifically your purposes, which must be charitable (they give definitions of what that means and how you can use that term), disposition of assets on dissolution (again they provide sample language), as well as limitations on any of the funds of the organization inuring to the benefit of any individuals. As discussed above, I recommend using the language that is pre-approved by the IRS for these purposes. Some organizations wish to have a more narrowly tailored definition of their charitable purpose, which is fine, so long as it comes within one of the accepted descriptions the IRS has provided. For other organizations, we recommend that they keep a more general charitable description, as permitted by the IRS, to allow them more latitude in terms of the ways that the organization may choose to execute its purposes. A very narrow definition of purpose would require an amendment of the Articles of Agreement or Trust document, should the organization decide to branch out in another area that may still be legitimately charitable but outside its stated purposes. Such amendments must be submitted to the IRS as long as the organization exists.
- **Compensation and Financial Arrangements with Officers, Directors, Trustees, Employees and Independent Contractors:** Compensation of officers, directors and trustees is not recommended because of the limitations on liability of volunteer officers and directors in New Hampshire and the complications with conflicts of interest. The only exception would be for a large charitable organization where the CEO needs to be compensated at a level commensurate with his or her responsibilities. The bottom line is that compensation must be reasonable,

it must be based on arm's-length negotiations, and it must be based on a review of comparable salaries for similar individuals in the same field in the same geographical area. The IRS has lengthy descriptions of what it means by arm's-length and fair market value, all of which must be read and absorbed by the organizations if they provide substantial compensation to officers and employees. This is covered later in the program in the section on Intermediate Sanctions.

- **Description of Activities:** This is a narrative section of the form that organizations should use as an opportunity to really wax eloquent on what they do, how well they do it, and how it is tied to their charitable purpose. The more information provided to the IRS, generally the better. The IRS seems to like letters of explanation, flyers, brochures, printouts of the website, fundraising material, etc., as ways of demonstrating exactly the kinds of programs that the organization is conducting. Of course, it must be consistent with your charitable purpose.
- **Financial Data:** This is a section that needs to be completed by the organization itself rather than by an attorney or other person assisting them with filling out the form. Depending on how long the organization has been in existence, it may need to provide information going back 2 years as well as the current year, or going forward 2 years. In general, the IRS is looking for at least 3 years of data, as well as a balance sheet. All this needs to be filled out to the best of the ability of the organization. It is a good example of how much detail an organization should have in its financial accounting. It should not be too burdensome for a well run organization.

- **Public Charity Status:** This is where the IRS will presume that the organization is a private foundation, unless the organization indicates differently. As noted above, there are several tests for a publicly funded or publicly supported charity, which should be checked off as appropriate. Otherwise, organizations will end up being considered a private foundation.
- **Request for Advance or Definitive Ruling:** No longer required, per the Addendum.
- **Schedules:** There are many schedules for different types of organizations that conduct different types of activities. Some organizations will have to fill out one or more, many will not have to fill out any.
- **Appendices:** There are a couple of appendices that are very useful, including Appendix A, a sample Conflict of Interest Policy which should be combined with New Hampshire requirements to make a document that would cover both; Appendix B, dealing with private foundation requirements and state law; and Appendix C, a glossary of terms, very useful for those going through this for the first time. There is also an Index at the end of the form.
- **Finally, a check for the filing fee, payable to the IRS.** See the Addendum for new amounts.