Basics of Serving on a Nonprofit Board

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Overview

- Nonprofit Corporations
- Tax-Exempt Organizations
- Fiduciary Duties
- Statutory Procedures
- Best Practices
- Ongoing Filing Requirements
- Substantiation Requirements
Nonprofit Corporations: Governance Documents

- **Articles of Incorporation**
  - This document incorporates the nonprofit corporation (i.e., a distinct legal entity) at the state level.
  - The Indiana Nonprofit Corporation Act of 1991, as amended (the “1991 Act”), sets forth the state law requirements for status as a nonprofit corporation in Indiana.
  - The 1991 Act places all nonprofit corporations into one of three categories based on the nonprofit corporation’s goals: (1) public benefit; (2) religious; or (3) mutual benefit.
  - A public benefit corporation is organized for public or charitable purposes and generally includes those organizations recognized as tax exempt under Internal Revenue Code (“Code”) Section 501(c)(3).

- **Bylaws**
  - Bylaws are a companion document to the Articles of Incorporation and generally contain more detailed provisions regarding the governance of the nonprofit corporation.
  - Bylaws are a private document and are not filed with any state office.
Tax-Exempt Organizations: Form 1023 Application

- The Form 1023, Application for Recognition of Exemption, is filed with the Internal Revenue Service (“IRS”) to apply for federal tax exemption under Code Section 501(c)(3).
- Form 1023 contains a narrative description of the organization’s anticipated activities as well as an estimated budget for three years.
- An organization must operate in accordance with the activities that it described in its Form 1023.
Tax-Exempt Organizations: Charitable Purposes

An organization may be exempt under Code Section 501(c)(3) if it is organized and operated exclusively for one or more of the following purposes:

- Religious;
- Charitable;
- Relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency.
- Scientific;
- Testing for public safety;
- Literary;
- Educational; or
- Prevention of cruelty to children or animals.
Private Inurement

The private inurement doctrine provides that an organization may not be operated for the benefit of private individuals. An organization’s net earnings may not inure to the benefit of individuals who control the organization (e.g., founders, directors, officers). The concern is whether substantial benefits inure to private individuals who created or are involved in the organization (i.e., “insiders”).

Code Section 4958 imposes a tax on any disqualified person who engages in an excess benefit transaction with a public charity, as well as on any foundation manager who knowingly participates in the excess benefit transaction. This tax is commonly referred to as an “intermediate sanction” because it provides the IRS with a sanction short of revoking the tax-exempt status of an organization that has engaged in private inurement.

An excess benefit transaction is a transaction in which an economic benefit is provided by a tax-exempt organization, directly or indirectly, to or for the use of a disqualified person, and the value of the economic benefit provided by the organization exceeds the value of the consideration received by the organization.
Private Benefit

Even when an organization does not allow earnings to inure to the benefit of “insiders,” the organization must operate in a manner that does not benefit any particular private class of persons. The prohibition against private benefit extends to “disinterested persons.”

Under the private benefit doctrine, the groups that benefit from the organization: (1) must be members of a charitable class; and (2) must not comprise a select group of members earmarked to receive benefits.

To be members of a charitable class, the groups must possess charitable characteristics (e.g., poor, underprivileged, educational, religious, etc.).
Tax-Exempt Organization: Limitations and Prohibitions

- **Legislative Activity**
  
  A substantial part of an organization’s activities may not consist of attempting to influence legislation by propaganda or otherwise.

  Thus, a substantial part of an organization’s activities may not include: (1) contacting or urging the public to contact legislators for the purpose of supporting or opposing legislation; or (2) advocating the adoption or rejection of legislation.
Political Activity

An organization may not participate or intervene, directly or indirectly, in any political campaign for or against any candidate to public office.

Unlike legislative activity, which can be conducted by an organization within limits, an organization will jeopardize its tax-exempt status if it participates or intervenes in a political campaign with respect to a candidate for public office.
The three primary duties of a director of a nonprofit corporation are:

1. The duty of care;
2. The duty of loyalty; and
3. The duty of obedience.

Directors are expected to have a working familiarity with the mission of the organization.

Directors should also have a basic knowledge of what nonprofit organizations may do, what they may not do, and how they differ legally, structurally and operationally from commercial enterprises.

Most importantly, directors should have a passion for the organization’s cause and the time and/or financial resources to support it in a meaningful way.
Fiduciary Duties:
Duty of Care

- The duty of care concerns the director’s competence in performing directorial functions.
- Standard: A director of a nonprofit corporation must discharge his or her duties in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances, and in a manner in which the director reasonably believes to be in the best interest of the organization.
- At a minimum, a director should read minutes, prepare for and attend meetings, listen and ask good questions.
- In discharging the director’s duties, a director may rely on information, opinions, reports, or statements, including financial statements and other financial data, if prepared or presented by a qualified professional whom the director reasonably believes to be reliable and competent in the matters presented.
- A director is not liable for an action taken as a director, or failure to take an action, unless:
  - The director has breached or failed to perform the duties of the director’s office in compliance with the duty of care; and
  - The breach or failure to perform constitutes willful misconduct or recklessness.
Fiduciary Duties: Duty of Loyalty

- The duty of loyalty is best described as the expectation that a director will place the interests of the corporation above his or her own personal interests or those of another person or organization, particularly when the potential for conflict arises.
- The essence of the duty of loyalty is to recognize and deal appropriately with conflicts.
- To satisfy the duty of loyalty, a director must avoid conflicts of interests and disclose them when they arise.
- Additionally, a director may not appropriate to his or her own use a business opportunity that, in fairness, belongs to the organization.

Example: Jane Doe is passionate about the arts. This passion leads Jane to serve as a board member of two organizations that focus their efforts on advancing the arts. At a board meeting for Organization A, Jane hears about a grant opportunity through a local foundation. Before Organization A can gather the necessary information and vote on the opportunity, Jane informs Organization B of the opportunity and Organization B secures the grant.

- To ensure effective enforcement of the duty of loyalty, nonprofit organizations should adopt conflict of interest policies and procedures for their directors and officers.
Fiduciary Duties: 
Duty of Obedience

- The duty of obedience requires that a director act with fidelity, within the bounds of law generally, to the organization’s mission as expressed in its Articles of Incorporation and Bylaws.
- To satisfy the duty of obedience, a director must ensure that the organization complies with all of the rules and regulations to which it is subject.
- In particular, a director must ensure that the board’s decisions further the stated objectives of the organization.
- Thus, the director should know the rules and abide by them, as well as encourage fellow directors to do the same.
Fiduciary Duties:
Confidentiality

- In addition to the three primary duties of directors, all directors should treat board matters as confidential.
- Remember: what happens in the boardroom, stays in the boardroom.
- This extends to email communications of the board.
Fiduciary Duties: Stewardship

In addition to the three primary duties of directors, all directors should act as good stewards of the organization.

All directors should:

- Share the vision and mission of the organization and promote it to others in a clear and compelling manner.
- Assist the organization in building and fostering relationships.
- Gift their time and talent to the organization in the places best utilized.
- Plan for the future and sustainability of the organization by adopting policies, strategies and activities that help the organization plan appropriately for the future and sustain its mission over time.
- Be good stewards of the assets of the organization.
Best Practices

 Governance Review

 Start by reviewing the organization’s current governing documents. In this review, determine if the organization is organized and operated under the most recent version of the nonprofit statute. In particular, review these documents to determine if the organization’s directors and officers are afforded the maximum indemnity protection afforded by the current law.

 Audits

 Does the organization have an audit committee? Is the audit committee independent? Is someone on the audit committee a “financial expert”? Can the audit committee hire and fire the auditor? Is the outside auditor independent? If the answer to any of these questions is “no,” the organization should consider making changes.
Best Practices

Conflict of Interest Policy

Conflict of interest policies are vital to sound stewardship practices. If an organization does not have such a policy, the organization should draft one. A sound conflict of interest policy should acknowledge that a nonprofit organization will seek to recruit and retain board members who, under a strict definition of “conflict,” have many conflicts because they are established individuals with many community connections. Therefore, conflict avoidance should not be the policy, but rather ethical conflict management and an overarching requirement that in all situations in which a conflict is present, a director’s duty of loyalty runs to the nonprofit organization.

Internal Controls

Does the organization have a document retention and destruction policy? Does the organization have documented internal financial controls? Does the organization have a documented policy that ensures that no one person is in charge of more than one of the following: (1) payment authorization; (2) custody of cash, checks, etc.; (3) financial reporting; or (4) record keeping? Has the organization approved and adopted a budget?
Ongoing Filing Requirements:

Federal

- **Form 990, Return of Organization Exempt From Income Tax**
  - An organization with annual gross receipts normally more than $50,000 is required to file the Form 990 with the IRS.
  - Form 990, if required, must be filed by the 15th day of the fifth month following the close of the tax year.
  - An automatic 6-month extension can be requested.
  - Based on an organization’s gross receipts and total assets, it may be eligible to file a condensed version of the Form 990.
Form NP-20, Indiana Nonprofit Organization’s Annual Report

This annual state information tax return is required of all Indiana nonprofit corporations and must be filed by the 15th day of the fifth month following the close of the tax year.

Form NP-20 is filed with the Indiana Department of Revenue.

Form 48725, Indiana Business Entity Report

This form is the biennial state information entity return.

It is not a tax return.

A nonprofit corporation must file Form 48725 every two years with the Indiana Secretary of State in the anniversary month of its incorporation.

Failure to file will eventually result in administrative dissolution.
Substantiation Requirements: Nothing Received in Return by Donor

- A donor cannot claim a tax deduction for any single contribution of $250 or more unless the donor substantiates the contribution with a contemporaneous, written acknowledgement of the contribution from the recipient organization (i.e., the donee).

- A written acknowledgement is contemporaneous if it is obtained by the donor on or before the earlier of: (1) the date the taxpayer files the original return for the taxable year in which the contribution was made; or (2) the due date for filing the taxpayer’s original return for that year.

- The written acknowledgement from the donee organization must contain the following information:
  - The name of the donee organization;
  - The amount of any cash the donor paid and a description (but not the value) of any property other than cash the donor transferred to the donee organization;
  - A statement of whether the donee organization provided any goods or services in consideration, in whole or in part, for any of the cash or other property transferred to the donee organization;
  - If the donee organization provided any goods or services other than intangible religious benefits, a description and good faith estimate of the value of those goods or services; and
  - If the donee organization provided any intangible religious benefits, a statement to that effect.
Substantiation Requirements: Nothing Received in Return by Donor

Sample Written Acknowledgement

We would like to thank you for your contribution of $250 [or provide a description, but no value, of any in-kind contribution - e.g., ten dance costumes] made on ___________. ABC, Inc. did not provide any goods or services in consideration, in whole or in part, for your contribution.
Substantiation Requirements: Quid Pro Quo Donations

- A donor may only take a charitable contribution deduction to the extent that the contribution exceeds the fair market value of the goods or services the donor receives in return for the contribution.

- A contribution made in exchange for goods or services is known as a “quid pro quo” contribution.

- A donee must provide a written disclosure statement to a donor who makes a payment exceeding $75 partly as a contribution and partly in exchange for goods and services provided by the organization.

- The written acknowledgement from the donee organization must contain the following information:
  - Inform the donor that the amount of the contribution that is deductible for federal income tax purposes is limited to the excess of cash (and the fair market value of property other than cash) contributed by the donor over the value of the goods or services provided by the donee; and
  - Provide the donor with a good faith estimate of the fair market value of the goods or services that the donee provided in return.
Substantiation Requirements: Quid Pro Quo Donations

Sample Written Acknowledgement

We would like to thank you for your contribution of $100 made on _______. In connection with your contribution, ABC, Inc. provided a dinner to you.

Please note that, pursuant to Section 6115 of the Internal Revenue Code of 1986, as amended, the amount of your contribution that is deductible as a charitable contribution deduction for federal income tax purposes is limited to the excess of the amount of any money [and the value of any property other than money] which you contributed over the value of the goods or services which we provided to you. [We cannot estimate for you the value of any property you contributed. You must determine that on your own.] However, we have made a good faith estimate that the fair market value of the goods and services which we provided for your benefit is [$_______].
Questions?

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