Fiduciary Responsibility

<u>What is Fiduciary Responsibility?</u>

Volunteer leaders have an implicit responsibility to act in the best interest of the organization they represent. This is commonly referred to as the **<u>fiduciary responsibility</u>** of a volunteer and is difficult to define but easy to breach. Volunteers must constantly be aware of potential conflicts of interest and not be involved with these conflicts in any manner. A volunteer's fiduciary responsibility consists of a Duty of Care, Duty of Loyalty, Duty of Obedience and Reliance of Experts:

<u>Duty of Care</u>

The duty of care requires an individual to exercise ordinary and reasonable care in the performance of their duties, exhibiting honesty and good faith. The "ordinary man" rule often applies when measuring this responsibility

<u>Duty of Loyalty</u>

The duty of loyalty requires a duty to avoid conflicts of interest and provide undivided allegiance to the mission of the organization. Loyalty in appearance, as well as fact, is equally critical.

<u>Duty of Obedience</u>

The duty requires an individual to operate within and in accordance with an organization's governing documents that include Articles of Incorporation, Bylaws, and policies and procedures. Compliance with federal and state laws, regulations and procedures are also required.

<u>Reliance on Experts</u>

A volunteer leader is entitled to rely on information, opinions, reports or statements prepared by committees, consultant and/or staff, that the leader believes is reliable and competent in the matters being presented. Once identified or accepted as an expert, any information, opinions, reports or statements cannot be ignored and must be given ample and proper consideration. Anyone who knows more than the average person can constitute an expert.

10 Basic Functions of a Governing Board

1. Determine the organizations mission and purposes

   Establish a Mission, Strategic Plan, Articles of Incorporation, Bylaws and Tax Exemption.

2. Select the Executive Staff through an appropriate process

   The Executive Director represents the only employee of the Board. All other Association staff report to the Executive Director.

3. Provide ongoing support and guidance for the Executive

   Establish clear direction and lines of communication, adopt the organizations policies and procedures, approve an annual budget, etc.

4. Ensure effective organizational (strategic) planning

   Routinely evaluate the Strategic Plan and identify the tangible goals, tied to the budget, that need to be met to achieve this plan.

5. Ensure adequate resources

   Develop the annual budget in a conservative, realistic and dynamic manner.

6. Manage resources effectively

   Routinely review the internal financial statements, audit reports and any consultant reports. Evaluate operational and organization efficiencies routinely.

7. Determine and monitor the organization's program and services

   Periodically survey members to ensure the benefits provided are valued and meet their expectations.

8. Enhance the organization's public image

   Promote and protect the organization.

9. Serve as a court of appeal

10. Assess its own performance

Legal Considerations of a Governing Board

1) Leaders cannot abdicate their responsibility to be in charge and to direct.

2) Leaders must make certain that their Association is working within the legal frame work.

   Ignorance of the law is no excuse. Federal, state and local regulations, and reporting requirements for tax-exempt organizations are among the more complicated.

3) Leaders have the responsibility for the protection of all Association assets.

   Insurance, audits, budgeting, and oversight are among the internal controls that can minimize any risk to the organization.

4) Leaders must validate all major contracts by giving and recording formal approval.

   Establishing polices and ensuring compliance with those policies are typically how organizations avoid micro-management.

5) Leaders must attend all Board meetings, not just on occasion. Absence from meetings does not release a Board member from the responsibility for the decisions made.

Practical Considerations for a Governing Board

1) Attend meetings. Rely on information presented and the integrity of others; however, always use reasonable judgment.

2) Read minutes ensuring completeness and accuracy.

3) Record objections and ensure controversial issues are debated. The assumption under the law is not that the correct decision was made but serious consideration of an action before the action was taken.

4) Maintain current policies and procedures that have been reviewed by professionals (legal, audit, database managers etc.) and that are thoroughly understood by the Association's staff.

5) Ensure all laws and regulations are followed in a complete and timely manner. Employment and income taxes must be paid and gain a thorough understanding of the distinction between independent contractor and employee.

6) Ensure adequate insurance is maintained to properly safeguard the Association's assets.

7) Review financial statements and ensure that you have a thorough understanding of the financial position and performance of the Association.

Leadership Protection

The Volunteer Protection Act of 1997 provides immunities from personal liability for volunteers of qualifying nonprofit organizations. This law supersedes any conflicting state regulations and is intended to limit any liability from the good faith efforts of those volunteers. **This law does not cover employees; consequently, this law may not cover any Board member that receives salary, wages, or a stipend either directly or indirectly.** Additionally, the law does not cover:

Willful Misconduct
Gross Negligence
Fraud
Violation of State Laws
Wrongful Action Committed Prior to Passage
Employment Practices
Violations of Civil Rights
Sexual Offenses
Personal Injuries (Libel, Slander etc.)

To minimize any exposure related to these areas covered by the Volunteer Protection Act of 1997, it is strongly recommended that a tax-exempt organization consider contacting an insurance professional and consider adopting the following insurances:

<u>Directors and Officers Liability Insurance</u> typically covers the decisions and action of a tax exempt organization's Board of Directors during the course of providing leadership to the organization they represent. This type of insurance will cover any breach of duty, error, neglect omission or act committed solely in the course of the activities of the organization.

<u>Professional or General Liability</u> insurance covers the organization for damages against third parties or property by the breach of duty, error, neglect omission or act committed solely in the course of the activities of the organization.

<u>Fiduciary Liability</u> insurance protects the insured from claims of "breach of fiduciary duty" by the breach of duty, error, neglect, omission, or act committed solely in the course of the activities of the organization.

Understanding Conflict of Interests

What is a Conflict of Interest Policy?

Conflict of Interest policies are those rules, regulations, and/or procedures adopted by an organization to ensure that an individual in a position of authority does not allow their private interests to compete with their professional responsibilities. These policies are intended to ensure that decision makers act in a fiduciary manner and that all decisions affecting an organization are made by individuals who are independent in appearance and in fact.

Why have Conflict of Interest Policies?

There may be many answers to this question. Here are probably the two most compelling:

1) Document compliance with the law

Under the Internal Revenue Code a tax-exempt organization receives favorable tax treatment not offered to for-profit organizations. Exemption from federal and state income tax, lower postal rates, and deductibility of membership dues are among those benefits resulting in considerable savings each year to tax-exempt organizations. Should an organization lose its tax exempt status it could cost the organization hundreds of thousands of dollars in any given year. The Internal Revenue Code states:

“**A section 501(c)(3) organization must not be organized or operated for the benefit of private interests, such as the creator or the creator's family, shareholders of the organization, other designated individuals, or persons controlled directly or indirectly by such private interests. No part of the net earnings of a section 501(c)(3) organization may inure to the benefit of any private shareholder or individual. A private shareholder or individual is a person having a personal and private interest in the activities of the organization.”**

2) Document the Board is acting in a fiduciary manner

Membership organizations cannot exist without the trust and confidence of their members. The trust and confidence of members are the essential assets of any membership organization, without it the organization would be ineffective and eventually cease to exist.

What is a Conflict of Interest?

A conflict of interest is any arrangement or agreement with an individual who has a direct or indirect financial interest through business, investment, or family. Here are a few examples where a conflict of interest may arise within ACA:

A. Any leader or principal officer who owns or family owns stock, is a principal or is employed by a company with whom the Association conducts or may conduct business.

B. Any author who sits on Governing Board or the Publication Committee that receives a royalty or may receive one from the Association.

C. Any compensated Governing Board member or officer who is asked to vote on that compensation.

D. Awarding a grant to a region, branch or university to which you or your family member may belong.

What are my Responsibilities if a Conflict of Interest Exists?

In the event a conflict of interest exists an individual is required to disclose it when it has been or should have been realized in the Association's annual Conflict of Interest statement. While the interested person is free to make a presentation they should not participate in any discussion or vote that is directly or indirectly related to any actual or potential conflict of interest.

How Does the Board Handle Conflicts of Interest?

Once identified, the conflict of interest should be investigated and discussed by disinterested members of the Governing Board. While the interested party may make a presentation they must leave the room when the conflict of interested is being discussed and voted on. The disinterested members of the Governing Board or a committee of disinterested individuals would decide if the conflict of interest precludes the Association entering the transaction or if the transaction is in the best interest of the Association.

Do I have an Obligation to Report Conflicts of Interest Other Than my Own?

Yes. As a member of the Governing Board each member has a duty to act in a fiduciary manner. Conflicts of interest may be detrimental to the organization. Accordingly, if a member of the Governing Board is aware of any conflict of interest, they have an obligation to disclose this conflict to the president.

10 Golden Concepts of Budgeting

In my experience, I have found that an individual's initial perception of budgeting varies from the simplistic to the horrific; and, from exciting to tedious. However, I have also found that as an individual gains a greater conceptual understanding of budgets, the degree of tension or dread starts to diminish. Accordingly, outlined below we are providing the 10 Golden Concepts of budgeting that we hope will provide you more insight.

1) The responsibility of developing the annual operating budget rest with all board members.

2) The manner in which a budget is developed could adversely influence planned programs, benefits, and projects.

3) A budget is simply a tool. It is a quantified set of assumptions that translates the intangible goals of a strategic plan and converts them into the programs, benefits, and projects needed to carry out the mission of the organization.

4) Some budget line items can be predicted with a great deal of certainty while others can not.

5) Budgets are flexible and should be changed as the assumptions used to develop the budget change.

6) The more conservative a budget the more flexible it can be.

7) Budgets based on complete and timely information are generally more accurate.

8) Barring significant changes, financial performance tends to follow the historical trends of the organization.

9) A comparison to the current year activity and projections, if reasonably, accurate, is a good indicator whether a budget is realistic.

10) Budget overruns are acceptable. Too many budget overruns or significant budget overruns could be problematic.

Budgets vary greatly from organization to organization and even within organizations. There is not a set format that budgets must follow nor are there standard categories that must be used. Even the method used to calculate and measure costs widely differ. However, if you exercise due diligence and have a basic understanding of the concepts presented not only will budgeting be easier but monitoring it will also be easier.

Dues Rate Increases-When and How

Should we increase dues?

Unless membership and/or non-dues revenues increase, costs decrease or some positive combination of these two situations occurs, an organization's membership rates typically will have to increase. This is a necessary evil that most organizations will eventually have to face. Given increasing costs and/ or declining membership, it's not a matter if they need to raise dues rates but when and how much they need to be raised. Given this dilemma, an organization is faced with a philosophical choice to make: that is, whether to be proactive or reactive.

A proactive organization will plan for these increases and minimize the adverse effects. These groups typically consider rate increases annually as part of their budgeting process. Whether needed or not groups will raise dues incrementally and create reserves. This "saving for a raining day" mentality allows these groups to minimize if not eliminate the need to ever substantially have a significant rate increase. Consequently, this is the recommended approach.

Conversely, a reactive organization will increase rates infrequently. These rate increases tend to be more significant and creates "sticker shock" to some of its members. As a result, membership tends to decline temporarily if not permanently. Accordingly, any organization adopting this philosophy should have significant non-dues revenues that could help minimize the amount of any rate increase.

How much to raise dues?

To minimize rate increases there are three things any membership organization must do well; be operational efficient and profitable, retain, renew members, and grow non-dues revenues sources.

My experience has been that minimal rates (1-5%) increases draw little attention and few complaints. This makes sense as most people have an expectation that prices will increase from year to year. On the other hand, larger rate increases (8 -15%) have resulted in numerous complaints and a drop in membership of 4-6%. When this happens your problems have now increased (retention, recruitment, cash flows, etc.).

When to raise dues?

Rate increase should be planned at least twelve months in advance. Dues rate increase has a more immediate impact on cash flows than on the financial performance of an organization. Generally accepted accounting principle requires an annual membership to be pro-rated over twelve months. Since division memberships are based on anniversary dates rather than fixed date the actual financial impact of most members is realized over two years. Conversely, cash is received normally in one payment and is immediately available to an organization. Consequently, planning is particularly important in considering when to increase membership rates.

Recommendation

In my opinion a 10% increase in a three year period is easier for members to absorb at 3.33% each year than a 10% increase in any one year. By spreading it over time the impact is more subtle not only because the increase is less significant but it corresponds to a members increase earnings each year.

Reading Financial Statements

Balance Sheet

The Balance Sheet refers to the financial position of an organization at a particular point in time. It consists of assets, liabilities, and equity, and most importantly the date that these elements are being reported.

Assets are anything of value that is owned by the organization or rights that the organization is entitled. These can be either tangible or intangible and include cash, investments, furniture, equipments, monies owed, and goodwill.

Liabilities are any debts or obligations that are owed by an organization. These include unpaid bills, employee benefits, loans, deferred membership dues and subscription revenues that have yet to be earned.

Equity section is typically divided into three sections: unrestricted, restricted and retained earnings. The first two are self-defined. Retained Earnings represent the activity of the current period.

Equity represents a residual of the difference between Assets and Liabilities. This is known as the accounting equation that is its basic premise and touches us in our daily lives. When purchasing a home, obtaining a loan, using a credit card, writing checks, or even working, each of us affects our personnel accounting equation. Unfortunately, corporations whether profit or nonprofit are much more complicated since significantly more individuals affect this equation. However, the bottom line remains the same. If any organization has more assets than liabilities the organization is by definition solvent. If the converse is true, the organization is technically bankrupt.

Statement of Revenue and Expenses

The Statement of Revenue and Expenses is also referred to as a Profit and Loss Statement or an Income Statement. This report unlike a Balance Sheet can cover multiple periods (years) or periods within a period (months). These periods are defined as fiscal years and generally cover a twelve-month period. The Statement of Revenue and Expenses consist of three sections Revenue, Expenses and the difference of the two.

The Statement of Revenue and Expenses can be modified to provide essential information of any organization. Comparisons to the prior year(s), quarter or month can be used to identify trends and develop projections. Comparisons to the approved budget can be used to evaluate the current performance to expectations. Comparisons to industry standards can provide management with useful information regarding the organizations efficiencies or lack thereof.

UNDERSTANDING AUDITS

An audit is an independent attestation of an organization's financial statements by a certified public accountant that provides assurance that the financial statements are not materially misstated. State law, bylaws, loan documents or other contractual obligations, may require an organization to have an annual audit. Audits are strongly suggested, whenever cost effective, to not only ensure the accuracy of an organization's financial statements but compliance with laws and regulations; and to evaluate an organization's efficiencies and system of internal controls.

Audits must be performed by independent certified public accountants. If an auditor lacks independence he is precluded from performing the audit. Audits unlike a review of an organization's financial statement are far greater in scope and provide the greatest assurance. Upon completion of their fieldwork and review process, auditors will issue their opinion on the financial statements they examined. Four types of opinions exist:

1) An **unqualified opinion** means that the financial statements are fairly presented. This is the most desirable outcome of any audit.

2) A **qualified opinion** means the financial statements are stated accurately with a notable exception that is disclosed in the audit report.

3) A **disclaimer of an opinion** means that the auditors could not determine whether the financial statements were stated fairly. This opinion is issued when the auditors cannot gather or are not provided sufficient support to determine that the financial statements are fairly stated.

4) An **adverse opinion** is issued when the auditors believe the financial statements are materially misstated and does not present an accurate picture of an organizations financial condition or activity.

In addition, the auditors will also provide the organization a report of any material weaknesses noted in an organization's financial reporting process or internal control noted during their examination. Recommendations to correct these flaws are also included in this report.

An audit can last anywhere from two days to six months. It involves a detail examination of an organization's financial records and conversations with both leaders and staff. During the course of an audit, an independent auditor will thoroughly inspect a number of checks issued and received by an organization; bank deposits, withdrawals and statements, executed contracts, investment statements and minutes of Board meetings. Accordingly this information should be complete and neatly organized prior to any audit.

An audit of an organization's financial statements can be a useful tool. Understanding the process will help you understand how it not only helps the organization but also helps its leaders.

REVIEW CHECKLIST

Because so many decisions are based on an organization's financial statement, it is strongly recommended and encouraged that any tax-exempt membership organization have their financial statements audited or reviewed annually by independent certified public accountants. However, in the event the organization does not incorporate this process, outlined below are some basic checks and balances. This checklist is intended to serve as an informal review checklist and should not be relied on as a substitution to a complete audit or a review. ***More importantly, this checklist should not be interpreted, implied or construed in anyway to represent a complete audit or review in any manner.***

1. Tie opening cash balance to last year's closing bank reconciliation and bank statement. Any items appearing on the bank reconciliation should be traced to canceled checks or deposits.

2. Account for all checks. Ensure for completeness by numerically accounting for every check written. Starting number should be traced to the last year's check register, while ending number is traced to the current year check register. All checks should be traced to the bank statement and cancelled checks.

3. Review all checks to ensure they were properly approved, authorized and used for the organizations exempt purpose. Evaluate all expenses to determine they are reasonable and at a fair market value. All large expenses should be traced to the Board minutes.

4. Deposits should be traced to the bank statements to ensure all monies received have been deposited in a complete and timely manner. On a random basis active memberships should be traced to deposit slips to ensure all deposits are complete.

5. Review the Statement of Revenue and Expenses. All revenues should be traced to a deposit slip and all expenses should be traced to a check that has been a properly approved, authorized and is properly supported.

6. Review all bank and investment statements to ensure all accounts are in the name of the organizations.

7. Review all insurance policies to ensure all assets are properly safeguarded.

8. Examine any fixed assets to ensure they exist and are the property of the organizations.

9. Review all federal, state and local filings to ensure they were completed and filed in a complete and timely manner.

10. Compare actual results to prior year and budget to determine if financial activity meets expectations.

Federal Reporting Requirements

Completing the Annual 990 or 990-EZ

Who Must File:

A 990 is required to be filed by any tax-exempt organization whose **gross receipts** are more than $25,000.

If an organization's gross receipts are less than $100,000 and its total assets are less than $250,000 it is eligible to file Form 990 E-Z.

In addition to the 990 Section 501(c)(3) organizations are also required to file Schedule A and possibly a 990-T if unrelated business income tax exceeds $1,000.

When to File:

990s or 990 E-Zs are required to be filed no later than **the 15th day of the fifth month following the end of the organization's fiscal year**. If an organizations calendar year is December 31st than the return is due May 15th. Likewise, if the year-end is June 30th the deadline for filing is November 15th.

An **extension** of 90 days can be obtained by filing Form 2758. If additional time is needed a second Form 2758 can be filed for an additional 90 days: however, this is only granted in situations of extreme hardship. In no event will the IRS grant an extension greater than 6 months.

Where to File:

Once completed all 990s or 990 E-Zs and any related forms should be sent to the **Internal Revenue Service, Ogden Utah 84201-0027.**

Filing a Group Return:

In order to file a group return a parent organization must meet the following criteria:

Affiliated with the central organization.

Subject to the central organization's general supervision and control.

Exempt from tax under a group exemption letter that is still in effect.

Have the same accounting period.

Every year the subsidiary organizations must authorize the central organization in writing to be included in the group return. In addition, it must also attest in writing that the information provided is complete and true.

Complete Form 1023 to apply for a Group Exemption ruling.

Unrelated Business Income:

Unrelated business or trade income is any income derived from any trade or business that is regularly carried on but is not substantially related to the organizations exempt purpose or function**. Trade or business** is any activity that is carried on for the production of income from selling goods or providing services. **Not substantially related to** means the activity does not contribute importantly to the exempt purpose of the organization, other than the need of funds.

State Filings:

Some states accept federal form 990 in place of all or part of their reporting requirements; however, this report may not satisfy all state reporting requirements: therefore; please **consult the appropriate agency in the state which your organizations operates.**

Public Inspection

Tax-exempt organizations are **required to disclose and make copies** of the organization's Application for Tax Exemption (Form 1023 or 1024) and the 990 of the three immediate past years. This information must be available during regular business hours at the permanent headquarters of the Association. If a permanent office does not exist the information must be available at a reasonable location of choice. Copies must be provided within 10 days of receiving the request.

Penalties

Penalties against an organization is **$20 per day up to a limit of $10,000 or 5% of the organization's gross receipts** for the year the return was not filed.

Penalties against an individual **are $10 per day up to a limit of $5,000**. If one or more persons are liable than the penalty is applicable jointly and/or individually. Willful disregard can result in imprisonment.

Help Line:

If you have any questions or need any assistance, the IRS maintains a help line at Monday through Friday from 8:00 a.m.- 9:30 p.m. eastern. Call **1-877-829-5500**. Forms and instructions can be ordered by calling **1-800-Tax-Form** or via the Web at **www.irs.gov**.

Obtaining an Employer Identification Number

Completing Form SS-4

What is an Employer Identification Number (EIN)?

An employer Identification number is comparable to an individual's social security number. It is a nine-digit number assigned to sole proprietors, corporations, partnerships and estates for tax filing and reporting purposes.

Who Must File:

An EIN number is required if you are an employer or are required to use any federal return, statement, or other document. Corporations and nonprofit organizations are among those groups who must have an EIN.

When to Apply:

A business should apply for an EIN prior to commencing operations. If you are starting or maintain an existing business and do not have an EIN Form SS-4 should be immediately completed.

How to Apply:

An EIN can be obtained by mail or telephone by completing form SS-4 and mailing or faxing it to the appropriate Internal Revenue Service Center. See the instructions for the telephone number and address of the appropriate center.

Types of Tax Exempt Organizations

501 (c)(3) verses 501(c)(6)

501(c)(3) organizations are generally those whose primary purpose is charitable, religious, educational, scientific etc. Advantages include:

Advantages include:

- Preferred postal rates
- Exemption of certain federal and state taxes
- Contributions are tax deductible
- Greater likelihood to receive grants and awards

Disadvantages include:

- Limited lobbying efforts
- More stringent reporting requirements

501(c)(6) organizations are generally those whose primary purpose is a business league or trade associations.

Advantages include:

- Unlimited lobbying

Disadvantages include:

- Dues are not completely tax deductible by members
- No preferred postal benefits
- Allocation of dues must be calculated each year

Organizational Structure

Five Easy Steps in Setting Up a Tax Exempt Organization

Evaluate the tax-exempt purpose of the organization.

Develop a strategic plan and **determine whether the tax-exempt purpose of the organization is viable**. Can it be adequately funded? Can the goals be realistically achieved? Is the purpose of the organization consistent with the Internal Revenue Code's criteria for tax-exempt status?

Determine the need for incorporation.

While **incorporation isn't necessary for tax-exempt status it is strongly suggested** due to potential liability inherit with in business today. Some states require tax-exempt organizations to be incorporate; therefore, the appropriate agency should be contacted to determine whether incorporation is a requirement.

Develop Organizing Documents.

For those entities that are incorporated a conformed copy of the Articles of Incorporation and bylaws along with a certification that they are complete and accurate are required. For those entities that are not incorporated a conformed copy of the constitution, articles of association and with a certification that they are complete and accurate are required.

The organizing document must clearly specify the purpose of the organization. **Bylaws alone are not organizing documents since they merely represent the internal rules and regulations of the organization.** In addition, the organizing documents must contain a dissolution clause that transfers the assets of the corporation to one or more 501(c)(3).

Apply for Employer Identification Number

All organizations **must have an EIN number** to be considered for tax exemption.

Apply for Tax Exemption

Complete and mail the appropriate Application for Tax Exemption. Form 1023 for those organizations seeking 501(c)(3) and Form 1024 for those seeking 501(c)(6). In addition, Form 8718 is also required along with a $150 or $500 filing fee depending the organization's proposed budget.

Lobbying

Lobbying can constitute a significant part of an organization's activity. Every tax-exempt organization is permitted to lobby. However, certain organizations are limit to the degree in which they may lobby. In addition, reporting of this activity can be complicated and is closely monitored. Violations of lobbying regulations can result in a reclassification or revocation of an organization's tax-exempt status. This could have a disastrous effect to an organization. Consequently, the need for a general understanding of the lobbying regulations is essential for both leader and management of any tax-exempt organization.

Lobbying is supporting or opposing any piece of legislation at any level of government. Direct lobbying is attempting through communications with a member or an employee of a legislative body; communication that reflects a view, clarifies, amplifies, modifies, or provides support to a particular legislation. All preparatory activities such as research, planning and coordination are considered lobbying. Further, the regulations provide that there is **no distinction between influencing legislation, education, or providing technical advice to a legislator**. As a result, the same rules apply.

Indirect or **"grassroots lobbying"** is the attempting to influence the general public or segments of the public with respect to an election, legislative matters or referendum, indirect influencing or legislation or an election.

Political campaigning is the participation or intervention in any political campaign for public office. A campaign is deemed to begin when someone announces either by public statement or by filing with the state election commission that they are a candidate for public office. <u>Tax-exempt organizations classified as 501(c)(3) are specifically excluded from any political campaigning</u>.

Any direct communication with high-level officials constitutes lobbying and/or political campaigning. This includes communication with the President, Vice-President, Cabinet Members, and the two most senior level officers of any agencies.

Lobbying Issues of a Tax-Exempt Organization

Notification Requirement

Taxpayers are not entitled to a deduction for lobbying expenditures. As a result, certain tax-exempt organizations (50(c)(4-6) must disclose how much of the annual dues paid by these individuals is associated with lobbying. This percentage must be disclosed on the organization membership application and renewal form. In addition, this must be reported each year in the organizations 990. Organizations not providing proper notification are subject to a proxy tax equal to 35% of the organization's membership dues or lobbying expenses. Organizations incurring less than $2,000 in direct in-house lobbying expenses are exempt from the notification requirement.

Those organizations that are classified as a 501(c)(3) are exempt from disclosing the percentage of dues allocated to lobbying efforts since these organizations are not allowed any substantial lobbying efforts. Like other organizations, these organizations must disclose the extent of their lobbying activities through their annual 990.

Substantial Lobbying

"Substantial" has been subjectively interpreted; consequently, the IRS developed an objective standard to measure the lobbying activity of these organizations. This is referred to as the 501(h) election and made via Form 5768-Election or Revocation of Election by an Eligible Section 501(c)(3) Organization To Make Expenditures to Influence Legislation. Organizations making this election agree to be governed by the following standard:

20% of the first $500,000 of an organization exempt purpose expense plus
15% of the next $500,000, plus
10% of the next $500,000, plus
5% of the remaining expenditures.

Exempt purpose expenditures are defined as any amount paid or incurred during the year to accomplish the organization's exempt purpose.

Political Action Committee (PAC)Funds

501 (c)(3) organizations are prohibited from any political campaigning; consequently, assets of these organizations cannot be expended on endorsing any candidate.

However, many tax-exempt organizations have established PAC funds. These are separate organizations completely funded through the contributions and donations of the members of the particular tax-exempt.

Independent Contractors vs. Employees

Before a tax-exempt organization (EO) can determine how to treat payments for services rendered, the EO must first know the business relationship that exists between the organization and the person performing the services. In determining whether the person providing the service is a common law employee or an independent contractor, all information that provides evidence of the degree of control and independence must be considered. It is critical that the EO, as the employer, correctly determine whether individuals providing services are employees or independent contractors. Generally, the EO must withhold income taxes, withhold and pay Social Security and Medicare taxes, and pay unemployment tax on wages id to an employee. The EO does not generally have to withhold or pay any taxes on payments to independent contractors.

Caution: An EO can be held liable for employment taxes, plus interest and penalties, if a worker is incorrectly classified as an independent contractor.

Who Is an Independent Contractor?

A general rule is that the EO, as the payer, has the right to control or direct only the result of the work done by an independent contractor, and not the means and methods of accomplishing the result.

Outlined below are guidelines to determine if a worker is an employee or an independent contractor:

Employees are provided training and required to comply with instructions
Employees services are integrated into the business.
Employees services are rendered personally and are presumed in the interest of the employer.
An employee/employer relationship exist over a continued period of time.
Employees do not hire, supervise or pay their employees.
Employees establish full time set working hours.
Employees work on an employer's premises.
Employees perform work in an order or set sequence.
Employees are more likely to provide regular reports and are paid routinely.
Employees are reimbursed for business expenses.
Employees are furnished tools and materials.
Employees do not realize profit or loss and do not work for multiple businesses time.
Significant investment in employees are provided by employer.
Employees do not make their services available to the general public.
Employee may be discharged by their employers.
Employees generally are not bound by contract and have the right to terminate the relationship.

Record Retention

Indefinitely

Tax returns and any correspondence with the IRS or any other governmental agencies; annual financial reports; general ledger; general journal; income tax records and payment; documentation substantiating the purchase or sale of fixed assets, certificate of incorporation; corporate charter; bylaws, minutes; pension records; and any significant contracts.

Six Years

Canceled checks; invoices and register tapes; bank reconciliation and statements for all bank accounts, records for all revenues sources; documentation of any bad debt or account receivables; purchase records and orders; travel and expense records; personnel and payroll records.

Three Years

Internal financial statements, subsidiary ledger, all other accounting records not noted above.