



2016

Legal Tool Kit for Texas Nonprofits



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1. Overview of Nonprofit Governance Requirements

An organization can incorporate as a Texas nonprofit by filing the appropriate documents with the Texas Secretary of State. To attain the status of a *tax exempt* nonprofit, the organization must apply for and be approved by the IRS. This toolkit includes the legal requirements under the Texas Business Organization Code (“Code”), the Internal Revenue Code (“IRC”), and other laws applicable to tax-exempt nonprofits in Texas.

The following is a summary of some of the most important legal obligations governing Texas nonprofits. Unless otherwise indicated, references to sections of the law are from the Code and preceded by the symbol “§”.

A. General Legal Requirements

Regardless of whether an organization has paid staff, its board members are legally responsible for the management of the nonprofit. An active, attentive board may be the most important component of an organization. Board members should understand their roles and responsibilities, be actively involved, and have a wide range of skills to perform their duties.

- 1. Applicable Texas law.** Nonprofits are governed by the Code. As of January 1, 2010, all nonprofits are governed by the [Texas Business Organizations Code](#).
- 2. Name.** A nonprofit has legal restrictions on its name.
 - *No business abbreviation required:* A nonprofit is not required to use the word “incorporated” or “Inc.” in its name. §5.054.
 - *Deceptively similar name:* An organization may not use a name that is the same as or deceptively similar to the name reserved or used by another entity without consent of that entity. §5.053.
 - *Assumed name:* A nonprofit may operate under an assumed name by filing an assumed name certificate with the Texas Secretary of State (SOS [Form 503](#)) or “DBA” (Doing Business As). §5.051.
 - *Other name restrictions:* Use of the words or variations of the following words require special permission: Veteran, Legion, Foreign, Spanish, Disabled, War, or World War. §5.062.
- 3. Registered office and registered agent.** A nonprofit must maintain a current registered office and registered agent for service of process. §5.201.
 - *Registered office:* A nonprofit’s registered office must be a physical street address, not a post office (PO) box.
 - *Registered agent for service.* The registered agent for service of process is the person authorized by the nonprofit to receive notice of a lawsuit or claim against the nonprofit. The nonprofit must name the registered agent in its original Certificate of Formation (formerly known as the Articles of Incorporation, or Charter) filed with the Texas

Secretary of State. Additionally, the person named as registered agent must consent in writing to this designation by completing SOS [Form 401A](#), and the nonprofit must keep a copy of the consent with its books and records. § 5.201(b).

- *Failure to maintain current registered office and registered agent:* A nonprofit's failure to maintain a current registered office and a registered agent with the Texas Secretary of State can have dire consequences. In the absence of current information, lawsuits or claims against the nonprofit can be served directly on the Texas Secretary of State, which has no legal obligation to defend or otherwise attempt to notify the nonprofit. This may result in entry of a default judgment against the nonprofit without its knowledge. §5.251. To change the registered address or registered agent, the nonprofit must notify the Secretary of State by completing [Form 401](#) (address) or [Form 408](#) (agent) and pay the applicable fees.
- 4. Officers.** A nonprofit must have at least two officers, a president and a secretary. A nonprofit may have other officers, but must name a president and secretary, which cannot be the same person. §22.231. The term of an officer cannot exceed three years. §22.232. In the absence of a provision in the bylaws or certificate authorizing a specified term, the officers must be appointed or elected annually. §22.232.
- 5. Board Members.** A nonprofit's Board of Directors must have at least three members. The certificate of formation may establish any number of members, as long as there are at least three board members. There is no age requirement for board members. However, a person must be 18 years old to enter a legally binding contract, so a nonprofit should have at least three board members over the age of 18.
- *Board vacancies.* Board vacancies are filled according to the certificate of formation and the organization's bylaws. If neither the certificate of formation nor the bylaws address how to fill vacancies, they will be filled by a majority vote of the remaining directors. §22.204.
 - *Term limits.* The Code does not specify the term limits of board members. Term limits may be set forth in the certificate or the bylaws. §22.208. Board members do not need to be residents of Texas unless required by the certificate of formation or bylaws. §§22.203, 22.204. Nonprofits may have *ex officio* members of the board. §22.210.
- 6. Quorum.** A nonprofit must have a quorum to conduct business. A quorum is the number of directors (not less than three) required to conduct business. The bylaws or the certificate of formation should indicate the number of members that constitute a quorum.
- *No stated minimum for quorum.* If the bylaws or certificate do not provide for the minimum number of members to constitute a quorum, the Code provides that a quorum is three directors or a majority of the number of board of directors listed in the certificate of formation, whichever is greater. A director who votes by proxy is not counted toward a quorum. §22.213.
 - *Quorum for nonprofit with voting members.* For nonprofits with voting members, a quorum is 10% of eligible voting members represented in person or by proxy, unless otherwise provided by the certificate of formation or bylaws. §22.159.

7. Proxy. A nonprofit must follow the laws for proxy voting.

- *No voting members.* For nonprofits *without* voting members, proxy voting is not allowed unless authorized. A director may vote by proxy only if the certificate of formation or bylaws specifically authorize proxy voting.
- *Written proxy.* A proxy must be in writing. It may be revoked unless it states otherwise or is irrevocable by law. The proxy expires within three months, unless a shorter period is stated in the proxy. §§22.215, 22.216.
- *With voting members.* For nonprofits *with* voting members, the proxy expires in eleven months, unless a shorter period is specified in the proxy. §22.160.

8. Meetings. Notice and location of meetings is stated in the certificate of formation or bylaws.

- *Procedure for conducting.* Meetings may be conducted in accordance with standard procedures. The most common procedure is Roberts Rules of Order. For more information, see www.robertsrules.org and this [quick reference](#).
- *Notice.* The Code permits notice by mail, fax, or email. §6.051.
- *Location.* Meetings may be held in any location provided in the certificate of formation or bylaws, or by agreement of all persons entitled to notice. If no place is stated, the meetings are held at the nonprofit's registered or principal office in Texas §6.001.
- *Telephonic meetings* are permissible if:
 - not restricted by the certificate of formation or bylaws;
 - all persons can hear each other concurrently;
 - the notice for the meeting lists the type of communication system to be used for the meeting and states how to access that system;
 - reasonable methods are taken to identify every person voting at the meeting; and
 - a record is kept of any vote or action taken. §6.002.
- *Other remote electronic communication meetings* are permissible if:
 - not restricted by the certificate of formation or bylaws;
 - each member entitled to participate in the meeting consents beforehand to the type of communication system to be used;
 - all persons can communicate concurrently with each other;
 - the notice for the meeting lists the type of communication system to be used for the meeting and states how to access that system;
 - reasonable methods are taken to identify every person voting at the meeting; and
 - a record is kept of any vote or action taken. §§6.022; 22.002.

9. Board Action. A board cannot take action without a meeting unless there is unanimous written and signed consent.

- *Contents of written consent.* Consent that is sent via telegram, email, fax, or similar transmission is "written consent". The written consent must contain:
 - the specific action to be taken;
 - the date; and

- signatures of all of the directors.
- *If consent is not unanimous.* In the absence of unanimous consent, action is allowed only if
 - the certificate of formation permits lack of unanimity, and
 - at least the same numbers of members, directors, or members of a committee agree to the action as necessary to take an action at a meeting, at which all are present and voting, and
 - the board gives prompt notice to all members, directors, or members of a committee who did not consent in writing, and
 - delivers the written consent to the corporation in person or by certified mail, return receipt requested within 60 days, and
 - addresses the consent to the president or primary managing officer of the corporation. §22.220.
- *Exception.* The strict consent delivery requirements do not apply to member-based nonprofits, if the nonprofit is soliciting the consent.

B. Board Responsibilities

1. **Board Management.** The board of directors manages the affairs of the nonprofit, unless limited by the certificate of formation or bylaws § 22.202.
2. **Duty of Directors, Officers, and Committee Members.** Directors and officers are required to perform their duties as a director or committee member:
 - In good faith;
 - With ordinary care; and
 - In the best interest of the nonprofit.
3. **Best Interest.** A director acts in the best interest of the nonprofit if the director reasonably believes that the action will benefit the nonprofit. The director should have a proper motive based on sufficient information. Hindsight is not the test, even if the action turns out badly, as long as the action was taken with the best interest of the nonprofit in mind at the time the vote was made to approve the action (§ 22.221 and 22.235). To meet this requirement, directors must follow certain legal responsibilities also known as the Duty of Obedience, the Duty of Care, and the Duty of Loyalty.
 - *Duty of Obedience.* Directors must act in a manner that is consistent with the provisions of the Certificate of Formation (Articles of Incorporation), bylaws, and tax-exempt status of the nonprofit. Directors should be familiar with the mission of the nonprofit and act in a manner consistent with such mission. The organization should carefully consider a decision to change its direction or expand the organization's mission. In addition, directors must comply with all federal, state, and local laws as they apply to the organization.

- *Duty of Care.* Directors must perform their responsibilities with “ordinary care,” which is the use of good judgment and common sense. Directors should devote a reasonable amount of time and attention to their responsibilities, attend meetings, and review and understand material submitted to them. They should ask questions, if necessary, to obtain information sufficient to fulfill their responsibilities. Ordinary care may differ from director to director based on their background, experience, and the role they play in the organization.
- *Duty of Loyalty.* When a director assumes office, the law requires that the best interest of the nonprofit prevail over the director’s personal or business interests. A conflict of interest can arise in many situations including leasing property, buying goods and services, and borrowing or lending money. If a director has a business, financial or familiar relationship with a party to the transaction, other directors must consider such transactions cautiously and in accordance with the law. Conflicts of interest have legal consequences and can adversely affect public perception. Nonprofits should adopt policies and procedures to ensure that those with decision-making power in the organization do not act to benefit themselves, their families, or their business interests at the expense of the nonprofit.

C. Conflicts of Interest

1. **Interested director transactions.** Interested director transactions are prohibited unless they meet legal requirements. Contracts and transactions between a nonprofit and a director are prohibited under Texas law unless the following requirements are met:
 - *Material facts disclosed.* the material facts about the director's interests are disclosed to the board, and the contract or transaction is specifically approved in good faith and with ordinary care by vote of the disinterested members (even if less than a quorum); or
 - *Fairness.* The transaction is fair to the corporation at the time it is authorized (§ 22.230). The IRC also prohibits insider transactions in which an insider benefits unreasonably. See Section Four for more information.
2. **Documenting transactions.** A nonprofit must carefully document transactions with a director.
 - *Record in meeting minutes.* The organization should carefully document in writing any transaction with an interested director in the minutes of a meeting at which the transaction is considered.
 - *Contracts with director.* A nonprofit must disclose and document contracts between the nonprofit and a director. A contract between the corporation and an officer or director is valid if the material facts of the relationship and the contract have been disclosed and

Sample Minutes - Interested Director Transaction

“A motion was made by Barack Obama to rent an office from ABC Leasing. Board member Joseph Biden stated that he owned the building in which the office was located. The board compared the rental rates with other comparable offices and determined that the rent was lower than other similar spaces. A second to the motion was made by Hilary Clinton.. The vote to approve the lease was 6-0 and Joseph Biden did not participate in the vote.”

one of several specified approval procedures are followed. Under the Code, it is presumed that a contract with an interested director is not void or voidable if the relationship is disclosed and documented in the minutes.

3. Avoiding A director must avoid corporate opportunities. A director cannot take advantage of business opportunities that would be of interest to the nonprofit without first offering it to the organization.

4. Board compensation. Board members cannot be paid for service as a member.

- *No compensation or tax deduction.* Directors should not be compensated for their service as a board member. They also cannot claim a deduction for the value of their donated services to the nonprofit.
- *Reimbursement.* However, directors may be reimbursed for their reasonable out-of-pocket expenses incurred on behalf of the nonprofit in accordance with its expense reimbursement policy. The organization should not reimburse a member of the board of directors for the cost of his or her spouse's or other dependent's travel to organization events. Directors may decline reimbursement for out-of-pocket expenses and treat it as a charitable contribution to the organization instead.
- *Provision of other goods or services by board member.* If a director provides some other goods or services to the nonprofit in addition to serving on the board, the nonprofit may compensate the director by following the conflict of interest provisions discussed above.

5. Loans to director or employee. Loans to a director are prohibited. Loans to employee are restricted.

- *Directors.* There is an absolute prohibition on paying dividends or lending the money of a nonprofit to a director. Directors who allow a loan to be made to a co-director will be personally liable for the full amount of the loan until it is repaid. §§ 22.053, 22.054 and 22.225.
- *Employees.* Loans to an employee are restricted. A nonprofit may lend money to an employee only in very limited circumstances. Typically, such loans are an enticement for a new hire. The loan must benefit the organization, and be made only to finance the employee's principal residence. The principal amount cannot exceed 100% of the employee's annual salary if made during the first year of employment or 50% if made in any subsequent year. §22.055.

6. Distribution of nonprofit assets. Directors are subject to restrictions on distribution of assets of the nonprofit. Directors are prohibited from distributing the assets of a nonprofit if it is insolvent, or the distribution would make it insolvent, unless the nonprofit is paying a debt. Directors who violate this rule can be personally responsible for the value of the unpaid debts of the nonprofit. A director is presumed to have agreed to the distribution unless their dissent is appropriately entered into the minutes of the meeting. Directors may be protected if they acted in good faith and relied on the written opinion of an attorney for the nonprofit. §§ 22.226, 22.227 and 22.228.

2. Accountability, Transparency, and Reporting

Nonprofits are required to comply with state and federal laws governing recordkeeping, federal tax returns and various recordkeeping and tax requirements under state laws. This section addresses some of the more common reporting and filing requirements for nonprofits.

A. Books and Records

1. Complete and current books and records.

Nonprofits must keep correct and complete books and records. All nonprofits must maintain the following information at their registered or principal office in Texas:

1. names and addresses of members, if any, entitled to vote;
2. the written consent of the registered agent §5.201(b);
3. minutes of meetings of members, board of directors, and any committees having the authority of the board of directors; and
4. complete books and records of accounts §3.151.

2. Financial records.

Nonprofits must keep true and accurate financial records. Records should contain full and correct entries, including income and expenditures, in accordance with generally accepted accounting principles. The records must be kept at the registered or principal office of the nonprofit in Texas for at least three years after the close of the fiscal year §22.353.

3. Archiving documents.

Nonprofits should maintain and destroy records and files according to a written archival policy. This policy should also cover email and voice mail. If the nonprofit knows of pending or threatened litigation, any document destruction should be curtailed. It is a felony to falsify or destroy a document with the intent to obstruct an investigation of any branch of the federal government. See Texas C-Bar's sample [Document Retention Policy](#).

4. Non-membership contributions over \$10,000.

Generally, non-membership contributions to a nonprofit in excess of \$10,000 in a fiscal year require additional documents. Most nonprofits that receive contributions from sources outside their membership in excess of \$10,000 during a fiscal year must maintain additional documents and make them available to the public. Religious organizations, institutions of higher learning, alumni associations, and a few other types of organizations are exempt from this requirement §22.355. Nonprofits do not need to disclose the names of donors.

5. Annual financial report.

Nonprofits must prepare an annual report of financial activity for the preceding year. Nonprofits must prepare or approve an annual report that must include a statement of support, revenue and expenses, changes in fund balances, a statement of functional expenses, and balance sheets for all funds. The report must conform to accounting standards as promulgated by the American Institute of Certified Public Accountants §22.352.

6. Public inspection of documents.

Publicly available documents must be available to the public for inspection and copying.

- *Making copies.* Members of the public may copy publicly available documents during normal business hours. A nonprofit may charge for the reasonable expense of preparing a copy of a record or report.
- *No disclosure of members or contributors.* Nonprofits do not have to disclose the names of members or contributors.
- *Penalties for failure to produce and maintain records and reports.* Failure to maintain financial records, prepare an annual report, or make the records available to the public is a Class B misdemeanor under state law §22.354. There are additional penalties under federal law. Note: The Internal Revenue Code also requires that the three most recent annual information returns (IRS series Form 990) be available for public inspection. For more information on federal public disclosure requirements, see Section Four.

7. Inspection of documents by member or governing person.

Nonprofits must allow any member or governing person to examine and copy books and records. This includes the names and addresses of voting members. A member can make a written demand to examine the nonprofit's books and records. The purpose of the demand must be stated in writing. The member or a member's agent, attorney, or accountant may examine the books at any reasonable time and for any proper purpose. The cost of copying is the responsibility of the member.

8. Examination of books and records by Attorney General.

Nonprofits must allow the Texas Attorney General's office to examine books and records.

- *Examination and investigation.* The Attorney General of Texas may inspect all the books and records of the nonprofit. The Attorney General may investigate an organization to determine if it is in violation of its governing documents §12.153
- *Penalties.* Failure to allow the Attorney General to examine or copy records is a Class B misdemeanor under state law and may lead to penalties, forfeiture of property, and additional criminal charges §§3.152-.153; §§12.154-.156.

9. Open Meetings Act.

Most nonprofits are exempt from the provisions of the open meetings act, but there are exceptions.

- *Open Meetings.* The [Texas Open Meetings Act](#) was adopted to add to make the governmental decision-making process accessible to the public. Meetings of governmental bodies are generally open to the public, and the public is entitled to notice of the time, place and subject

matter of the meeting. These requirements generally apply to governmental bodies, some nonprofits must also comply

- *Nonprofits that must comply with the Act.* Nonprofits subject to the Texas Open Meetings Act include:
 - A nonprofit eligible to receive funds under the federal community services block grant program and authorized to serve a geographic area of Texas;
 - A nonprofit organized under Chapter 67 of the Water Code that provides a water supply or wastewater service, or both, and is tax exempt under §11.30 of the Texas Tax Code.
 - Certain property owners' associations in Houston. Tex. Gov't Code § 551.0015
 - Governing body of an open enrollment charter school and the governing body of the charter holder of an open enrollment charter school. Tex. Educ. Code §12.1051.
 - *Open Meetings Handbook.* See the Texas Attorney General's [Open Meetings Act Handbook 2016](#) for more detailed information.

10. Texas Public Information Act.

Nonprofits usually are exempt from the Texas Public Information Act. The Texas Public Information Act applies to the part, section, or portion of an organization, corporation, commission, committee, institution, or agency that spends or that is supported in whole or in part by public funds. The Act does not apply to a nonprofit that receives public funds under a contract with a government agency that imposes a specific and definite obligation to provide services in exchange for money, as would be expected in a typical arms-length contract between a vendor and a purchaser Tex. Gov't. Code § 552.002(a)(xii). Note: See Tex. Att'y Gen. OR 2004-2044 (2004) (relating to the applicability of this Act to a Texas nonprofit.)

11. Employment records.

Nonprofits with employees must keep extensive records in accordance with employment laws. Different employment laws apply to nonprofits depending on the number of full and part-time employees. Record-keeping requirements vary under each law. A good rule of thumb is to keep all payroll information, including time cards, sick and other leave, overtime, and payment history for at least four years. Keep records of work-related injuries and illnesses for at least five years. For more information, see [Employment Law Issues: A Guide for Nonprofits in Texas](#).

12. Penalties for filing false documents.

Nonprofit directors and staff must file correct documents. A person who signs or directs the filing of a false document is liable for damages, court costs, attorney's fees, and criminal offenses §4.007-.008.

B. Federal Tax Return

1. What kind of IRS forms to file.

Tax-exempt nonprofits must file an annual return with the IRS. The return is a financial report, which provides the IRS with information about the organization's gross income expenses, disbursements, assets, liabilities, net worth, contribution, gifts, lobbying expenditures, and other corporate information.

- **Series 990 Forms.** There are three types of tax forms available to tax exempt nonprofits: Form 990, Form 990-EZ ("short form") and Form 990-N ("ePostcard"). Which form an organization must file generally depends on its financial activity. See the [IRS Form 990 chart](#) below, with links to the Forms and Instructions:

Status	Form	Instructions
-Gross receipts normally <i>less than \$50,000</i> . -Organizations eligible to file e-Postcard may file a full return.	E-Postcard 990-N	n/a
Gross receipts <i>less than \$200,000</i> and total assets less than \$500,000	990-EZ or 990	Instructions
Gross receipts <i>over \$200,000</i> , OR total assets greater than \$500,000	990	Instructions

- **Form 990.** The more detailed Form 990 has questions about corporate governance matters. Nonprofits should review these items carefully to ensure the organization has adopted best policies. Both forms can be filed electronically.
- **Form 990 N e-postcard.** Most small tax-exempt organizations whose annual gross receipts are less than \$50,000 can file the simplified Form 990-N electronically if they choose not to file Form 990 or Form 990-EZ. Only eight items of information about the tax-exempt nonprofit are required to complete Form 990-N:
 - Employer identification number (EIN), also known as a Taxpayer Identification Number (TIN);
 - Tax year;
 - Legal name and mailing address;
 - Any other names the organization uses;
 - Name and address of a principal officer;
 - Web site address if the organization has one;
 - Confirmation that the organization's annual [gross receipts](#) are \$50,000 or less; and
 - If applicable, a statement that the organization has terminated or is terminating (going out of business).
- **Ineligible to file Form 990-N.** Some organizations that cannot use Form 990-N regardless of gross receipts. Visit the IRS website to determine which [organizations are not eligible to file a Form 990-N](#).

Example: Due Date for Return

DoGood is a tax-exempt 501(c) nonprofit with annual gross receipts of less than \$50,000. For accounting purposes, it adheres to a fiscal year ending on September 30th. DoGood timely filed its 990-N e-postcard with the IRS before the deadline of February 15th of the following year (the 15th day of the 5th month after the end of its fiscal year).

2. When the annual federal tax return is due.

The return must be filed by the 15th day of the 5th month after the end of the nonprofit's accounting period or fiscal year. Depending on when a nonprofit filed for tax exempt status, it may be required to file the form before the end of its first year of operation. If a due date falls on a Saturday, Sunday, or legal holiday, the due date is delayed until the next business day. The Form 990-N e-Postcard cannot be filed until after the end of the tax year.

- *Accounting period.* A tax year is twelve consecutive months. An organization's tax year or accounting period can be found in the bylaws, the application for tax-exempt status filed with the IRS; The IRS the determination letter approving tax-exempt status, the application for EIN, or the tax return for the preceding year. There are two kinds of tax years:
 - *Calendar Tax Year*, which is a period of 12 consecutive months beginning January 1 and ending December 31; or a
 - *Fiscal Tax Year*, a period of 12 consecutive months ending on the last day of any month except December.
- *Extension of time to file.* The IRS allows organizations to apply for an automatic three-month extension by filing [Form 8868, Application for Extension of Time to File an Exempt Organization Return](#). It can use the same form to file for one additional extension. With two extensions, the maximum time allowed for an extension beyond the original filing date is six months.

Return Due Dates for Exempt Organizations –

Annual Returns

Ending date of tax year	Initial due date	1st extension	2nd extension
December 31	May 15	August 15	November 15
November 30	April 15	July 15	October 15
October 31	March 15	June 15	September 15
September 30	February 15	May 15	August 15
August 31	January 15	April 15	July 15
July 31	December 15	March 15	June 15
June 30	November 15	February 15	May 15
May 31	October 15	January 15	April 15
April 30	September 15	December 15	March 15
March 31	August 15	November 15	February 15
February 28/29	July 15	October 15	January 15
January 31	June 15	September 15	December 15

3. Penalties for late filing, incomplete filing or failure to file.

Nonprofits that are not compliant with IRS regulations and deadlines face serious consequences.

- *Reminder from IRS.* The IRS will send a reminder notice to the last address on file for the organization. If the nonprofit changed their address and did not notify the IRS, it might not receive the reminder. For change of address and other forms, see the IRS page [Exempt Organizations-Reporting Changes to IRS](#).
- *Filing late.* Late filing may come with a financial penalty. There is no monetary penalty for late filing of the ePostcard, Form 990-N. For Form 990 and 990-EZ, failing to file or filing an incomplete or incorrect return comes with a penalty of \$20 a day for each day the return is late. The maximum penalty usually the lesser of \$10,000, or 5 percent of the organization's gross receipts for the year. Organizations with gross receipts of over \$1 million for the year can face a penalty of \$100 a day, up to a maximum of \$50,000.
- *Abatement of penalties.* A nonprofit that has failed to timely file IRS Form 990 or 990 EZ in a timely manner may [request abatement of penalties from the IRS](#). The abatement request must include supporting documentation to show reasonable cause for failure to file and steps to show why it won't happen again.
- *Failure to file.* Failure to file a required return (Form 990, 990-EZ or 990-N) for three consecutive years will result in automatic revocation of the organization's tax exempt status. Revocation will happen on the filing due date of the third consecutively-missed year.

Tax-exempt nonprofits that fail to file tax returns for three consecutive years will automatically lose their tax-exempt status.

4. IRS revocation.

Revocations of tax-exempt status are published.

The IRS publishes a [list of organizations whose tax-exempt status was automatically revoked](#) for failing to file for three consecutive years. The list includes the name, employer identification number (EIN), organization type, last known address provided to the IRS, effective date of revocation and the date the organization was added to the list. It is worthwhile to keep in mind that donors often check with the IRS, [GuideStar](#), or similar service before contributing to a tax-exempt nonprofit to determine if it is at risk for automatic revocation of its tax-exempt status.

5. Reinstatement of tax exempt status after automatic revocation.

The IRS will grant retroactive reinstatement of exemption under certain limited circumstances. Organizations whose tax-exempt statuses were automatically revoked can apply for reinstatement. All options require re-filing of the application for exemption and payment of appropriate filing fees. The *four options* available for reinstatement are described in an [IRS reinstatement fact sheet](#). The first two options are available to organizations re-applying within 15 months of revocation. The latter two options are available to organizations whose status was revoked *over 15 months ago*. These options

require a reasonable cause statement that includes a detailed description of facts and circumstances as to why the organization failed to file, and the steps it will take to avoid future failures. If the IRS approves the application, donors may rely upon the date of the new IRS determination letter and on the updated [*Exempt Organizations Select Check*](#), updated monthly. For organizations that applied for and received reinstatement, the list gives the date of reinstatement.

Organizations not previously revoked that re-apply within 15 months of revocation may be eligible for the IRS's Streamlined Retroactive Reinstatement Process.

6. Annual IRS returns available for public inspection.

Tax exempt nonprofits must make certain annual returns and applications for exemption available for public inspection and provide copies to individuals who request them. If the request is made in person, copies must be provided immediately; if the request is written, the nonprofit has 30 days to provide them. The organization may charge a reasonable fee for copying and postage. The IRS must also make this same information [publicly available](#); generally, it may take the IRS up to 60 days to process the request. *Note: Donor lists that may be included in the Form 990 are generally not public information.*

7. Tax return for unrelated business income.

A tax-exempt organization must still pay tax on its unrelated business income. Unrelated business income is income from a trade or business, regularly carried on, that is not substantially related to the charitable, educational, or other purpose that is the basis of the organization's exemption. A nonprofit that has more than \$1,000 in gross income from an unrelated business must file [IRS Form 990-T](#). This is in addition to the annual tax return, Form 990, 990-EZ, or 990-N. If a nonprofit expects the unrelated business income tax to exceed \$500, it must make quarterly payments of the estimated tax. The form must be filed by the 15th day of the 5th month after the end of the nonprofit's fiscal year. Penalty for failure to file. A nonprofit that fails to pay the proper tax may be charged an underpayment penalty for the period of underpayment.

8. Other required IRS returns.

Each nonprofit that pays wages to employees is responsible for withholding, depositing, paying, and reporting federal income taxes and social security taxes. Nonprofit organizations are not subject to federal unemployment tax and are not required to file Form 940. Organizations must file with the IRS the:

- *Form 941 or 944:* Employer's Quarterly Federal Tax Return (Form 941). If an organization's annual tax liability is \$1,000 or less, it may request to file Form 944 instead of Form 941. The organization, as the employer, must withhold and deposit the employee's part of the taxes and pay a matching amount. The Social Security tax is withheld from the employee's gross wages until the employee's cumulative wages for the year reach the wage base limit. Wages above the wage base limit are not subject to Social

Security tax withholding. However, there is no wage base limit for Medicare tax; all covered wages are subject to Medicare tax.

- ***W-2 and W-3:*** Wage and Tax Statements (Form W-2), and Transmittal of Wage and Tax Statements (Form W-3). Form W-2 must be sent to the employee by January 31st for the income earned the preceding year. In addition, Form W-2 must be filed along with Form W-3 with the Social Security Administration (Data Operations Center, Wilkes-Barre, Pa. 18769-0001) by January 28th and with the IRS by April 1st.
- ***1099-MISC:*** If a nonprofit pays more than \$600 in the preceding tax year to an independent contractor, it must also file Form 1099-MISC. To complete Form 1099-MISC the nonprofit will need the social security number or EIN of an independent contractor. If the independent contractor is a sole proprietor, the SSN is preferred. The organization should always ask the independent contractor to complete [Form W-9, Request for Taxpayer Identification Number and Certification](#) before beginning work. Form 1099 MISC must be sent by January 31st to an independent contractor who received payment of more than \$600 for the income earned the preceding year. The form must also be filed with the IRS by February 28th.

9. Penalty for failure to file.

Nonprofits who fail to file the above forms, file incorrect forms, or fail to deposit withheld taxes on a timely basis are liable for fines that range from \$15 per form to \$300,000. Individuals, including directors, who fail to collect, truthfully account for, or pay payroll taxes can be held personally liable for taxes, and in some cases, penalties.

FORM or NOTICE	TIME TO FILE
Form 990, 990-EZ, 990-N (annual return)	By 15th day of the 5th month after the end of the nonprofit's fiscal year.
Form 990-T (unrelated business income)	By 15th day of the 5th month after the end of the nonprofit's fiscal year.
Form 941 or 944 (employer's quarterly tax return)	Within 30 days after the last day of each calendar quarter.
Forms W-2 and W-3 (wage and tax statement and transmittal)	By Jan. 31 to employee for income earned the preceding year. Form W-2 must be filed with Form W-3 with the Social Security Administration by January 28 th , and with the IRS by April 1st.
Form 1099-MISC (payment to independent contractor)	By Jan 31 to independent contractor paid more than \$600 the preceding year. Form must also be filed with the IRS by Feb. 28th.
Notice 797 (EITC)	By March 1. Notice required if income tax not withheld; recommended if employee earns less than \$35,458. Notice can be person, by email, by flyer included with pay stub (email or paper), or by mail.
Special Tax Returns	Varies

10. Special returns.

There are a number of special IRS forms required depending on the types of activities the nonprofit engaged in during the fiscal year, including:

- *Excess benefits transactions*: IRS Form 4720.
- *Vehicle donations*: IRS Form 1098-C.
- *Election by an Eligible Organization to Make Expenditures to Influence Legislation*: IRS Form 5768.
- *Reporting political activities*: IRS Form 1120-POL. Nonprofits that spent any resources or time on political activities must file this form.
- *Donee information return*: IRS Form 8282. Nonprofits that sell or dispose of donated property within three years of the contribution date are required to file IRS Form 8282 if a donor of property (other than money or publicly traded securities) presents a nonprofit with an appraisal summary of the property (IRS Form 8283) and the value is over \$500. The nonprofit must file the form with the IRS within 125 days of the nonprofit's sale or disposition of the property. A copy of the completed Form 8282 must also be provided to the donor of the property and, if the property is transferred to another nonprofit, the nonprofit must give a copy to the successor donee. The penalty for failure to file Form 8282 is generally \$50. There is an exception for food banks, disaster assistance, and other distributors of donated property. If a nonprofit distributes the donated property free in furtherance of its tax-exempt purposes, Form 8282 does not have to be filed.
- *Cash donations over \$10,000*: IRS Form 8300. This form is designed to catch money laundering activities.

11. Notice of EITC.

Nonprofits are required by federal law to provide notice to employees regarding the earned income tax credit ("EITC"). The EITC is a refundable federal income tax credit for low to moderate income workers and families. A nonprofit must provide IRS Notice 797 to each employee from whom the nonprofit did not withhold income tax. A nonprofit is encouraged to notify each employee whose wages are less than \$35,458 that the employee may be eligible for EITC. A nonprofit employer must notify its employees of the federal Earned Income Tax Credit (EITC) no later than March 1st of each year. The employer may provide notice to its employees in person, by email, with a flyer included with a pay stub (wage statement), in paper or electronic form, or by mail. Employers may use [IRS Notice 797](#) or a written statement with the same wording.

C. State Filing Requirements

1. Status Report.

Secretary of State Form 802. Every four years, a nonprofit must provide a report, which includes the names and addresses of the nonprofit's officers, the address of the nonprofit's principal office, and the name and address of the agent for service of process. The Secretary of State should send this report approximately every four years to the address of the

nonprofit's registered agent or to the address on file at the Secretary of State for the nonprofit's headquarters (§ 22.359).

- *When the report is due.* The report must be filed, along with the applicable fee, within 30 days after the Secretary of State mails the notice stating the report is due (§ 22.357).
- *Penalty for failure to file.* Nonprofits who fail to file the report forfeit their right to conduct business in Texas. If the report is not filed within 120 days after the notice is mailed, the nonprofit will be involuntarily dissolved. (§ 22.360). Because the penalty is severe, the nonprofit should appoint someone to monitor the four-year period in case the nonprofit does not receive the notice.

2. Texas Taxpayer Questionnaire.

The Texas Comptroller sends this questionnaire to new organizations. Fill it out and return it.

3. Changes and Amendments.

A change to the nonprofit's name, address, registered agent, and certificate of formation. A nonprofit that changes its name, address, registered agent, or adopts amendments to the certificate of formation is required to file notice of the changes with the Secretary of State and pay the applicable fees.

- *When the filing is due.* A nonprofit should file changes and amendments as soon as possible after their adoption by the board of directors or members.
- *Penalty for failure to file.* The above changes do not take effect until they are filed with the Secretary of State. The Secretary of State can involuntarily terminate the nonprofit and the Attorney General can sue the nonprofit for termination for transacting business outside the scope of its certificate of formation. A nonprofit also might not receive copies of important correspondence for notice of lawsuits if it does not have a current address or registered agent on file with the Secretary of State.

4. Changes that affect a nonprofit's tax-exempt status.

A nonprofit must provide written notification to the Comptroller of any change that may affect its tax exempt status for purposes of the Texas franchise tax exemption.

- *Sale of taxable items.* A nonprofit must obtain sales tax permits, collect and pay sales taxes on items it sells, and file reports with the Texas Comptroller. There are some exceptions. For more information, go to the Texas Comptroller's [Texas Sales Tax Frequently Asked Questions](#).
- *When the report is due.* Reporting periods vary, depending on the volume of sales. However, all reports are due by the 20th day of the month following the applicable

reporting period. Reports are due even if no sales are made. Payment of the applicable sales taxes is due at the same time the report is due.

- *Penalty for failure to file.* Failure to file timely reports can have the following consequences: a 5% percent penalty on taxes due; an additional \$50 penalty for two or more late reports; suspension of sales permits; and involuntary dissolution.

5. Articles of Termination: Secretary of State.

A nonprofit that voluntarily terminates (dissolves) must file two copies of the Articles of Termination on Form 603 with the Secretary of State, along with a \$5 filing fee. The Secretary of State will then issue a Certificate of Termination.

- *When the articles are due.* The Certificate of Termination should be filed as soon as possible after their adoption by the board of directors or members.
- *Penalty for failure to file.* The corporation only ceases to exist after the Secretary of State receives the Certificate of Termination.
- *Penalty for false statement.* If a person makes a false statement or omits material facts in a filing with the Secretary of State, and the intent is to defraud or harm another, the offence is a state jail felony.

Notify the Attorney General of any lawsuit in which the nonprofit is involved. This notification is required for all lawsuits in which the nonprofit is a plaintiff or defendant. The Attorney General can choose to intervene in a case if he or she decides that it is in the public interest.

D. State and Local Taxes

1. Sales and use tax exemption.

Pay the sales and use tax or apply to the Texas Comptroller for an exemption from sales and use taxes or to obtain a sales tax exemption. A nonprofit is exempt only if it applies for an exemption and receives a letter from the Texas Comptroller stating that it is exempt. The Texas Comptroller's website contains links and instructions for Form AP-205, Application for Exemption – Charitable Organizations and all other [Texas Tax Exempt Forms](#). To obtain an exemption from a retailer from whom the nonprofit is purchasing items, a nonprofit must present a sales tax exemption form at the time of sale. Otherwise, request a refund of sales taxes from the Comptroller.

2. Margin tax exemption.

A nonprofit is exempt from paying margin taxes if it files a copy of the IRS Determination Letter and the completed Texas Comptroller application AP-204. Note: If a nonprofit receives a Tax Due Form, do not ignore it.

3. Hotel tax exemption.

Pay hotel taxes or submit an exemption form to the hotel operator. Hotel owners and operators may accept hotel occupancy tax certificates (Comptroller Form 12-302) from representatives and employees of a nonprofit traveling on official business. The exemption only applies to the state hotel tax and not local taxes. At the time of registration, hotel owners may require an exemption form from the Texas Comptroller or a printed copy of the organization's name on the Comptroller's website. Forms and information on hotel occupancy tax are available from the [Texas Comptroller](#).

4. Property tax exemption.

Pay property taxes or obtain an exemption in a timely manner from the county tax assessor's office. Property taxes are assessed on both real estate and equipment owned by a nonprofit, unless the nonprofit applies and qualifies for an exemption from the county tax assessor's office. In order to claim this exemption, an organization must receive a determination letter from the Comptroller's office stating that it is either: 1) engaged primarily in charitable functions as defined under Tax Code Section 11.184, or 2) a 501(c)(2) corporation that holds title for a qualified charitable organization, as defined under Tax Code Section 11.184. To obtain an exemption for property as of January 1st of the tax year, a nonprofit must normally file a [charitable exemption application](#) before May 1st of the tax year. [Form 50-299, Primarily Charitable Organization Property Tax Exemption](#) must be filed with the local tax appraisal district. Tax relief is not available for all charitable organizations. In some cases, a nonprofit may need to work closely with the local appraisal district to obtain an exemption.

E. Public Disclosure Requirements

A nonprofit is required by law to make certain types of information about the organization available to the public and to its members.

1. Disclosure of information to the public.

Federal law requires that a tax-exempt nonprofit make certain information available upon request during normal business hours. Documents and information must be maintained in the main office of the nonprofit as well as in each office of the nonprofit with more than three paid employees on site, unless the nonprofit obtains an exemption from the IRS. The following documents must be made available to the public:

- IRS Form 1023 (the application for tax exempt status filed by 501(c)(3) organizations), and any correspondence between the organization and the IRS relating to the application;
- IRS determination letter;
- IRS Form 990, 990-EZ, or 990-N (annual returns), including all attachments and supporting documents, for the past three years (donor information may be redacted);
- IRS Form 990-T for unrelated business income (certain proprietary information may be redacted).

Under Texas law, nonprofits must also make available to the public all records, books, and annual reports related to the financial activity of the corporation. Exception: the names and addresses of contributors.

2. Disclosure of information to members.

Membership organizations must make books and records of accounts available to members of the organization. The member must make the demand in writing and state the purpose of the demand. The member has the right to examine and copy the books and records at any reasonable time at the member's expense. Additionally, a member has the right to examine and copy the names and addresses of other board members.

3. Disclose public information appropriately.

- Allow public inspection in nonprofit's office, and
- Provide copies of documents upon request.
- Charge a reasonable fee for copies, plus actual postage costs. A reasonable fee is considered to be no greater than the fees charged for Freedom of Information Act requests. This fee is currently \$.20 per page. Unlike Freedom of Information Act requests, nonprofits do not have to provide the first 100 pages for free.

4. Comply with document requests in a timely manner.

- If request is made in person, the nonprofit must comply the same day.
- If request is made by mail, the nonprofit must comply within 30 days of receiving the request.
- If request is made by mail and nonprofit charges for copies, the nonprofit must comply within 30 days of receiving payment.

5. Federal exemptions to disclosure requirements

- *Information widely accessible:* A nonprofit does not need to make the information available for inspection if the IRS application, IRS determination letter, and the past three years of 990s are widely accessible. To be considered "widely accessible" each of the following must be met:
 - Nonprofit publishes the materials on the internet,
 - The information can be downloaded at no cost, and
 - The requestor is told the web site address where the information is located.
- *Harassment:* A nonprofit can be exempt from disclosure requirements if the requestor is engaged in a harassment campaign against the nonprofit.
- *Multiple requests:* A nonprofit can ignore multiple requests for the same information from the same person or address beyond the first two within any 30 day period or the first four within any one year period without applying for an exemption from IRS disclosure requirements.
- *IRS investigation:* A nonprofit can apply to the IRS to investigate whether a harassment campaign is being waged against it. The application (there is no specific form) must be filed with the director of the district where the organization's principal office is located. It must be

filed within 10 business days from the time the organization reasonably believes the request is part of a harassment campaign.

6. Texas exemptions to disclosure requirements.

The broader Texas law requiring disclosure of all the records, books, and annual reports of financial activity does not apply to nonprofits that solicit funds only from members, or do not receive contributions outside of membership in excess of \$10,000 a year. Texas law does not require disclosure of:

- the names and addresses of contributors, or
- the names and addresses of members.

Other exemptions might also apply; consult legal counsel.

7. Penalties for nondisclosure.

Penalties for failure to disclose required information are stiff.

- Federal law: \$20 per day per Form 990 return.
- Federal law: \$5,000 for willful failure to allow inspection or copies.
- Texas law: Class B misdemeanor.

Complaints about noncompliance may be filed with the IRS. If a request for copies is not fulfilled, a complaint Form 13909 may be mailed to: IRS EO Classification Mail Code 4910 1100 Commerce Street Dallas, Texas 75242 or emailed to eoclass@irs.gov. A nonprofit can make some of the required disclosures on the Internet. [GuideStar](#) allows tax exempt charities to post some of the information required to meet federal disclosure requirements.

F. Financial Policies

1. Best Practices.

A nonprofit must be accountable to donors, its board, and the public. In order to ensure accountability, a nonprofit should develop best practices to protect against fraud and provide for maximum transparency. A nonprofit should:

- Adopt a detailed operating budget,
- Conduct training in finances for board members,
- Adopt internal control procedures for cash, deposits, check writing, spending and disbursements,
- Maintain minimum reserve funds,
- Set compensation similar to nonprofits peers,
- Reconcile bank statements monthly,
- Obtain bonds for senior financial staff
- Prepare financial reports monthly,
- Analyze earned income,
- Obtain an annual, independent audit, and
- Establish investment guidelines.

2. Annual financial statement.

Federal law requires the board chairperson to sign the financial statements under penalty of perjury. Independent audit committees should also be established.

3. Procurement policies.

The purchase of goods and services is usually one of the most significant organizational expenditures. Written procurement policies ensure that a nonprofit pays the most reasonable price for items and services. Nonprofits may use federal funds to purchase items allowed by OMB Circular A-122.

4. Inventories.

Nonprofits should take periodic inventory of property. When property becomes unusable or obsolete, it should be donated to another nonprofit or recycled. Disposition of property should be documented.

5. Whistleblower policies.

A nonprofit should provide employees and volunteers with a confidential way to report suspected financial wrongdoing. See www.texascbar.org for a sample whistleblower policy.

6. Reporting inappropriate activity.

A person may file a complaint with the Exempt Organizations Examination Division by completing a Referral Form (IRS Form 13909) or by calling 1-800-829-3676.

7. Role of Texas Attorney General.

The Office of the Attorney General represents the public interest and acts to protect that interest through legal oversight of charities.

- *Attorney General's oversight includes:*
 - investigating and initiating legal action against charitable organizations, their directors and/or their professional fundraisers to ensure that charitable donations and assets are lawfully raised and expended;
 - reviewing transactions involving the sale or conversion of non-profit, charitable corporations to for-profit entities or status; and
 - reviewing all legal proceedings involving charities pursuant to Texas Property Code §123.002. Chapter 123 provides the Attorney General with standing to intervene in any proceeding involving a charity on behalf of the interest of the general public of this state.
- Problems that the Attorney General frequently investigates include:
 - illegal use of charitable funds;
 - diversion of charitable trust funds from their intended purpose;
 - sale of a charity or conversion of a non-profit corporation to "for profit" status at a price that is unfair to the charity;
 - excessive amounts paid by a non-profit corporation or charitable trust for salaries, benefits, travel and entertainment; and

- self-dealing transactions either between a director and/or trustees and the non-profit corporation.
- *Attorney General does not generally investigate:*
 - homeowners' associations and other non-profit membership benefit corporations;
 - matters involving internal labor disputes, contested elections and disagreements between directors and/or members over policy and procedures;
 - claimed violations of religious laws or doctrine by churches or religious corporations.
- *Filing a complaint:* The Texas Attorney General also investigates complaints of financial mismanagement. Anyone who wishes to file a complaint against a Texas charity may do so by completing the [Charitable Trust Division online complaint form](#). If misconduct is found, a court may allow the Texas Attorney General to collect attorney's fees and costs of investigation.

3. Fundraising

Nonprofit organizations rely on the financial support and generosity of donors. Federal tax law imposes requirements on organizations that receive charitable donations, as well as on the taxpayers who make contributions.

A. Donor Acknowledgements

See IRS Publication [Charitable Contributions, Substantiation and Disclosure Requirements](#).

1. Donor privacy considerations may arise.

Nonprofits should respect the privacy of the donors and safeguard the confidentiality of the information. In light of the new antiterrorism legislation, organizations question the obligations they have regarding anonymous donations. At this time, both executive order 13224 and the USA Patriot Act do not appear to apply to donors. Individual donors should have the opportunity to remain anonymous and to restrict the disclosure to the public of their name, amount of donation, or other similar information. For more information on charitable contributions, see IRS Publication 526.

Example: Donor Disclosure

Ms. McDonor makes a \$100 contribution to attend a dinner. The dinner has a fair market value of \$25. The disclosure should state that Ms. McDonor is entitled to a \$75 deduction on her income taxes.

2. Disclosure when donor receives goods or services valued at over \$75.

A charitable organization is required to provide a written disclosure to a donor whose contribution is more than \$75 and receives goods or services in exchange. The amount is the nonprofit's good faith estimate of the value of goods or services provided TO the donor.

The disclosure must contain the following information:

- amount of the contribution or description of a noncash contribution,
- whether any goods or services were provided in return for the donation, and
- a good faith estimate of the value of the goods or services provided to the donor.

3. Exception for token goods or services.

Token goods or services do not have to be described in a written disclosure. This exception applies in three situations:

- The value of the goods is less than 2% of the amount of the donation, or \$8.30, whichever is less; OR
- The item or items meet the following requirements:
 - the item is one for which the donor gives at least \$41.50;
 - the only goods provided in return are items inscribed with the nonprofit's logo, and the items cost less than \$8.30; OR
- Goods, if they meet the following requirements:

- the goods are free, unordered, and not requested; and
- the prospective donor is sent a statement saying that she may keep the goods whether or not a donation is given; and
- the aggregate value of all items given to the donor during the year cost less than \$8.30.

Note: These dollar amounts may change. Check the IRS web for updated information.

4. Claiming the token goods or services exception.

If the nonprofit intends the goods or services to qualify for this exception, it should say so in writing.

Example: Token Goods or Services - Notice to Donor

"Under IRS guidelines, the estimated value of the benefits you receive (*describe the benefits*) is not substantial. Thus, the value of your donation is fully deductible."

5. Exception for membership benefits.

Membership benefits received in exchange for annual dues do not have to be described in a written disclosure if:

- the dues are \$75 or less, or
- the benefits consist of privileges such as a free or discounted admission to the nonprofit's events, discounts from purchases, or parking privileges.

6. Penalties.

A penalty of \$10 per contribution, not to exceed \$5,000 per fundraising event or mailing, is imposed on nonprofits that fail to meet the written disclosure requirement.

7. A nonprofit should provide written acknowledgment for donations of \$250 or more.

It is the donor's responsibility to obtain a written acknowledgment for any single donation of \$250 or more in order to claim the donation as a tax deduction. A donor must receive the acknowledgment by the earlier of:

- the date on which the donor actually files his individual federal income tax return for the year of the contribution; or
- the due date (including extensions) of the return.

A nonprofit may provide either a separate acknowledgment for each contribution of \$250 or more, or an annual summary of all contributions from the donor of \$250 or more. The acknowledgment should contain the following information:

- name of the nonprofit,
- amount of contribution or description of the noncash contribution,
- whether any goods or services were provided in return for the contribution, and
- a good faith estimate of the goods or services provided in return.

For information on acknowledgement and disclosure requirements, see IRS Publication

Example: Written Acknowledgment with Return Goods or Services

"Thank you for your cash contribution of \$300 to DoGood Nonprofit, received on March 23, 2016. In exchange for your contribution, we gave you a book with an estimated fair market value of \$60."

Example: Acknowledgment of Unreimbursed Expenses

Debbie Director pays her own airfare and hotel expenses of \$800 of her own expenses to attend a statewide annual conference. At the next board meeting, she reports on funding opportunities, technical assistance, and ideas for new strategies learned at the conference.

The nonprofit does not reimburse the director but instead provides a written acknowledgment for unreimbursed expenditures for the director to deduct from her personal income tax return.

1771.

8. A nonprofit should provide written acknowledgment for unreimbursed expenses of \$250 or more.

If a donor incurs expenses in order to perform donated services for an organization, she must obtain written acknowledgment from the nonprofit to deduct the expenses on her tax return that includes a description of the services provided.

9. A nonprofits should acknowledge whether the donor received anything in return for a donation.

Obtaining a written acknowledgment is the donor's burden, but the best practice for a nonprofit is to provide the donor with a written acknowledgment.

The donor may be more inclined to make future contributions if the nonprofit acknowledges the donation.

10. Non-cash contributions require special record-keeping.

Nonprofits should review Schedule M to Form 990 for different categories of donated property. In addition, nonprofits should consider adopting a gift acceptance policy for any nonstandard contributions. Certain donations of intellectual property may require the organization to file IRS Form 8899. For information on determining the value of donated property, see IRS Publication 561.

B. Vehicle Donations

Vehicles include cars, boats, and airplanes. Generally, a nonprofit must provide a donor with a written acknowledgment for the donation of a vehicle worth \$500 or more.

1. Acknowledgment. The acknowledgement must include:

- name of the donor,
- taxpayer identification number of the donor,
- vehicle identification number, and
- date of the donation.

2. Nonprofit sells vehicle without using it: If the vehicle is sold by the nonprofit without significant use or improvement, the nonprofit must provide the information listed above AND an additional written acknowledgment that includes:

Example: Written Acknowledgment with no Goods or Services in Return

Cash contribution: "Thank you for your contribution of \$300 to DoGood nonprofit received on March 23, 2016. No goods or services were provided in exchange for your contribution."

Noncash contribution: "Thank you for your contribution of a used oak baby crib and matching dresser to DoGood Nonprofit received on March 23, 2016. No goods or services were provided in exchange for your contribution."

- date the vehicle was sold,
 - that the vehicle was sold between unrelated parties in an arm's length transaction,
 - sales price, and
 - statement that the deductible amount may not exceed the sales price.
- 3. Other required acknowledgments for donated vehicles.** An *additional acknowledgment* must be provided if the nonprofit plans to:
- significantly use,
 - make a material improvement, or
 - give or sell the vehicle to a low income individual (if the nonprofit's mission includes providing transportation at below fair market value).
- "Significant use" includes providing transportation for a significant period of time or use directly related to instruction in vehicle repair, but does not include training in general business skills, such as marketing and sales. "Material Improvement" means an improvement that significantly increases the value of the vehicle. Application of finishes, removal of dents, cleaning or repairs of upholstery, and installation of antitheft devices, are not material improvements. In this case, the acknowledgment must include:
- a description of what and for how long the nonprofit will use the vehicle, or
 - the material improvement of the vehicle, and that the nonprofit will not sell the vehicle before completion of the use of improvement, or
 - that the vehicle will be given or sold (at a price below fair market value) to a low-income individual.
- 4. Acknowledgment:** The nonprofit must use IRS Form 1098-C to acknowledge the donation of vehicle. Submit this form to the IRS as well.
- 5. Deadline:** The nonprofit must provide the acknowledgment **within 30 days** of the donation or the sale of the vehicle, as applicable.
- 6. Valuation:** A reasonable method of determining the fair market value of a vehicle is by reference to an established used vehicle pricing guide. See IRS Publication 561.
- 7. Penalties**
- *Penalties for sale without significant use or improvement; inflating sale price.* A nonprofit that sells a vehicle without significant use or improvement and knowingly provides
 - a false acknowledgment or fails to provide an acknowledgement must pay the greater of: the highest rate of tax (currently 35%), times the sales price stated on the acknowledgment, or
 - the gross proceeds from the sale of the vehicle.
 - *Penalties for :* A nonprofit that significantly uses, makes a material improvement, or gives/sells a vehicle to a low income individual and knowingly provides a false acknowledgement, or fails to provide an acknowledgment, must pay the greater of:
 - the highest rate of tax (currently 35%) times the sales price stated on the

- acknowledgment, or
- \$5,000.

**Example: Penalties for Knowingly Providing False
Acknowledgement for Donated Vehicle**

Example 1. A supporter of DoGood, a 501(c)(3) tax-exempt nonprofit, donates a vehicle. DoGood does not make any significant use of the vehicle or improvements to it. DoGood sells the car and receives \$500 gross proceeds from the sale. DoGood then knowingly provides the donor with a false acknowledgment, stating that the vehicle sold for \$1000. The amount of the penalty is \$350, which is 35% of the sales price of \$1000 stated on the acknowledgment.

Example 2. DoGood's mission is to deliver food to elderly persons in remote locations. A supporter donates a subcompact car that is not suitable for food delivery. DoGood provides a donor acknowledgment falsely stating that it plans to use the car to further its mission. The donor claims a tax deduction of \$2,300. The nonprofit must pay \$5,000, because that amount is greater than \$805, the product of the claimed value (\$2,300) and 35%.

IRS brochure for vehicle donors - [A Donor's Guide to Car Donations](#)

IRS brochure for charities - [A Charity's Guide to Car Donations](#)

9. Acknowledging contributions of clothing and household items.

Taxpayers who itemize deductions may only claim deductions for such items if the items are in good condition.

- If a donor contributes any single item for a deduction of more than \$500, the donor must obtain a qualified appraisal of that item.
- If a charity sells or disposes of any donated item valued at more than \$500 within three years after receiving it, the organization must file IRS Form 8282. For further information, see IRS Publication 561.
- Penalties: Any person is subject to substantial penalties (\$10,000) if they fraudulently claim an item was used for charitable purposes to support a larger deduction by the donor if the person knows the item will not be used in such a manner.

10. Valuation of donated art.

The value of donations of art varies. Nonprofit organizations should not place a value on donated art. A donor may submit a qualified appraisal (IRS Form 8282). Since 1969, artists can deduct only their costs, rather than the items fair market value from their income. Art collectors and an artist's estate, on the other hand, may claim fair market value of the donated work.

11. Valuation of donated taxidermy.

The deduction for a donor is the property's fair market value the lesser of the cost of stuffing and mounting or whether or not the item is used in furtherance of the charity's mission (such as display in a nature museum).

C. Earned Income and Unrelated Business Income Tax

Nonprofits regularly look to new ideas to generate funds for programs. Earned income has been hailed as an underutilized moneymaking opportunity. However, nonprofits must carefully structure earned income programs so that they do not run afoul of federal tax laws.

- 1. Unrelated Business Income.** Nonprofits may be taxed on what the IRS calls “unrelated business income,” which is income from:

- a trade or business,
- regularly carried on, which,
- is not substantially related to the nonprofit’s exempt purpose.

- 2. UBIT.** The federal tax on unrelated business income is called Unrelated Business Income Tax (“UBIT”). UBIT may be generated from activities such as selling unrelated products to raise money, advertisements, and selling the organization’s mailing list. Some types of activities are automatically excluded from UBIT including:

- activities run by volunteer labor,
- items provided for the convenience of members,
- the distribution of low cost items (currently \$8.30),
- the sale of donated merchandise, or
- in some circumstances, rental income from real property.

The IRS examines various factors to determine whether an activity is unrelated business. Organizations face less risk of losing their tax-exempt status when engaged in profitmaking activities if:

- there is a direct relationship to the charitable purpose of the organization,
- the size of the commercial activity is not greater than necessary to accomplish the charitable purpose, and
- the activity does not further private interests or confer an inappropriate benefit on insiders.

For more information on UBIT, see [IRS Publication 598](#). A nonprofit should consult with an attorney before operating a regularly carried on business.

- 3. Corporate sponsorships may fall under UBIT.**

Nonprofits often question the difference between donor acknowledgements and corporate sponsorships when trying to thank a donor publicly for supporting the organization. No nonprofit wants a donation to turn into a corporate sponsorship on which taxes could be owed. The IRS regulations provide some guidance to determine whether a corporate sponsorship will be considered unrelated business income. Under these regulations, a payment could qualify as a sponsorship payment if the payer receives a substantial return benefit in exchange for the payment. The regulations distinguish between advertising and acknowledgement.

- Acknowledgement is recognition such as identification of the sponsor and logos that do

not contain descriptions of the sponsor's products, services, location, or telephone numbers.

- Advertising, on the other hand, promotes or markets the corporate sponsor. Consequently, nonprofits should carefully review how they recognize donors.

D. Restrictions on Use of Funds

1. A nonprofit must use funds from tax-exempt donations to accomplish the charitable purposes stated in the nonprofit's certificate of formation or mission.

2. A nonprofit may not redirect the use of funds donated or raised for one purpose to a different purpose.

If a donor gives money for a specific purpose, a nonprofit cannot use the funds for a different purpose. If a nonprofit wants to redirect such funds, it must obtain permission from the donors or file suit seeking permission from a judge and give notice to the Texas Attorney General of the suit.

3. A nonprofit may not use funds to support terrorism or terrorist organizations.

The USA Patriot Act prohibits nonprofit organizations from providing financial support, programmatic support, or technical assistance to individuals or organizations supporting or planning to support terrorism. Penalties include fines, jail time, freezing of a nonprofit's assets, and loss of the organization's 501 (c)(3) status. Nonprofits that receive United States Agency for International Development (USAID) funding have special certification requirements.

E. Miscellaneous Considerations

1. Comply with laws governing outside fundraisers. An organization should have a written agreement with any outside fundraiser outlining compensation, responsibilities, registration, and legal compliance issues, such as phone solicitation.

2. Obtain a seller's permit and resale certificate if selling goods subject to the Texas sales tax. Generally, exempt groups must obtain sales tax permits and collect and pay sales tax on all items they sell. For questions about sales tax permits, visit the Texas Comptroller's [Texas Sales Tax Frequently Asked Questions](#).

Exceptions:

- *Rummage Sales.* Up to two, one-day rummage sales or auctions each year. This exception does not apply to items sold for more than \$5000, unless the item is made by the organization, or the item is donated and not sold back to the donor.
- *Banquets.* One annual banquet if the banquet:
 - is not professionally catered,
 - is not held in a restaurant, hotel, or other similar place of business,

- is not in competition with a retailer required to collect tax, and
 - the food is prepared, served, and sold by members of the organization.
 - *This exception does not apply to the sale of alcoholic beverages.*
- *Sales.* Up to four sales each year (lasting a total of 20 days) of items made and sold by senior citizen groups (persons 65 and over).
- *Meals and food products* if:
 - sold in a church or by a church organization,
 - served by schools and PTAs,
 - served to a permanent resident of a retirement community,
 - served by a prison or hospital,
 - sold by a volunteer or member of a nonprofit exclusively devoted to education, religious, or physical training, or
 - sold by a group associated with a public or private K-12 school, as part of a fundraiser drive when all net proceeds from the sale go to the group for its exclusive use.
- *Membership dues and fees.*
- *Publications.*
- *Coupon books and commissions.*
- *Amusement services.*

Note: A nonprofit should not call a sale of an item (such as a T-shirt) a donation to avoid compliance with this law. See the Texas C-BAR publication [What Nonprofits Need to Know About Texas Sales Tax Collection.](#)

3. Food sales – health permits.

Obtain needed permits from the applicable health authority. Different state and local authorities regulate the sale of food items. A nonprofit may be required to obtain and pay fees if selling food at a bake sale, spaghetti dinner, street fair, or other similar fundraising event. To determine if a permit or a food manager certificate is required, contact a local health authority or the Texas Department of Health, Retail Foods Division, at 5127190232. Penalties vary by jurisdiction, but may range from Class C to Class A misdemeanors. Each day the violation occurs is a separate offense.

4. Liquor license.

Obtain a liquor license from TABC for one-day events. A nonprofit may obtain up to ten temporary liquor licenses, but must file reports after each event. For more information, see www.tabc.state.tx.us

5. Do not hold unauthorized charitable raffles, which are considered gambling under the Texas Penal Code.

- A nonprofit may not hold a raffle unless it meets each of the following requirements:
 - it is an organization that has been in existence for at least three years as a 501(c)(3) nonprofit;
 - it does not distribute any of its income to its members, officers, or governing body;
 - it does not devote a substantial part of its activities to influence legislation; and
 - it does not participate in any political campaign.

- A qualified nonprofit may hold only two raffles a year; the raffles cannot be at the same time. Raffle tickets must contain certain language required by law including:
 - the organization's name,
 - the organization's address,
 - the ticket price,
 - a general description of the prizes, and
 - the date the prizes will be distributed.
- *The value of raffle prizes is limited.* The total value of the prizes purchased for the raffle cannot be over \$50,000 (or \$250,000 for a house). There is no limit on the value for donated items. The prize cannot be money. Money includes: cashier's checks, and travelers checks. Money does not include: savings bonds or "stored value" credit cards. The organization must have each raffle prize in its possession or must post a bond for the full amount of the value of the prize with the county clerk of the county where the raffle will be held. If the organization cannot award the prize within thirty days of the date printed on the ticket, the group must refund or offer to refund all tickets.
- *Reporting and filing requirements are tricky.* If a prize is worth \$600 - \$5,000, a nonprofit must file Form W2-G with the IRS. If a winner refused to provide a tax payer identification number, a nonprofit must withhold 28% of the value of the prize and file Form 945 by January 31 of the year after the year in which the taxes were withheld. If a prize is worth over \$5,000, a nonprofit must withhold 25% of the value and file Form W2-G. For more information, see IRS Notice 1340; Forms and Instructions for Forms 945, 5754 and 1096; and IRS Publication 3079.
- *A nonprofit may not compensate ticket sellers.* The nonprofit must not compensate anyone for organizing a raffle or selling tickets. *Penalty:* Conducting an unauthorized raffle is a Class A misdemeanor. Participating in an unauthorized raffle is a Class C misdemeanor. *Suggestion:* Because the requirements of charitable raffles are tricky and the penalties for violations are severe, seek legal advice before holding a raffle.

6. Nonprofits may be exempt from auction laws.

A tax exempt organization does not have to comply with the Texas auction laws if the person organizing, arranging, or conducting the action receives no compensation. See Tex. Occ. Code § 1801.002(3).

7. Obtain charitable solicitation permits if required.

Except for public safety and veteran organizations, Texas does not require persons soliciting on behalf of nonprofit organizations to register with the state, but several cities do impose such requirements. Check with the city, county, or local chamber of commerce to determine whether there is a requirement to obtain a charitable solicitation permit in your area. Also see the Texas C-BAR Legal Minute: [What Permit? Legal Issues for One-Day Fundraising Events.](#)

8. Check registration requirements for multistate and out-of-state solicitation.

If a nonprofit solicits funds in other states, registration may be required. See National Association of Attorneys General to determine if registration is required. An organization may file a Unified Registration Statement (URS). For more information, go to www.multistatefiling.org.

9. Obtain nonprofit mailing privileges.

Generally, nonprofits can mail materials at less than general postage. Nonprofit mailing privileges are obtained by filling out United States Postal Service Form 3624 and submitting the form at any post office. Then, the organization must apply for a permit to mail at a local mailing facility. The organization can apply for a permit to mail at additional facilities by completing United States Postal Service Form 3623. There is no fee for the permit, but there is a onetime \$150 fee to set up mailings with a permit imprint. Mailings must be done at least once every two years (from any location) to keep the permit current. For more information on guidelines for nonprofit mailings see USPS – [How to Prepare Nonprofit Mailings](#).

10. Do not spam.

When selling a product or service, a nonprofit should not make unsolicited phone calls, or send faxes or emails unless the organization has an established relationship or signed written consent from the person or entity. This includes advertising for conferences, membership drives, publications, and certain large gifts given in exchange for charitable contributions. All written materials should clearly provide the name of the organization, contact information, and describe how the recipient can ask not to receive further correspondence. If an organization uses a telemarketer to solicit donations, the organization cannot call the numbers listed in the [National Do Not Call Registry](#). A state by state listing of anti-spam laws may be found at the [National Conference on State Legislatures](#). *Exception -* A nonprofit may send a fax to a new contact if the number is provided by the recipient or is publicly available in a published directory, advertisement, or website.

4. Federal Tax Matters

This manual discusses various tax matters and issues in several chapters, as they relate to other topics. Here we note additional tax issues that nonprofits should understand.

A. IRS 501(c)(3) Application and Exemption Letter

1. Applying for tax exemption

Nonprofits with less than \$5,000 in receipts are presumed tax exempt. No formal application for recognition of exemption needs to be filed with the IRS, however the organization will not have any written acknowledgement of its tax-exempt status without filing. Nonprofits formed prior to 1969 are not required to file an application for recognition of tax exemption.

After a nonprofit receives its IRS tax exemption letter from the IRS, the board's interest in the exemption application (Form 1023) often disappears. After a few years, many nonprofits have no idea where the application is located. Nonprofits must maintain a copy of the application in an accessible location because federal law requires nonprofits to make the application available for public inspection. For more information, see the Section on public disclosure requirements.

2. Advance rulings on public charity status have been eliminated.

As of September 9, 2008, the IRS no longer issues advance rulings.

B. Serving as a Fiscal Sponsor for a Start-up Organization

Fiscal sponsorship is an alternative way to permit groups performing charitable services to give their donors the ability to take a charitable contribution deduction but avoid the commitment of time and energy needed to comply with filing requirements, tax, and other legal obligations associated with incorporation and tax exemption. Fiscal sponsorship typically involves an arrangement under which an existing 501(c)(3) tax-exempt public charity (a "Sponsor") assists another organization (a "Project") by receiving and dispersing funds.

Fiscal sponsorship may be appropriate when the proposed charitable program is relatively small in scope, temporary in nature, or when the business plan is in its beginning stages. The important point for a sponsor is that the IRS considers the two organizations to be combined under the sponsor. The sponsor should execute a fiscal sponsorship agreement and monitor operations and transactions.

1. Operate the project in accordance with terms of fiscal sponsorship agreement.

Give written notice to all funding sources that the Sponsor retains complete discretion and control over the use of the contributions it receives on the Project's behalf. Donations should be made to "XYZ" Sponsor, for the Benefit of "ABC" Project. If the Project controls its own funds, the Project should make periodic written reports to the Sponsor showing its actual expenditures of disbursed funds and its progress towards

accomplishing its charitable purposes. Sponsors often impose an administration fee for the financial paperwork. See the Texas C-BAR Legal Minute: [Getting Tax Exempt Donations Without All the Paperwork: Fiscal Sponsorship as an Alternative to Forming a 501\(c\)\(3\) Corporation](#).

C. Private Inurement, Private Benefit, and Excess Benefit Transactions

The Internal Revenue Code gives tax-free status to charitable organizations because they provide important benefits to the general public. However, the Internal Revenue Code also provides that a tax-exempt organization must be operated for the benefit of the public and not for the benefit of “insiders” or a private individual. The IRS has interpreted this requirement to identify three types of inappropriate transactions by tax-exempt nonprofits: private inurement, excess benefit transactions, and private benefit transactions.

1. Private inurement is prohibited.

Private inurement occurs when an insider (such as a director) of the corporation benefits receives favorable treatment at the expense of the nonprofit. There is an absolute prohibition against private inurement. Even a tiny amount of private inurement will threaten a nonprofit’s exempt status. Insiders include the following persons:

- Officers,
- Members of the Board of Directors,
- Executive Director or CEO, and
- Relatives of the above list such as a spouse, parent, siblings and their spouses, children and their spouses, and great grandparents, grandparents, grandchildren, and great grandchildren and their spouses, and
- Anyone who can exercise control or influence over the organization and the application of its funds or assets. *Note:* This last category is very broad.

2. Private benefit is prohibited.

Nonprofit assets should not be used to serve a private, as opposed to the public, good. Private benefit occurs when an exempt organization creates a benefit for a single, non-charitable third-party. Directors should make sure that all business transactions further the nonprofit’s exempt mission.

3. Nonprofits may be penalized for excess benefits transactions.

An excess benefit transaction may occur if benefits or compensation received by a person in an influential position in the organization (a “disqualified person”) exceeds the value of their contribution. This policy is similar to private inurement but, unlike private inurement, it provides for intermediate sanctions instead of revocation of exempt status. Section 4985 of the Internal Revenue Code also provides a procedure that charities can follow to avoid wasting charity assets and for setting salaries. See 26 U.S.C.A. § 4985(c). The list of disqualified persons is the same as the list of insiders discussed above.

Note: The IRS audited over 500 organizations for paying excessive compensation and benefits to their officers and other insiders in 2005. A nonprofit may pay reasonable compensation to a director if the director provides services to the nonprofit. The key qualification is “reasonable,” which will be determined by the IRS, the Attorney General, donors, and the public based on all the facts and circumstances of the situation. Compensation includes all benefits received including cell phone use for personal calls and parking fees. Nonprofits must document the rationale behind any compensation (including reimbursements) paid to employees and directors or the IRS may consider any payments made to be automatically excessive. If a nonprofit is found to have paid excessive compensation, the IRS can impose a tax equal to 25% of the excess benefit and a 10% tax on the directors or officers (up to \$10,000 per occurrence).

D. Making Changes to the Organization

Nonprofits are subject to restrictions on making changes to the organization.

1. Any material change in the organization may lead to revocation of tax exempt status. If a nonprofit wants to significantly change its purpose, activities, or method of operation, review the nonprofit’s original Form 1023 (exemption application) to determine whether the new purpose and activity were mentioned in the application. If they are included, there may be no need to file a new application with the IRS. If not included, the IRS may require the nonprofit to get a new determination letter. A nonprofit should also review its certificate of formation and bylaws. If the new purpose and activity are not authorized by these documents, the documents must be amended.

Note: If a nonprofit transacts business beyond the scope of the purposes listed in its certificate of formation, the Texas Attorney General can sue the nonprofit for involuntary termination.

- *Notify the IRS of changes in the name, certificate of formation, and bylaws of the nonprofit.* If a nonprofit changes its name, certificate of formation, or bylaws, the nonprofit should notify the IRS TEGE Customer Account Services PO Box 2508 Cincinnati, OH 45201, (877) 8295500, or send the updated information with the nonprofit’s next Form 990 filing.
- *Changes in proposed budgets may affect public charity status.* The IRS classifies a nonprofit as a public charity on the basis of budget information supplied when the nonprofit applied to receive its 501(c)(3) status as a public charity. If the level of public support that enabled the nonprofit to qualify as a public charity changes substantially, the nonprofit could be reclassified as a private foundation.
- *Notify the IRS of a change in the nonprofit’s accounting period.* If the nonprofit wants to change its fiscal year, it must file IRS Form 1128 by the 15th day of the 5th month following the close of the new fiscal year. *Example:* Current fiscal year runs from

January 1 to December 31; new fiscal year to run from October 1 to September 30. Form 1128 is due on February 15th of the following year.

E. Joint Ventures

Sometimes nonprofits consider partnering with another organization or business. Joint ventures can help a nonprofit reach more clients or serve more of their needs. A nonprofit may consider a joint venture in order to earn more reliable income. This type of joint venture may cause problems with the IRS.

1. Nonprofits cannot violate the rules against private inurement.

In order to preserve an organization's tax-exempt status, IRS regulations specify that "no part of the net earnings of (the organization) inures to the benefit of any private shareholder or individual." This provision is designed to keep those who have an insider relationship with the organization from privately gaining as a result of that relationship. Specifically related to this issue are factors that the IRS has deemed "unfavorable" as they apply to a tax-exempt organization participating in a partnership with a for-profit entity. Those factors include the disproportionate allocation of profits or losses in relation to capital contributions, commercially unreasonable loans by the tax-exempt organization to the partnership, and inadequate compensation for services provided by the tax-exempt organization.

2. Nonprofits cannot benefit private interests rather than the common good.

Private benefit is similar to private inurement but is concerned with whether participation in a joint venture, regardless of its form, will result in a benefit for private interests (e.g., private investors) substantial enough to demonstrate that the Section 501(c)(3) organization is operating for private benefit, rather than for public purposes. In order for a company to preserve its tax-exempt status, the benefit accruing to non-insider private entities must be "incidental." For a benefit to be considered incidental, it must be both quantitatively and qualitatively incidental. For example, paying reasonable compensation to a physician for his or her health care services provides only an incidental (quantitative and qualitative) benefit, because the compensation is necessary to further the health care purpose of the tax-exempt organization. Therefore, as long as the compensation is reasonable, the net benefit to the doctor is insubstantial.

3. Unrelated business income (UBI) is taxed as if it was earned by a comparable for-profit entity.

The IRS tends to look to the issue of "control" when determining whether the income derived by the tax-exempt organization from the pass-through entity is related or unrelated to the organization's exempt purpose. Where control is demonstrated, and it can be shown that the operations of the partnership business further the charitable purpose of the tax-exempt organization, the income derived often can be classified as related to the organization's exempt purpose and, thus, is not subject to the UBI tax rules. When considering a joint venture, nonprofits should pursue projects that advance the charitable purpose of the organization, maintain control of the transaction, and ensure the deal is

economically fair to the nonprofit. Nonprofits should obtain qualified legal and accounting advice when they consider such an activity.

5. Corporate Changes, Mergers, and Terminations

A. Certificate of Formation and Bylaws

The certificate of formation and bylaws are the most important documents of a nonprofit organization. Like a birth certificate, the organization should keep track of these documents. All board members should have copies and the organization should keep the documents in a corporate record book. Any amendments or revisions should also be kept in the record book. Additional information about amendments or revisions to the certificate of formation can be obtained from the Texas Secretary of State's Office, www.sos.state.tx.us/corp/nonprofits.html, which also contains model forms and other nonprofit corporate documents.

1. Amending the Certificate of Formation

If a corporation needs to add, delete, or alter provisions of its certificate of formation or change its name, it needs to file a certificate of amendment with the Secretary of State. If extensive amendments are needed or to avoid having more than one document that comprises the certificate, the corporation should consider filing a restated certificate of formation instead of a certificate of amendment. See Secretary of State Form 415.

2. Adopting a Certificate of Amendment

The method of adopting a certificate of amendment depends on whether the corporation has members with voting rights.

- *Corporations with members having voting rights.* The board of directors adopts a resolution setting forth the proposed amendments. The resolution is submitted to a vote at a meeting of the members. The proposed amendments must be approved by at least two thirds of the votes which members present (in person or by proxy) are entitled to cast. In the alternative, amendments may be adopted by the unanimous written consent of the members. In addition, there are certain specific non substantive amendments, such as deleting the names of the initial directors, which may be adopted by a majority of the board of directors.
- *Corporations with no members, or with no members having voting rights.* Unless the certificate provides otherwise, the amendments must be adopted by a majority vote of the board of directors. An authorized officer of the corporation should sign the certificate of amendment.
- *Where to send amendments.* Two copies of the amendment should be submitted to the Secretary of State, along with the appropriate filing fee, to Statutory Filings Division, Corporations Section, P.O. Box 13697, Austin, Texas 78711-3697. If the documents conform to law, the Secretary of State will file the documents, note the date of their filing, and return a file-stamped copy along with a certificate of amendment.

3. Restating the Certificate of Formation.

A Texas nonprofit corporation which has made numerous amendments to its certificate of formation or wishes to adopt an all new certificate of formation should adopt a restated certificate of formation. After the restated certificate is adopted by the board or by the members, two copies of the restated certificate must be filed with the Secretary of State's office along with the appropriate filing fee. The Secretary of State, upon approval of the restated certificate, will issue a restated certificate of formation. At the time the certificate is issued, the original certificate of formation and all amendments are superseded, and the restated certificate is deemed the certificate of formation for the corporation.

The restated certificate may take one of two forms:

- a compilation of all previous amendments with no further amendments (simply a reinstatement of what has already been adopted by the corporation), or
- a compilation of all previous amendments with any new amendments included in the restated certificate. See Secretary of State Form 414.

4. Amending the Bylaws

Bylaws govern the internal operations of a corporation. The law often provides that "unless the certificate of formation or bylaws state otherwise, then . . ." In these circumstances, when the certificate of formation and bylaws are silent on a topic, state law governs by default. When the certificate of formation or bylaws are not silent on a topic, the provisions in the certificate of formation and bylaws apply, provided they are not illegal. In the event that the certificate of formation conflicts with the bylaws, the certificate of formation governs. Model bylaws may be found at www.texasbar.org.

A nonprofit may amend its bylaws in accordance with the existing bylaws. If the bylaws say amendments may only be made once a year and with approval of two thirds of the board, those provisions govern. Bylaws changes do not need to be filed with the Secretary of State, but must be sent to the IRS. The amended bylaws may be submitted with Form 990.

B. Mergers

There are thousands of nonprofits in Texas. Due to dwindling foundation and other support, nonprofits often consider merging with another similar organization to lower overhead costs and better serve the community.

- 1. Requirements for Merger:** The requirements for a plan of merger are found in Section 10.002 to 10.004 of the Code. The certificate and plan of merger should be approved by each organization. The certificate and plan must state:

"The plan of merger has been approved by the laws of the jurisdiction of formation of each organization that is party to the merger and by the governing documents of these organizations."

- If a new entity is created, an additional statement regarding the entity's formation required under Section 3.005(a)(7) and 3.006 of the Code must be included.

- The plan of merger may be, but is not required to be, filed with the Certificate of Merger. In order to merge, a nonprofit may file Certificate of Merger Form 624 with the Secretary of State and pay the applicable filing fee.
- A nonprofit that does not survive the merger must file a Final IRS Form 990 four months and 15 days after the date of the merger. See also, IRS Publication 4779, Facts about Terminating or Merging Your Exempt Organization.

C. Termination

Termination is the end of a nonprofit's legal existence. After termination, the organization may not continue formal operations or enter into contracts, except as necessary to wind up its affairs. Voluntary termination is initiated by the organization's board of directors or a majority of its members. The decision to terminate may result, for instance, from the loss of the organization's membership or donors, or perhaps because the function of the organization has become obsolete. Involuntary termination is initiated by actions of the government or private persons who oppose the continued operations of the nonprofit. Prior to the grant of an involuntary termination, a nonprofit corporation must be given 90 days' notice of its negligence, delinquency, or omission and an opportunity to cure its default.

Without formal termination, the nonprofit continues to exist. Reporting and filing requirements, and the obligation of directors to manage the affairs of the corporation in good faith, with ordinary care, and in the best interests of the corporation, continue. Most certificates of formation provide for 'perpetual existence' so in the absence of termination, the nonprofit will continue as a legally valid entity. If the nonprofit does not terminate, the directors and officers may still be liable for certain types of claims against the nonprofit.

1. Process for termination

- *Voluntary termination.* A nonprofit may terminate any time after the certificate of formation has been filed with the Secretary of State. For example, circumstances may arise whereby anticipated funding does not come through and the nonprofit may want to terminate shortly after incorporating. Termination may also occur after the organization has ceased formal operations, so that, after the articles of termination have been filed, the winding up process will be minimal (§ 11.051(2)). See Secretary of State Form 652.
- *Revoking voluntary termination.* Voluntary termination may be revoked *prior* to the issuance of the certificate of termination from the Secretary of State. The procedure for revocation is the same as for initiating termination, requiring either the resolution of voting members at a meeting called for such purpose or the resolution of the board of directors. Once the certificate of termination is issued by the Secretary of State, termination cannot be revoked. The only exception is where a court may order the revocation of termination of a corporation that was terminated as a result of actual or constructive fraud.

2. Legal requirements in Texas to terminate a nonprofit

- *Update the financial statements of the nonprofit.* The nonprofit needs to have a clear

record of its outstanding debts and liabilities.

- *Adopt a resolution to terminate the nonprofit.* The manner in which the resolution is adopted depends on whether or not there are members with voting rights, or whether the management of the corporation is vested in its members.
- *If there are members with voting rights, as indicated in the articles of incorporation or bylaws.* The board of directors must adopt a resolution recommending that the corporation be terminated, and directing that the question of such termination be submitted to a vote at a meeting of members having voting rights. The nonprofit can then adopt the resolution in one of the following two ways:
 - Written or printed notice stating that the purpose, or one of the purposes, of the meeting is to consider the advisability of terminating the corporation, shall be given to each member entitled to vote at such meeting. At the meeting, a quorum must be present, and at least two thirds of the votes of members present, or represented by proxy (unless proxy is prohibited), must approve the resolution.
 - The resolution may also be adopted by written consent. Written consent requires a statement setting forth the action to be taken and requires the signature of all members entitled to vote. Each written consent shall include the date of the signature of the member.
- *If there are no members, or no members with voting rights,* the termination of the corporation should be authorized at a meeting of the board of directors, by the adoption of a resolution to terminate approved by a majority of the directors in office.
Once the resolution is adopted, either by members or by the board, the nonprofit must cease the conduct of its affairs, except as necessary for the winding up of the corporation.

3. Notice to creditors.

By law, the nonprofit must immediately send notice of the proposed termination to creditors after adopting the resolution. If the nonprofit changes its mind about terminating, a new corporate resolution is necessary to reverse the action.

4. Pay or make provisions for all debts and liabilities.

- If the nonprofit's property and assets are *sufficient* to satisfy the debts and liabilities, then the nonprofit must pay those obligations. If the certificate of termination is filed before these obligations are paid, then provisions must be made for payment and indicated in the filing.
- If the nonprofit's property and assets are *not sufficient* to discharge the debts and liabilities, then the property and assets should be applied as far as they will go to the just and equitable payment of the debts and liabilities.

Note: If there are not sufficient funds to pay all creditors, the corporation should not show preferential treatment to any of the creditors of a particular class (such as secured or unsecured). Decisions to prefer one creditor over another could lead to breach of fiduciary duty claims against the directors.

5. Distribution of remaining assets.

Unless otherwise provided for by the certificate of formation, any remaining assets should be distributed only for tax-exempt purposes to one or more organizations that are exempt under 501(c)(3), 170(c)(1) or 170(c)(2) of the Internal Revenue Code. If assets held by the corporation require return, transfer, or conveyance upon termination, such assets shall be transferred in accordance with such requirements upon termination.

6. Adopt a plan of distribution of assets.

After adopting the resolution to terminate, the law requires that the nonprofit begin to collect its assets and apply and distribute them. To do so, a plan of distribution may, and in some cases must, be adopted. A plan of distribution must be adopted when the nonprofit has assets to be transferred or conveyed. To adopt a plan of distribution, follow the same steps as detailed in adopting the resolution to terminate, outlined above.

7. Filing the certificate of termination

- The Secretary of State has a sample [Certificate of Termination, Form 652](#).
- The minimum requirements are as follows:
 - Name of the corporation,
 - File number of the corporation,
 - Statement about the manner in which the resolution to terminate was adopted,
 - Statement that debts, liabilities and obligations were discharged or provisions made for their discharge; alternatively, where property and assets are insufficient to discharge obligation, a statement that property and assets have been applied as far as possible and nothing remains available for distribution,
 - Statement that remaining property and assets are transferred or provisions have been made for their transfer, and
 - Statement that no suit is pending or adequate provision has been made for the satisfaction of any judgments or decrees that may be ordered.
- A certificate of account status from the Comptroller is not required.
- An officer must sign the certificate.
- The original and one copy of the form with the filing fee should be sent to the Office of the Secretary of State, Corporations Section, P.O. Box 13697, Austin, TX, 787113697. If the copies are being delivered in person, the delivery address is James Earl Rudder Office Building, 1019 Brazos, Austin, TX, 78701. One document will be placed on record and, if a duplicate copy was provided, the second file stamped copy will be returned with a certificate of termination.
- Upon issuance of the certificate of termination from Secretary of State, the corporation ceases to exist. Such certificate should be kept with corporate records.

8. The “winding up” process.

The role of the directors and officers. Although terminated, the nonprofit may still act, through its officers and directors, to the extent necessary to wind up the affairs and operations of the nonprofit. During this time, the directors may vote on matters related to this process, and officers may take appropriate actions on behalf of the corporation. For this reason, directors and officers should generally be encouraged to stay in office, even after

termination. However, once the bulk of the issues are taken care of, it does make sense for the directors and officers to formally resign, leaving the final tasks such as filing of tax returns to one or two appointed individuals.

When to start windup process. It is not necessary to wait until the nonprofit is formally terminated to begin the winding up activities. If some of the activities are initiated even while the certificate of termination is being filed, then there is less winding up to take care of, and directors can more quickly move on to other commitments.

Acts permitted during windup. The acts permitted during winding up include:

- Collection of all of the corporation's assets,
- Disposing of assets, including the sale of assets for the purpose of converting them to cash to pay creditors,
- Discharging or making provision for the payment of all outstanding debts and liabilities, and
- Distributing available assets in accordance with the articles of incorporation, bylaws, or the Code.

9. Tax and regulatory filings.

- *Tax filings.* The nonprofit needs to make arrangements to pay outstanding taxes or penalties on unpaid taxes and to file any final tax returns, including income tax and sales tax returns.
- *Form 990.* File a final Form 990 with the IRS before the expiration of 4 months and 15 days of the termination. You will include a Schedule N regarding the disposition of assets as well as a certified copy of the certificate and plan of termination. See also IRS Publication 4779. Check the final return box on the IRS Form 990.
- *Licenses and permits.* The nonprofit should compile a list of all license and permits held by the organization. For instance, the nonprofit may have a bulk mail permit or a sales tax exemption, or may be a registered employer with the Texas Workforce Commission. The nonprofit then needs to evaluate which licenses and permits can be allowed to simply 'lapse' and which ones require notification to the regulatory authority.

10. Terminating contracts, including employee contracts.

The nonprofit should determine which contracts can and should be terminated.

- *Leases and bank accounts.* Contracts that may need to be terminated include leases and certain service providers, like banks. If the lease arrangements cannot be dismissed to the satisfaction of the landlord, then such contract will need to be treated alongside other creditors and claimants.
- *Employees.* The nonprofit should determine what legal obligations it has to employees, like notice requirements under COBRA.

11. Document retention.

Any records that may need to be referenced in the future should be stored in a relatively accessible location.

12. Continued “corporate existence” for lawsuits.

A nonprofit can still be sued following termination for a period of three years. Continued existence permits the survival of any remedy not barred by the statute of limitations against the nonprofit.

13. Potential director liability in the termination process

Officers and directors are legally required to conduct their duties in good faith, with ordinary care, and in a manner reasonably believed to be in the best interest of the corporation. (§ 22.221) These same standards of conduct should be observed by officers and directors when terminating the corporation. Failure to do so could result in liability for officers and directors.

The authority of the officers and directors remains intact during the winding up process. Therefore, officers and directors should be diligent in conducting all termination activities. Special attention should be given to creating a sound plan of termination and fair distribution of assets to creditors. It should be noted that the primary potential for officer and director liability in the termination process is the failure to pay off creditors when funds exist to do so.

6. Risk Management

All nonprofit organizations and their directors are exposed to risks such as injured employees or volunteers, theft, property damage, and lawsuits from disgruntled employees. The board should first evaluate the types of risk that its organization may be exposed to in the course of its activities. The board then has three options to address the risk: avoidance of the activity, modification of the risk, and obtaining insurance.

A. Evaluation of Risks

- 1. The board of directors should regularly evaluate the types of risks faced by the nonprofit.** The board should consider the probability of occurrence and the extent of losses that could arise from each risk. The types of risk may include:
 - loss or damage to property by fire, water, or accident,
 - fraud or embezzlement,
 - lawsuits by employees and clients,
 - lawsuits arising from an automobile accident,
 - injury to an employee or volunteer,
 - theft or vandalism of property,
 - failure of a contractor to pay its subcontractors or for materials, or
 - loss of information from computer breakdown.

2. Board governance

An active, attentive board may be the most important way to avoid major threats to an organization. Board members should have a wide range of skills and perform duties. Board members are legally responsible for the management of the affairs of the organization. A board member should:

- Understand roles and responsibilities of a board,
- Understand the organization's mission and services,
- Receive regular reports on finances and program performance, and
- Be actively involved in fundraising.

3. Financial assessment

- Financial mismanagement is a common concern for nonprofit organizations. In order to reduce the likelihood of such an occurrence, the board should receive training on nonprofit accounting practices. The training should focus on the topics discussed in Section 2. The board of directors should hire an independent auditor and meet with the auditor. This is not a function that should be delegated to the Executive Director. The board should carefully evaluate any significant deviations from actual or projected budgets. The board should have duplicate bank statements and computer programs with financial information.
- There is substantial risk to an organization that loses its Executive Director or other key role employee. The board must have all passwords for computers and company systems in a secure location.

- The organizations should:
 - Have internal controls on cash, deposits, spending, and disbursements,
 - Have authorized check signers and signatories for checks over a certain dollar amount,
 - Have an annual, independent, thorough audit,
 - Require a bond for senior financial staff,
 - Reconcile bank and cash accounts monthly,
 - Follow GAAP,
 - Prepare timely, accurate, and clear financial statements, including budget versus actual and three year trends,
 - Develop detailed operating budgets,
 - Take periodic inventories,
 - Comply with laws on payroll and benefits preparation, and
 - Conduct board trainings to understand financial policies.

B. Protections Against Liability for Directors

1. Acting in accordance with the duties of directors.

Directors are protected from liability if they act in good faith with ordinary care and in the best interest of the organization.

2. Dissenting from an action.

A director who dissents to an action must have the dissent entered into the minutes of the meeting or send a written dissent to the organization. (§ 22.226)

3. Indemnification of directors.

Directors, even those who work under the protection of a corporate form, can still be sued. Even if they cannot be held liable, they may be responsible for paying for attorney's fees and court costs. Indemnification means that the organization will reimburse a director for any fines, money damages, or attorney's fees that the director incurs as a result of the things the director did in the service of the nonprofit.

- *Mandatory indemnification.* A nonprofit is required to indemnify a director for reasonable expenses incurred in a lawsuit filed against the director, after a court order and all appeals are exhausted, as a result of actions made in his capacity as a board member if:
 - the director was wholly successful in the defense of the lawsuit, or
 - a court orders indemnification.
- *Permissive indemnification.* A nonprofit may reimburse legal expenses of a director if:
 - in a *civil proceeding*, if the certificate of formation, bylaws, corporate resolution, or agreement permit reimbursement, even if the director was not wholly successful in defense of the lawsuit, if it is determined that the director conducted himself in good faith and reasonably believed that his conduct was in the best interest of the nonprofit;
 - in a *criminal proceeding*, if the certificate of formation, bylaws, corporate resolution, or agreement permit reimbursement if the director had no reasonable

- cause to believe that his conduct was unlawful;
- the certificate of formation, bylaws, corporate resolution, or agreement permit reimbursement incurred by a director in connection with his appearance as a witness; or
 - a majority of disinterested directors approve advance payment of expenses prior to the final disposition of the lawsuit if the director affirms in writing to the nonprofit that he met the standard of conduct necessary for indemnification.
- *Exceptions*
 - Unless ordered by a court, indemnification is prohibited for directors who acted in their own self-interest or engaged in intentional wrongdoing.
 - One disinterested and independent director can make a determination that the standard for indemnification has been met if no quorum of disinterested directors can be obtained.

4. Reliance on certain information prepared by others.

In performing a duty, a director may in some cases rely on information prepared by certain other persons. If the director is acting in good faith and with ordinary care, she may rely on information, reports, financial statements, and other data prepared by another director or an employee of the organization, a board committee of which the director is not a member, legal counsel, accountants, or other professionals and experts. The director is not protected from liability if she has knowledge that makes the information unreliable(§ 3.105).

5. Delegation of investment authority.

The board of directors is not liable for any action taken or omitted by an investment advisor who invested the funds of the nonprofit, if the board acted in good faith and with ordinary care in selecting the advisor (§ 22.224).

6. Insurance and other protections.

A nonprofit may provide additional protection for directors by providing director's and officer's liability insurance.

C. Protections Against Liability for Volunteers

1. Volunteer Protection Act.

The Volunteer Protection Act (42 USC Section 14501, 42 U.S.C. §§ 14501-14505. et seq.) was established to encourage people to volunteer their services by easing fears of volunteer liability. The Act preempts state laws “to the extent that such laws are inconsistent with the Act” but does not preempt state laws that provide additional protection. The act protects a volunteer who:

- Performs services (including officers, directors, trustees and direct service volunteers),
- Volunteers for a nonprofit organization or governmental entity, and either
 - Receives no compensation (reasonable reimbursement for expenses allowed such as mileage; no personal income tax deductions for professional services), or
 - Does not receive anything of value in lieu of compensation in excess of \$500 per year.

- Provides immunity for volunteers serving nonprofit organization or governmental entities for harm caused by their acts or omissions if:
 - The volunteer was acting within the scope of his or her responsibilities,
 - The volunteer was properly licensed, certified, or authorized to act, if appropriate or required,
 - The harm was not caused by willful, criminal or reckless misconduct, gross negligence, or a conscious, flagrant indifference to the rights or safety of the individual, or
 - The harm was not caused by the volunteer operating a motor vehicle, vessel, or aircraft if state law requires a license and insurance.
- The act does eliminate volunteer liability for:
 - Crimes of violence or international terrorism,
 - Hate crimes,
 - Sexual offenses,
 - Misconduct which violates state or federal civil rights laws, and
 - Misconduct where defendant was under the influence of drugs or alcohol,
 - The act does prevent a nonprofit from bringing a civil action against a volunteer.

2. Immunity for Personal Injury and Property Damage.

A volunteer serving as an officer, director, trustee, or volunteer is immune from money damages for an act or omission resulting in death, damage, or injury if the person was acting:

- in the course and scope of her duties or functions (Tex. Civ. Prac. & Rem. Code §§84.004(a) and
- the organization maintains insurance coverage of at least \$500,000 for each person, \$1,000,000 for each single occurrence of death or bodily injury, and \$100,000 for each single occurrence of injury or destruction of property. This provision is related to employees, not volunteers (§84.005).

Exception. The volunteer is not immune for damages resulting from “intentional or wantonly negligent acts” or the operation of a motor vehicle (Tex. Civ. Prac. & Rem. Code §§84.004(d), 84.007(a)).

3. Immunity for damages arising from apparently wholesome food.

A person, gleaner (a person who harvests the food), grower, or nonprofit organization that provides free food to the needy is not liable for damages arising from food that goes bad if:

- the condition of food appeared to be wholesome,
- the food was donated to a nonprofit organization for distribution to the needy, and
- the organization complies with laws and rules regarding the storage and handling of food.

Exception. The immunity from liability does not apply to recklessness, intentional misconduct, or grossly negligent acts (Tex. Civ. Prac. & Rem. Code §§76.004(a), (c)).

4. Immunity for damage, death or injury to a patient.

Volunteer health care providers and physicians who are licensed to practice medicine or retired and eligible to provide health care services may be immune from liability when

providing services to nonprofit organizations. A volunteer health care worker is immune from damages for any action that results in death, damage, or injury to a patient if:

- the volunteer acted in good faith,
- the volunteer acted within the scope of the volunteer's duties,
- the act was committed in the scope of providing health care services,
- the services provided were within the scope of the volunteer's license, and
- the volunteer has submitted a written notification to the patient stating the limitation of liability and that the volunteer does not expect any payment for services, and has obtained a signed copy of the notification from the patient (Tex. Civ. Prac. & Rem. Code §§84.004(c)).

Hospitals and hospital systems also have limited liability of \$500,000.

Warning. The limitation does not apply unless the patient or patient's guardian signs a written statement saying: (1) that the hospital is providing free services and (2) there is a \$500,000 limitation on damages (Tex. Civ. Prac. & Rem. Code §§84.0065). **Exception.**

Immunity does not apply to the operation of motor vehicle or intentional, willful, or wantonly negligent acts (Tex. Civ. Prac. & Rem. Code §§84.004(d), 84.007(a)).

5. Good Samaritan Law.

Texas Good Samaritan Law protects volunteers who administer emergency care in good faith at the scene of an emergency if:

- Licensed practitioners do not expect remuneration, or
- Unlicensed volunteers are not willfully or wantonly negligent. (Tex. Civ. Prac. & Rem. Code § 74.151152)

6. Homeland security protection efforts.

Homeland Security Protections applies to officers, employees, or volunteers of state or local agencies performing homeland security activities at the request of or under the direction of state or local agencies. These persons are considered members of state military forces, and provided immunity from civil liability, but only for activities described in the governor's homeland security strategy. **Exception:** A person is not immune from liability if the conduct was willfully or wantonly negligent or done with conscious indifference or reckless disregard for safety. (Tex. Gov't Code § 421.061)

7. Hazardous or dangerous situation.

A person is immune from civil liability for act/omission that occurs in giving care, assistance, or advice with respect to the management of an incident that:

- Has already occurred,
- Is related to the storage or transportation of HAZMAT, and
- Endangers or threatens to endanger individuals, property, or the environment.

Exception. Immunity does not apply if compensation was expected, or if the conduct was reckless, or if there was intentional, willful, or wanton misconduct. (Tex. Civ. Prac. & Rem. Code § 79.002)

8. Disaster assistance immunity.

A person is immune from civil liability for acts or omissions when “a person is giving care, assistance or advice with respect to the management on an incident that is a manmade or natural disaster.” The person must be acting pursuant to a local, state, or federal agency request and must not expect to receive compensation.

Exception: Does not cover reckless, intentional, willful, or wanton misconduct. (Tex. Civ. Prac. & Rem. Code § 79.003)

9. Protections when implementing disease control measures.

A private individual performing duties in compliance with orders of a department or health authority is not liable for death or injury to a person or for property damage. This protection is limited to carrying out communicable disease control orders that have been issued. The exact definition of “private individual” is unclear. This would cover volunteers, but contractors are less certain.

Exception: There is no immunity from liability for willful misconduct or gross negligence. (Tex. Health & Safety Code § 81.007)

10. Donation of medical devices.

A person authorized to possess a device (i.e. DME, medical supplies, etc.) is not liable for injuries from packaging or condition of the device that the person donates in good faith to an entity authorized to possess it. The entity must be a 501(c)(3) or (4) and intend to use the device to provide free or reduced cost health care. (Tex. Civ. Prac. & Rem. Code § 89.002)

11. Youth Council volunteers.

A volunteer acting within the scope of his duty for the Texas Youth Council is not liable for damages arising from an act or omission that results in injury, death or property damage. (Tex. Hum. Res. Code § 61.096)

Exception: There is no immunity from liability if the act or omission was intentional or grossly negligent.

12. Volunteer firefighter.

A volunteer fire fighter and volunteer fire department are not liable for damage to property resulting from reasonable and necessary action to fight or extinguish the fire. (Tex. Civ. Prac. & Remedies Code § 78.001)

13. Higher education volunteer.

A volunteer who is serving as a direct service volunteer and acting within the scope of duty for an institution of higher education is immune from civil liability for the exercise of discretion or judgment. In this section, “volunteer” means a person providing services for or on behalf of an institution of higher education, on the premises of the institution or at an activity related to or sponsored by the institution on or off the property of the institution, who does not receive compensation in excess of reimbursement for expenses. This section does not apply to the operation or maintenance of a motor vehicle. (Tex. Educ. Code § 51.937)

Exception: There is no immunity from liability if the act or omission was intentional or

grossly negligent.

14. Alternative dispute resolution volunteer.

A person appointed to facilitate an alternative dispute resolution is immune from civil liability for an act or omission within the scope of duty as an improper third party. (Tex. Civ. Prac. & Rem. Code § 154.055)

Exception: There is no immunity from liability if the act or omission was wanton and in willful disregard of the rights, safety, or property of another.

15. Child abuse investigation volunteer.

A person acting in good faith that reports or assists in the investigation of a report of alleged child abuse or neglect is immune from civil or criminal liability that might otherwise be imposed. (Tex. Fam. Code § 261.106)

16. Child advocacy volunteer.

A volunteer is not liable for civil damages for a recommendation or opinion given in good faith while acting in the official scope of duty for a child advocacy center. (Tex. Fam. Code § 264.407)

Exception: There is no immunity from liability if the act or omission was intentional or grossly negligent.

17. Child welfare volunteer.

An authorized volunteer for the Department of Child Welfare and Protective Services is immune from civil or criminal liability for an act or omission related to an official duty, if acting in good faith and within the scope of the volunteer's authority. (Tex. Hum. Res. Code § 40.061)

18. Protective services for the elderly and disabled volunteer.

An authorized volunteer for the Protective Services for the Elderly and Disabled who, at the request of the department, participates in an investigation is immune from an act or omission if the person acted in good faith. (Tex. Hum. Res. Code § 48.054)

D. Addressing the Risks and Insurance

1. Avoidance of risk.

A nonprofit may address each type of risk in a different manner. Aside from incorporating and other statutory protections, avoidance of the risk is an option.

Example: The nonprofit could lease a space for a day care center rather than own it; or the board could decide that the risks of operating a day care center for its low-income tenants outweigh the benefits

2. Modification of risk.

A second and more common option is to modify the risks. One method of modifying risk is to isolate riskier activities by forming a separate organization.

Example: A nonprofit organization establishes a new entity for the operation of a daycare center or for construction activities. Other methods include using service contracts, requiring tenants to carry adequate insurance, or hiring independent contractors to perform some necessary functions.

The board can adopt other risk management strategies, which should include:

- establishing an independent and competent audit committee that has at least one “financial expert,”
- requiring financial literacy training for all board members,
- storing computers in a secure location and backing up data daily,
- instituting training for all employees on sexual harassment and other employment laws,
- performing a criminal background check on volunteers, or
- implementing job safety programs.

3. Obtaining insurance

The primary method of protecting against risk is to shift risk to an insurer. The board should become familiar with the types of insurance coverage and policies available that address the nonprofit's risks. The application for insurance is part of the insurance contract. The board should understand the limits of coverage, deductibles, exclusions; the difference between replacement value and market value of damaged property; and whether there are any gaps in the coverage.

4. Types of policies

There are two primary types of liability policies: “claims made” and “occurrence” policies.

- “Occurrence” policies provide coverage for a claim that occurs within the time period covered by a premium payment.
- A “claims made” policy provides coverage for claims made during the policy period, even if the event giving rise to the claim occurred outside the period.

5. Major types of insurance coverage.

- *Commercial General Liability Insurance:* Pays for the legal defense and any settlements or judgments as a result of negligent acts committed by the organization, employees, and volunteers that cause members of the public to suffer a bodily injury, property damage, or personal injury such as libel or slander. Wrongful termination is typically not covered. The policy limits should cover the acts of the organization, employees, and volunteers for \$500,000 per person, \$1 million for death or bodily injury, and \$100,000 for each single occurrence for damage to property in order for the liability protections under Texas law to apply.
- *Business Automobile Insurance:* Similar to commercial general liability, this type of insurance is used when coverage is needed by an incorporated entity for ownership, operation, maintenance, and general use of vehicles owned by the nonprofit.
- *Hired and Non-owned Automobile Coverage:* The “hired” automobile endorsement to

an auto policy covers bodily injury and property damage resulting from accidents that occur when the nonprofit rents or leases a car. The “non-owned” automobile policy protects the nonprofit from damages caused by volunteers driving their own vehicles on business for the nonprofit. This is very important coverage for nonprofits that utilize volunteers.

- *Commercial Vehicle Coverage:* A nonprofit that owns a vehicle designed to carry more than 15 persons, including the driver, must comply with laws for commercial vehicles, including appropriate licenses and insurance. Nonprofits should regularly review the driving record of employees and volunteers who transport persons as part of their duties.
- *Property Insurance:* Covers damages to property owned by a nonprofit after construction has been completed and is based on the type of occupancy. Covered losses include fire, hail, or vandalism. *Exclusions:* Property insurance may limit or exclude coverage for items such as mold testing or remediation and loss or damage to electronic data and associated systems and equipment.
- *Workers' Compensation:* Protects the nonprofit and provides benefits to paid workers for job-related injuries and illnesses. Maintaining this insurance limits the amount of money that is paid to an employee for the injuries. Nonprofits that do not provide workers' compensation insurance have no liability limit if an employee is injured on the job.
- *Fidelity Bond:* Protects the nonprofit if employees embezzle or steal assets of the nonprofit. The bonding company will replace the missing funds and then try to collect from the employee. Depending on the amount of funds handled, a nonprofit should consider conditioning employment in a position of financial responsibility upon the ability to obtain a bond.
- *Director's and Officer's Insurance (D&O):* Covers the costs of defense and damages for wrongful acts and omissions committed by directors, employees, and volunteers. Nonprofits should ask for two different coverages:
 - Full entity coverage: Reimburses the nonprofit for amounts paid to indemnify its directors and covers claims against the nonprofit; and
 - Directors and officers coverage: Protects the directors and officers for losses for which they are not indemnified. D & O policies are often “claims made” policies, which means that coverage is provided for claims made within the policy period rather than when the act occurred. A director could be uninsured for acts that occurred during the director's term of office, if the claim is made after the policy is discontinued. Some policies have “retroactive dates” or “extended reporting period” clauses. *Exclusions:* D & O policies typically do not provide for the payment of legal expenses until after a final determination of liability. The insurance company has no duty to defend a lawsuit, only to reimburse legal expenses. Lawyer board members who act as counsel to the nonprofit should also examine whether the D & O policy

applies to them and whether legal malpractice policies exclude claims that arise if the attorney is acting as a director of a nonprofit. Other exclusions in D & O policies may include: libel or slander actions, fines and penalties, fair employment claims, and punitive damages.

- *Employment Practice Liability (EPL)*: Protects nonprofits, directors, and employees. This insurance covers employment discrimination claims, suits of wrongdoing in employment hiring and firing, and other employment practices. Since employment claims are the most common types of insurance claims against nonprofits, it is important to obtain EPL coverage. One of the main values of this coverage is that it covers litigation expenses. Nonprofits should buy a D&O policy that includes EPL.
- *Errors and Omissions*: This type of policy protects the nonprofit, its officers, directors, and employees from acts or omissions arising out of the provision of professional services. Professional services could include construction consulting, surveys, or architectural designs.
- *Surety and Performance Bonds*: Protect the nonprofit from acts or omissions of others. For example, surety and performance bonds can be issued to guarantee that a contractor will conduct activities in accordance with all laws and ordinances or will complete a project in a timely and workmanlike manner. A performance bond could also guarantee performance on subcontracts and that all bills incurred by a contractor will be paid at the completion of a project.
- *Specialty Insurance Lines*: Provides coverage for special events such as a fun run or liquor liability. Certain types of activities, such as childcare, may not be covered by general liability insurance and, therefore, require a specialty line of coverage.
- *Owners and Contractors Protective Liability Policy*: Covers the owner or general contractor handling a construction project.
- *Builder's Risk Insurance*: Covers losses to property while property is being built, e.g., hail, vandalism, etc.
- *Umbrella Policy*: An option for directors to provide additional personal coverage. An umbrella policy may be purchased to provide coverage in excess of the individual director's homeowner's and automobile policies. A commercial umbrella policy might also be useful for the nonprofit.

E. Disaster Preparation

An organization may face emergency conditions at any time. A disaster plan can help minimize the loss of valuable staff, data, and equipment. In addition, the organization can recover more quickly to begin helping clients get through the crisis. A plan must be tailored to each

organization.

1. Plan for a variety of scenarios:

- Temporary disruption of electricity,
- Destruction of the entire building, or
- Impact on the entire geographic region.

2. The plan should address:

- Communication,
- Data protection,
- Safety,
- Facilities management, and
- Business continuation.

Once you have a plan, train staff, not just once, but on a regular basis to make sure employees are families and comfortable with the plan.

Useful planning information may be found at www.texasbar.org and http://www.nfccny.org/info/disaster_plan.htm.

F. Other Risk Considerations

1. OSHA.

Under federal law, the Occupational Safety and Health Act generally requires every employer to provide a place of employment free from recognized hazards that are likely to cause death or serious physical harm to employees.

2. Identity theft and data breaches.

Under the Texas Identity Theft Enforcement and Protection Act (the “ITEP Act”), each business in Texas is required to implement and maintain reasonable procedures to protect against the unlawful use or disclosure of sensitive personal information that the business collects or maintains. Each business must destroy records containing sensitive personal information that the business does not keep. (See Tex. Bus. & Com. Code §§ 48.001 to 48.201.)

A nonprofit may be required to pay a fine of \$2,000 to \$50,000 per violation. Individuals or businesses damaged by a data breach may also bring a lawsuit against the nonprofit based on common law claims of negligence or breach of contract. A data breach can also damage a nonprofit’s reputation and ability to solicit charitable contributions.

Under the ITEP Act, if a nonprofit suffers a data breach, it must disclose the breach (after becoming aware of it) to any Texas resident whose sensitive personal information was, or is reasonably believed to have been, acquired by an unauthorized person. The nonprofit must disclose the breach as quickly as possible in writing. If the nonprofit must notify more than 10,000 people of the breach, the nonprofit must also notify, without unreasonable delay, all consumer reporting agencies.

7. Other Legal Concerns

A. Copyrights and Trademarks

1. Copyrights

Copyright is a form of protection provided by U.S. law to authors of “original” works. Copyright gives the owner of such original work exclusive rights to do the following:

- reproduce the work,
- make a derivative work,
- distribute copies by sale or other transfer,
- publicly perform the work,
- publicly display the work, and
- in the case of sound recordings, publicly perform the work through a digital audio transmission.

2. Not all works may be copyrighted.

The following is a non-exclusive list of works that are copyrightable and those that are not:

Copyrightable	Not Copyrightable
Software (considered a literary work)	Facts
Pictorial, graphic, and sculptural works	US government works (laws, court decisions, etc.)
Sound recordings	Works in the public domain (the copyright has expired or been disclaimed)
Compilations	Unoriginal compilations of uncopyrightable materials, such as facts

3. A nonprofit may or may not “own” an employee’s creative work.

The “work made for hire” doctrine makes the employer the owner of the copyright in any work created by an employee within the scope of his or her employment. However, rather than have to prove that the employee created the work within the scope of employment, the safe approach is to require all employees to sign a copyright assignment to cover those situations that might not technically be in the scope of an employee’s employment. (For example, that question might arise if the grant writer designed the logo rather than the communications director.)

4. A nonprofit may or may not “own” the design of its own web.

The “work for hire” doctrine does not cover work done by an independent contractor unless the work is specially ordered or commissioned and it is expressly agreed in writing that it will be a work made for hire. The conservative approach is to have all independent contractors sign a copyright assignment, but this may increase the price of the work. In a business that is “copyright intensive,” such as a software company or photography studio, you should always get an assignment of copyright from both employees and independent contractors to alleviate any doubt about what you own.

5. A nonprofit may use a copyrighted work in limited circumstances.

The “fair use” doctrine carves out exceptions to the copyright owner’s exclusive rights. Section 504(c)(2) of Title 17 of the United States Code lists four factors to be considered in deciding what qualifies as fair use:

- the purpose and character of your use,
- the nature of the copyrighted work,
- what amount and proportion of the whole work was taken, and
- the effect of the use upon the potential market for or value of the copyrighted work.

There are seldom clear answers for what qualifies as “fair use” and what does not. There are even special rules and exceptions for libraries and other educational users of a copyrighted work. (See fairuse.stanford.edu for more details.) Consult an attorney before using any substantial portion of a work.

Note: You should ask for permission when fair use may not apply. “Permission” can be gained through an assignment (you gain ownership of the right through a permanent transfer), an exclusive license (you don’t own the right but you are the only one who can exercise it), or a nonexclusive license (you can exercise the right along with anyone else the owner gives like permission).

Penalty: If sued, you could be subject to an award of the copyright owner’s damages, your profits, or “statutory damages” in an amount up to \$150,000 for each act of willful infringement. Criminal penalties may also apply under the DMCA.

6. Trademarks

Registration of a trademark is not required in order to establish rights in a trademark. Rather, rights are built up automatically in a trademark when a company begins using it, depending on the strength of the trademark. Choosing a strong trademark is essential to all companies. A trademark is a term that identifies the owner to the public and ideally it has absolutely nothing to do with a service itself. The weakest trademarks are considered generic and they aren’t really trademarks at all because they are simply the name of the item. An example is selling apples under the brand name “APPLE.” This is simply not a protectable trademark because no one can claim exclusive rights to the generic name of an item. A strong trademark is immediately recognized—such as “Kleenex.” The trademark owner has exclusive rights only in the geographic area where the organization is actually using the mark. An owner may file a state or federal trademark registration to prevent infringement.

B. Lobbying

Generally, lobbying is a direct or indirect communication to legislators (or, in some instances, the public) that is intended to influence specific legislation. “Legislation” includes a bill, act, or resolution that is being considered by the U.S. Congress, by any state legislature, any local council, or similar governing body, as well as a public referendum, constitutional amendment, ballot initiative, or similar type of governmental or public action.

What’s commonly known to as “lobbying?” There are generally three main limitations that an

organization should remember:

- 1) federal law LIMITS the amount of lobbying an organization can engage in,
- 2) report the funds the organization spends on lobbying to the IRS, and
- 3) activities may NOT include taking positions on candidates for public office.

1. A nonprofit may be required to register as a lobbyist in Texas.

A nonprofit that spends more than \$500 in a calendar quarter on lobbying expenses on *state level* legislative or administrative actions must register with the Texas Ethics Commission. The fee is \$100 for 501(c)(3) organizations. In addition, a person who individually receives more than \$1,000 or spends more than \$500 must register.

Certain Texas cities also have their own lobbyist registration requirements. A nonprofit should contact the city attorney's office in all cities in which it plans to lobby for information on local registration.

2. Substantial lobbying is prohibited.

The IRS has set out two different ways to measure an organization's lobbying activities: the "substantial part" test and the expenditure test. An organization risks losing its 501(c)(3) status if lobbying makes up a substantial part of your organization's activities. Unfortunately, there are no clear guidelines in the law as to what amount of lobbying activities count as "substantial," as the IRS considers a number of different factors, including the amount of time an organization (or its members or representatives) devoted to lobbying activities, as well as the amount of money spent in connection with lobbying.

- *Expenditure test under section 501(h).* Determinations under the "substantial part" test are extremely fact-specific and therefore hard to predict. For this reason, many nonprofit organizations choose to have their lobbying activities measured by the expenditure test. Under the expenditure test, your organization's lobbying activities are "safe" and permissible so long as they do not exceed a specified spending limit (outlined below). In order for the expenditure test to apply to an organization (instead of the substantial part test), you must affirmatively file an IRS Form 5768 to make a 501(h) election at any time during the fiscal year in which you want the expenditure test to apply. The provisions of 501(h) – and thus, the expenditure test – will apply retroactively, and will generally continue for subsequent years unless specifically revoked.
- Section 501(h) provides specific guidelines for the percentage of expenditures that may be allocated to lobbying activities without jeopardizing an organization's 501(c)(3) tax exempt status. Under those guidelines, the following limits apply to lobbying expenditures:
 - For your organization's first \$500,000 of annual expenditures, up to 20% (\$100,000) may be used for lobbying activities (note that only $\frac{1}{4}$ of the 20% may be for grassroots lobbying);
 - Up to 15% of the next \$500,000 of annual expenditures may be spent on lobbying (with only 3.75% of expenditures from \$500,000 to \$1 million as grassroots lobbying);
 - For the next \$500,000 (\$1 million to \$1.5 million) of annual expenditures, up to 10% of the expenditures that exceed \$1 million may be used for lobbying (of that amount,

- only 2.5% may be for grassroots lobbying); and
- An organization whose annual expenditures exceed \$1.5 million may spend, in addition to the previous three “levels,” an additional 5% of the excess expenditures over \$1.5 million (only 1.5% of that excess may be used for grassroots lobbying).

3. There are penalties for substantial lobbying.

Regardless of how an organization chooses to be measured, exceeding the limit on lobbying activities puts an organization at risk of losing its tax exempt status and, as a result, having to pay taxes on all of its income. In addition, an organization and even individual managers of the organization may be liable for payment of an excise tax for a certain portion of the total lobbying expenditures for the year.

If an organization has made the 501(h) election, treatment under the expenditure test provides clearer guidelines as to the consequences your organization faces for exceeding lobbying expenditure limits. First, an organization will not lose its tax exempt status until after a period of four consecutive years of exceeding its applicable limit for lobbying expenditures. An organization that loses its 501(c)(3) status for such a violation will then be liable for payment of taxes on all of its income for the four year period. Second, an organization is subject to an excise tax of 25% of excess lobbying expenditures for each year in which the organization exceeds the stated spending limit.

Penalties for noncompliance with the prohibition relating to political intervention include a loss of tax-exempt status, as well as liability for payment of an excise tax. To complain about nonprofit political and lobbying activity, file IRS Form 13909. For more information, see “Worry Free Lobbying for Nonprofits” and “Nonprofit Advocacy Brochure”, by the Alliance for Justice, available at www.afj.org or the Center for lobbying the Public Interest at www.clpi.org.

8. Additional Resources

Texas Nonprofit Resources

Knowbility: www.knowbility.org

OneStar Foundation: www.onestarfoundation.org

Texas CBAR: www.texascbar.org

Texas Association of Nonprofit Organizations: www.tano.org

National Nonprofit Resources

Alliance for Justice: www.afj.org

Alliance for Nonprofit Management: www.allianceonline.org

Association of Fundraising Professionals: www.afpnet.org Blue Avocado: www.blueavocado.org

Chronicle of Philanthropy: <http://philanthropy.com>

eUpdate: www.harmoncurran.com/?fuseaction=eUpdate.main

Federal and State Laws for Nonprofit Organizations: www.muridae.com/npo regulation

Foundation Center: www.foundationcenter.org

Guidestar: www.guidestar.org

Independent Sector: www.independentsector.org

Local Initiatives Support Corporation: www.lisc.org

National Center for Nonprofit Boards: www.boardsource.org

National Council of Nonprofits: www.councilofnonprofits.org

Network for Good: www.networkforgood.org

Nonprofit Genie: www.genie.org

Nonprofit Good Practice Guide: www.npgoodpractice.org

Nonprofit Management: www.managementhelp.org

Nonprofit Risk Management Center: www.nonprofitrisk.org

Philanthropy Journal: www.philanthropyjournal.org

Roberts' Rules of Order: www.robertsrules.org TechSoup: www.techsoup.org

Tools for Nonprofits: www.idealst.org

Urban Institute: www.urban.org

U.S. Postal Service Regulations: www.nonprofitmailers.org

Voluntary Best Practices: www.treas.gov/press/releases/docs/tocc.pdf

8. Appendix

Legal Compliance Checklist for Texas 501(C)(3) Nonprofits

The following checklist is distributed for informational purposes only and should not be construed as legal services to any organization or individual. The checklist should be used as a starting point for a nonprofit to evaluate whether it is following Texas and federal reporting requirements and laws. Some of the items listed below are not mandated by law but are sound business practices an organization should follow to help ensure that the organization avoids problems. There are numerous other laws and reporting requirements that a nonprofit may have to comply with which are not included in this checklist.

Nonprofits should regularly assess their compliance with the following legal formalities:

1. Monitoring by the board

- ✓ The corporation furnishes each director and officer with a copy of the corporation's certificate of formation, bylaws, and most recent Form 990.
- ✓ The board reviews the certificate of formation and bylaws to ensure they accurately describe the corporation's current purpose and procedures.
- ✓ The board reviews board size periodically to determine the most appropriate size to ensure effective governance and to satisfy the charitable mission.
- ✓ The corporation assigns the responsibility for meeting all filing and reporting requirements to appropriate directors and staff.
- ✓ The board or a board committee regularly determines that all filing and reporting requirements have been met in a timely manner or that appropriate and timely corrective action has been taken.
- ✓ The board or a board committee records the rationale behind all compensation (including reimbursements) paid to officers and directors.
- ✓ The corporation holds all required board of director and member meetings.
- ✓ The board receives regular reports on finances, programs, and other important matters.
- ✓ The board regularly monitors and evaluates progress toward strategic goals and annually evaluates the Executive Director.

2. Federal tax and financial filings and reports

- ✓ The corporation files annual tax information returns (IRS Form 990) timely. If the corporation has unrelated business income, it files IRS Form 990-T.

- ✓ The corporation obtains an annual financial audit from an independent auditor and, if required by federal funding sources, the corporation obtains an A133 audit.
- ✓ The board meets with the independent auditor annually.
- ✓ The corporation engages legal counsel to conduct an annual review of its past year's operations and coming year's proposed operations to identify any conflicts and inconsistencies with the information previously provided to the IRS, and for an opinion on whether the corporation is or will be engaged in unrelated business activity.
- ✓ The corporation complies with IRS disclosure, substantiation, and reporting requirements for charitable contributions received.
- ✓ The corporation observes the IRS prohibition on political campaign activities.
- ✓ The corporation conducts an annual review to determine its compliance with public charity status requirements.
- ✓ The corporation observes the limitations on lobbying activities and maintains appropriate records to document its lobbying expenditures and activities.
- ✓ If the corporation lobbies and utilizes the 501(h) election, it makes appropriate filings with the IRS to comply with lobbying registration, disclosure, and reporting requirements.
- ✓ If the corporation has an employee benefit plan, the corporation makes annual benefit plan filings (IRS Form 5500) as required.
- ✓ The corporation has a DUNS number, if it plans to apply for federal funds.

3. Other filings and reports

- ✓ The corporation files amendments to its corporate documents with the Secretary of State and IRS as required.
- ✓ The corporation has applied for and maintains the appropriate property tax exemptions with the county tax assessor.
- ✓ The corporation files a status report (currently Form 9.01) with the Secretary of State every four years.
- ✓ The corporation has obtained a nonprofit mailing permit to use special bulk postal rates.
- ✓ The corporation registers with the state if it solicits funds for law enforcement, veterans, or firefighters.
- ✓ The corporation maintains a seller's permit from the Texas Comptroller for items it sells.

- ✓ The corporation maintains on record with the Texas Secretary of State a current name and address for its registered agent.
- ✓ The corporation maintains a written consent form from its registered agent.
- ✓ The corporation makes appropriate filings to protect its intellectual property, such as trademarks and copyrights.

4. Liability protection

- ✓ The corporation understands the policy limits of insurance policies, including: the events covered, exclusions, amount of coverage, deductibles, whether policies are “occurrence” or “claims made” policies, and any gaps in coverage.
- ✓ The corporation maintains appropriate commercial general liability insurance, with reasonable exclusions and limitations, with coverage for the acts and omissions of the organization and its employees and volunteers in the amount of at least \$500,000 for each person, \$1,000,000 for each single occurrence for death or bodily injury, and \$100,000 for each single occurrence for injury to or the destruction of property.
- ✓ The corporation maintains appropriate bonding for those persons who handle its funds with reasonable limitations and exclusions.
- ✓ The corporation maintains, as applicable, errors and omissions or other professional liability insurance with reasonable exclusions and limitations.
- ✓ The corporation maintains appropriate director’s and officer’s liability insurance, with reasonable exclusions and limitations or annually reviews the affordability of such insurance.
- ✓ The corporation maintains appropriate property and automobile insurance with reasonable limitations and exclusions.
- ✓ The corporation maintains appropriate workers’ compensation insurance with reasonable limitations and exclusions.
- ✓ The corporation maintains appropriate employment practices liability coverage with reasonable limitations and exclusions.
- ✓ The corporation has copies of executed waivers of liability for volunteers and clients, if applicable.
- ✓ The corporation has adopted policies and procedures to modify risks and monitors their implementation.
- ✓ The corporation promptly advises insurance companies of facts that could give rise to claims in accordance with notice provisions of the policies.
- ✓ The corporation has adopted a disaster plan.

5. General operations

- ✓ The corporation has selected a bank after comparing and negotiating rates and fees.
- ✓ The corporation has a documented set of internal controls including handling of cash and deposits, segregation of duties, and approval over spending and disbursement.
- ✓ The corporation has authorized at least two persons as check signers.
- ✓ The corporation keeps unissued checks in a secure area.
- ✓ The corporation revokes the check signing authority of former staff and board members.
- ✓ The organization requires bank statements be mailed to and reviewed by a person who does not write or sign checks.
- ✓ The corporation appropriately invests its assets that are held for investment and has a written investment policy.
- ✓ The corporation maintains an up-to-date copy of its certificate of formation, bylaws, 501(c)(3) tax exemption application and determination letter, the last three years of 990s, and franchise tax exemption letter from the Texas Comptroller at its principal office.
- ✓ The corporation has obtained a sales tax and franchise tax exemption from the Texas Comptroller.
- ✓ The corporation has obtained other federal, state, or local licenses as required for its activities.
- ✓ The corporation prepares and maintains for at least three years adequate and correct books and records of account, including records relating to all income and expenditures, and prepares or approves an annual report of financial activity.
- ✓ The corporation follows accounting practices which conform to accepted standards.
- ✓ The corporation prepares timely financial statements including a balance sheet and a budget vs. actual comparison.
- ✓ The corporation complies with its document retention policy.
- ✓ The corporation develops an annual comprehensive operating budget, which is approved by the Board and operated in accordance with it.
- ✓ The corporation prepares and maintains minutes of board, committee, and member meetings for a minimum of three calendar years following the end of the fiscal year.
- ✓ The corporation maintains copies of notices of board and member meetings, written waivers of notice, consents to votes taken without a meeting, and approvals of all minutes.

- ✓ The corporation maintains copies of written director and officer resignations, proxies, and similar documents.
- ✓ The corporation maintains an alphabetized list of members (if any), with name, address, and class of membership.
- ✓ The corporation makes available for public inspection a copy of its federal tax exemption application, IRS tax exemption determination letter, and IRS Forms 990 from the previous three years, and provides a copy on request.
- ✓ The corporation, unless it falls under an exception, makes all of its financial records available to members of the public for inspection.
- ✓ The corporation complies with its bylaws, including the provisions on the terms of directors, election of officers, quorums, and obtaining approval for certain actions. The corporation holds all meetings it is required to hold and provides proper notice of meetings.
- ✓ The corporation has at least three directors and has two different directors serving as president and secretary.
- ✓ The corporation has a written plan identifying actions to take in the event of a loss in funding.
- ✓ The corporation has a reserve of funds to cover at least three months of operating expenses
- ✓ The corporation has an independent audit committee, a document retention policy, and a whistleblower policy.
- ✓ The corporation makes training on relevant accounting topics available for board and appropriate staff.
- ✓ The corporation has a compensation plan and conducts a periodic review of salary ranges and benefits is conducted.

6. Transactions

- ✓ The corporation maintains a procurement policy to ensure that purchases are at a fair market value or are otherwise favorable to the corporation and, if applicable, the corporation complies with federal procurement standards.
- ✓ The corporation maintains a financial system that requires receipt of written invoices prior to payment for any services or goods.
- ✓ The corporation conducts appropriate investigations to ascertain that loans, leases, and other transactions are at fair market value or are otherwise favorable to the corporation.
- ✓ The corporation prepares appropriate documentation in support of all transactions with directors, officers, or other insiders, and to demonstrate the reasonableness of all compensation.

- ✓ The corporation prepares appropriate acknowledgements for all donations.
- ✓ The corporation tells donors the value of any benefit they receive in return for contributions over \$75.
- ✓ The corporation has written policies for paying or reimbursing expenses incurred by anyone conducting business or traveling on behalf of the corporation.
- ✓ The corporation uses all contributions consistent with the donor's intent.
- ✓ The corporation has adopted a conflict of interest policy for transactions and meets all requirements for approval of transactions involving a conflict of interest including transactions with corporations under its control.
- ✓ The corporation engages legal counsel to review proposed contracts and agreements, corporate obligations to perform acts that might jeopardize its tax-exempt status, and whether there are appropriate safeguards to assure that corporate funds granted to other organizations are being used for tax-exempt purposes.
- ✓ The corporation receives the benefits of, and meets its obligations under, all leases, loans, contracts, partnerships, joint ventures, and similar agreements.
- ✓ If the corporation is the fiscal agent for another organization, it monitors the other organization's performance and compliance with all corporate formalities.
- ✓ The corporation reconciles all cash accounts monthly.
- ✓ Grant agreements are reviewed by staff and an appropriate board committee to monitor compliance with all conditions.
- ✓ Payroll is prepared according to appropriate state and federal laws.
- ✓ The corporation has procedures for the disposition of property and equipment.
- ✓ The corporation has a maintenance schedule for equipment.
- ✓ The corporation takes periodic inventories.
- ✓ The corporation rotates auditors at least every five years.
- ✓ The appropriate officer signs all financial statements and 990 tax returns to ensure they are accurate, complete, and timely filed.
- ✓ The corporation pays all bills within 30 days of receipt.
- ✓ A designated staff backs up all computers monthly and stores the information offsite. A board member receives a copy.
- ✓ Mail is opened, date stamped, and logged by an employee who has no other accounting responsibilities.

- ✓ The corporation has adopted a whistleblower policy.

Legal Tool Kit for Texas Nonprofits



**Texas Community Building with Attorney Resources is a special project of
Texas RioGrande Legal Aid**



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