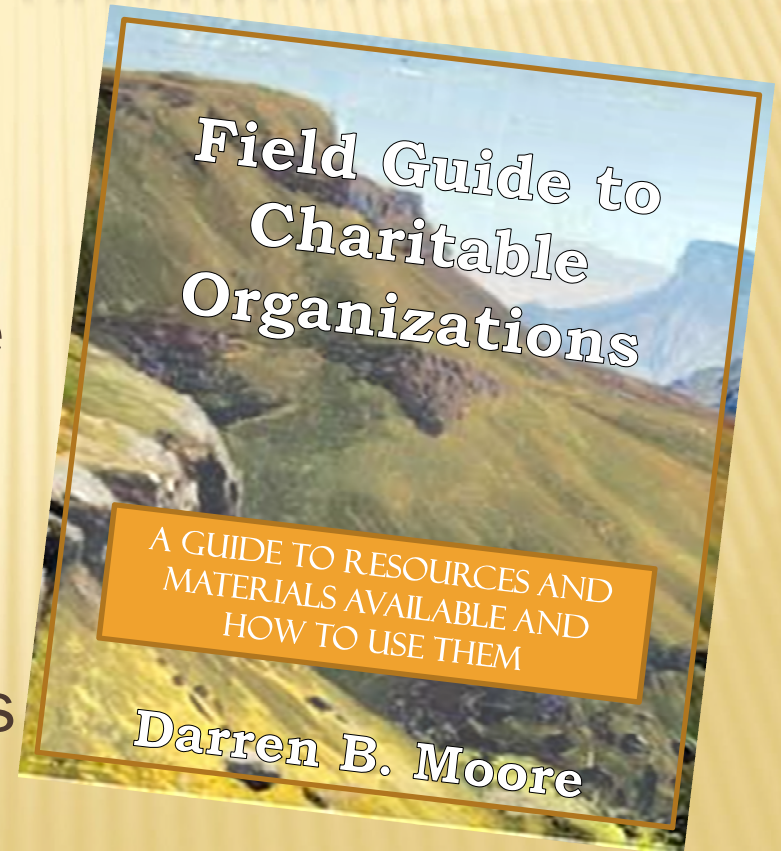


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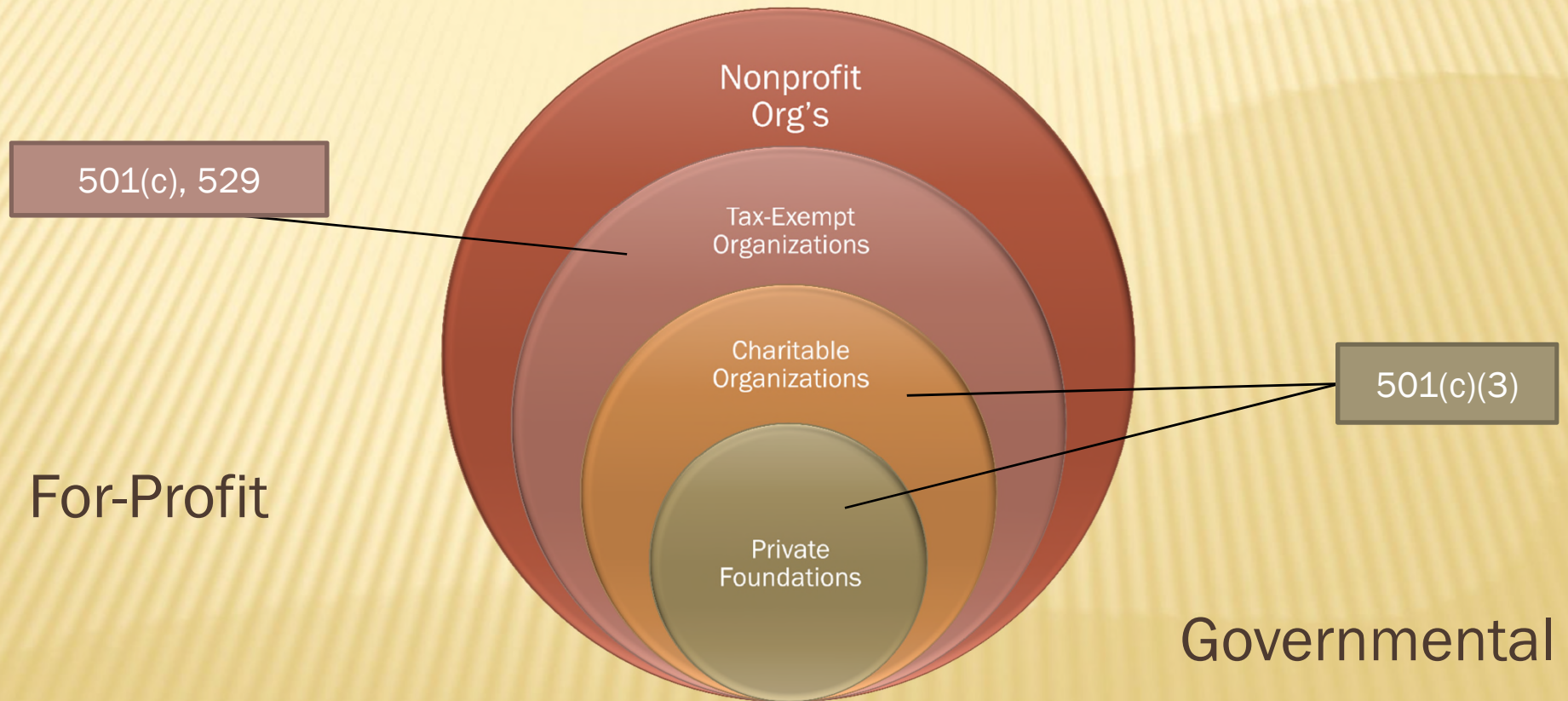
NAVIGATING UNFAMILIAR TERRAIN: NONPROFIT LAW FOR THE NON-NONPROFIT LAWYER

FACTS AND FIGURES ABOUT CHARITABLE ORGANIZATIONS

- ✖ 1.4 million tax-exempt (nonprofit) organizations
- ✖ 10% of the American workforce (11.4 million jobs)
- ✖ About 75% make up the “independent sector” – including 501(c)(3)s and (c)(4)s



NONPROFIT VS CHARITABLE ORGANIZATION



CHOICE OF FORM – STATE LAW



Charitable trust



Nonprofit unincorporated association



Nonprofit corporation



LLC [acceptable as disregarded entity or a stand-alone if all members exempt]

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CHARITABLE TRUSTS



Fiduciary relationship with respect to property created by declaration of trust by trustor investing trustee with legal title to property for the benefit of a charitable beneficiary

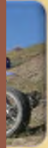


Governed by
state's trust
act

Ascertainable
or public
beneficiary

May have one
or more
trustees who
may be
corporate or
individual

Trustee owes
fiduciary
duties to the
beneficiary
(which may
be the public)



NONPROFIT UNINCORPORATED ASSOCIATIONS



Unincorporated association, other than one created by a trust, consisting of three or more members joined by mutual consent for a common, nonprofit purpose

Non-Code organization (usually have Constitution, Articles of Association)



Default rules in BOC Ch. 252

Powers: Promote aims and purposes and advance members' interests by all legitimate and legal means (not necessarily charitable, e.g. trade association, unions)



NONPROFIT CORPORATIONS



A corporation whose income may not be distributed to its members, directors, or officers in the form of dividends or otherwise (note: salaries paid must be reasonable)

Governed by the Texas Business Organizations Code (specifically Chapter 22)

May be organized for any lawful purpose (with limited exceptions)

Note: While purposes are broad, care should be taken if later applying for 501(c)(3) recognition (must be organized exclusively for charitable, educational or religious purposes)



COMMON USES OF THE LLC IN THE NONPROFIT* SPACE



Subsidiary of an Exempt Organization

- Risk Mitigation
- Participation in Joint Venture
- Focused Management of Activity (often revenue-producing)



Stand-alone Exempt LLC

- Members must be limited to tax-exempt entities

*LLC for Social Enterprise (Revenue Generating Activities)

- Subsidiary of Exempt Organization
- For profit “social enterprise”



§ 501(c)(3) Elements

1. Proper
organizational
structure

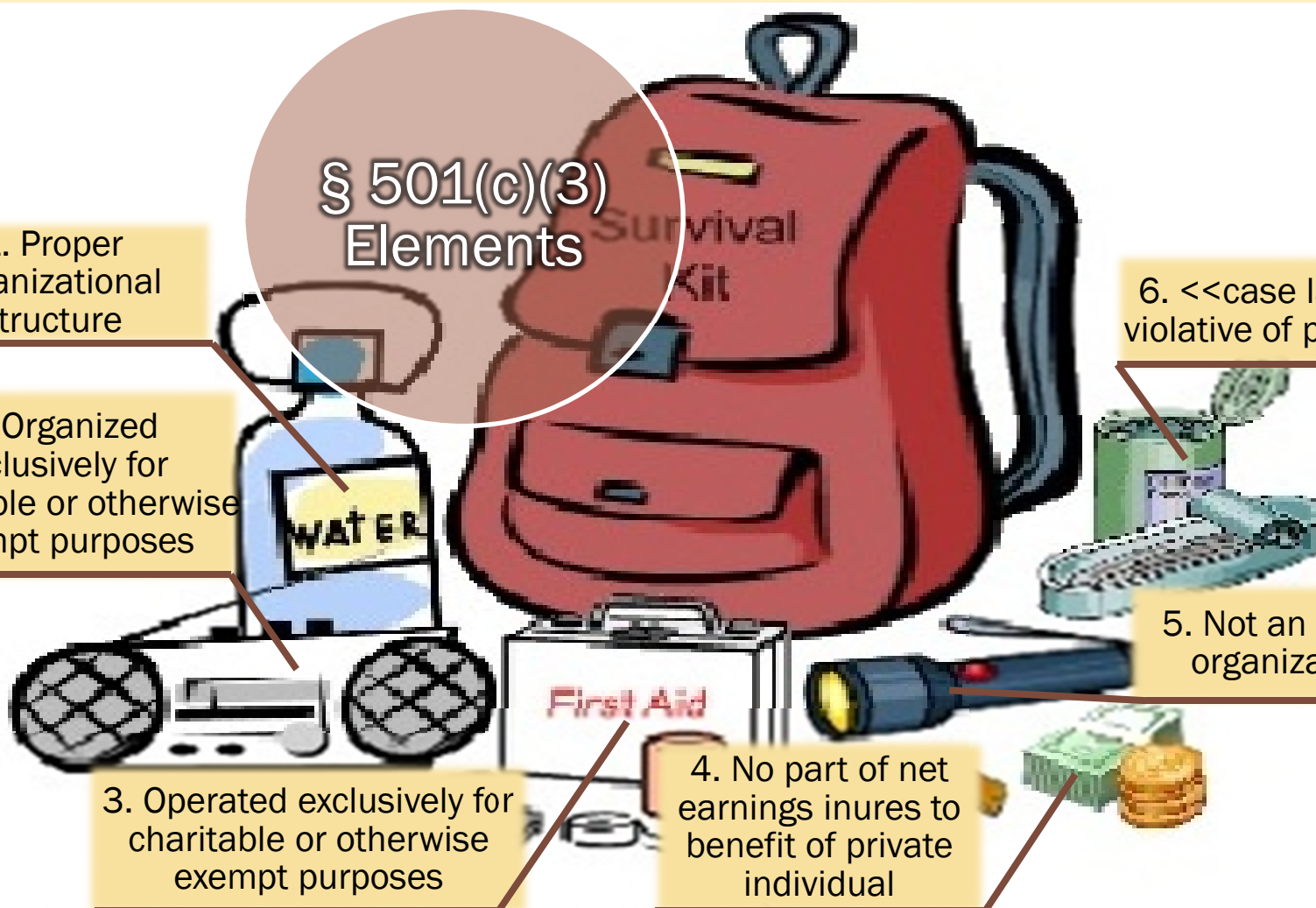
2. Organized
exclusively for
charitable or otherwise
exempt purposes

3. Operated exclusively for
charitable or otherwise
exempt purposes

4. No part of net
earnings inures to
benefit of private
individual

6. <<case law>> - not
violative of public policy

5. Not an action
organization





RECOGNITION OF TAX EXEMPT STATUS

1. Organize for state law purposes

2. File IRS Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code

3. IRS approves via determination letter

4. Apply to Texas Comptroller for exemption from state franchise, sales, use taxes

ORGANIZATIONAL/OPERATIONAL TESTS



Organizational

Look to enabling documents

Must be organized exclusively for charitable purpose(s)

May be general or specific

Operational

Look at actual activities of organization

Must be operated exclusively for charitable purpose(s)

No substantial activities that don't further charitable purposes



PRIVATE BENEFIT

- ✗ Implicit in requirement that the organization must be operated for charitable (public) purposes
- ✗ Benefits cannot be limited to a group of persons (results in private rather than public benefit)
- ✗ Insubstantial (incidental) private benefits
 - + Qualitative and quantitative analysis

A photograph of a forest floor with a wooden boardwalk made of planks. A large tree trunk is on the left, and dense green foliage is in the background. A thin orange line is visible across the upper part of the image.

PRIVATE INUREMENT

- Subset of private benefit
 - Privately benefitting an insider
- Private inurement can result in revocation of tax-exempt status or excise taxes/intermediate sanctions

COMMERCIALITY DOCTRINE

- ✗ Manner of conducting revenue-generating activities = substantial non-exempt purpose
- ✗ Operating with a “distinctly commercial hue”
 - + Direct competition with commercial firms (esp. in same locales)
 - + Pricing Structure designed to produce a profit
 - + Extensive advertising and use of commercial advertising materials
 - + Annual accumulated profits
 - + Lack of charitable donations



UNRELATED BUSINESS TAXABLE INCOME



- ✗ Subject to tax:
 - + Trade or business
 - + Regularly carried on
 - + Not substantially related to exempt purposes
- ✗ Primary Exceptions
 - + Volunteer Exception
 - + Convenience Exception
 - + Thrift Shop Exception
- ✗ Notable Exclusion
 - + Passive income (usually)

FOLLOWING THE TRAIL: STATE LAW FIDUCIARY DUTIES

DUTY OF CARE

- ✗ Good faith
- ✗ Person of ordinary prudence
- ✗ Decisions reasonably believe to be in the foundation's best interest
 - + May be afforded protection from business judgment rule or trust indenture

DUTY OF LOYALTY

- ✗ Act unselfishly
- ✗ Transactions with the foundation (if allowed) must be fair
- ✗ Maintain confidentiality
- ✗ Don't take foundation's business/ investment opportunities

DUTY OF OBEDIENCE

- ✗ Remain faithful to and pursue the goals of the foundation
- ✗ Follow the governing documents
- ✗ Follow gift restrictions
- ✗ Abide by the law/IRC
- ✗ Ensure charitable assets are not diverted

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GENESIS OF THE RESTRICTION

Express
(such as in
a gift
instrument)

- This gift is for the express purpose of medical research into cures for the Ebola virus.

Response
to
solicitation

- All funds raised will be used for humanitarian aid in Liberia.

Arising
from
governing
documents

- This Corporation is organized and shall be operated for the charitable purpose of animal rescue.

THE AUTHORITY OF THE OAG

- ✖ Common Law
- ✖ Constitutional
- ✖ Statutory
 - + Enforcement Authority
 - + Investigative Authority
 - + Proper Party (Ch. 123)



DISSOLUTION AND TERMINATION

- ✗ State law requirements
 - + Resolution approving plan of dissolution adopted by board of directors and members, if any
 - + Conveyance of assets pursuant to plan of dissolution
 - + Certificate of Termination
- ✗ Federal tax requirements
 - + File final Form 990 and provide a certified copy of the Certificate of Termination
 - + Special rules govern termination of private foundations
- ✗ Assets distributed for charitable purposes



The information set forth in this outline should not be considered legal advice, because every fact pattern is unique.

The information set forth herein is solely for purposes of discussion and to guide practitioners in their thinking regarding the issues addressed herein. Non-lawyers are advised to consult an attorney before undertaking any issues addressed herein.

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