

TRANSCRIPT

Tele-Workshop: 501(c)(3), (c)(6), etc., and the Law

I'd like to introduce our speaker today for today's tele-workshop, his name is Scott Hammerson. He's a CPA and a managing partner with Wegner LLP, CPAs and Consultants in Madison, Wisconsin. He's got over 25 years experience providing accounting, auditing, and not-for-profit advisory services to over 400 non-profit clients throughout Wisconsin. He is skilled in providing various forms of financial analysis and budgeting, as well as cultivating relationships between management boards and stakeholders. He was recently elected to the founding Board of Wisconsin Nonprofit Association. So, thank you for joining us today, Scott.

Thank you, Chel. I appreciate the introduction and I appreciate this opportunity to be with all of you here today. The presentation will be for about an hour and then I've reserved about a half-hour time at the end of the presentation for questions. I encourage you to, actually, during the presentations, as you think about questions, if, if you don't want to speak them out loud, you can certainly e-mail me during the presentation and I can monitor those as we progress to tailor my comments along the way.

We'll walk through the slides; the slides are numbered in the lower left-hand corner of each slide so you can stay along with me with those sorts of things. In page 2, slide #2, if you have those in front of you, is actually my e-mail address, and I'm online right now and would be happy to see whatever questions you have. Also attached to the things that American Byways had sent to you is a number of attachments and resources, and I'll make some reference to those along the way. Many are in PDF form. And I've also provided to you at the end of the presentation a slide that has links to where you can do those yourself. Moving on to slide 3, our, today's discussion will focus on these 5 areas. You'll receive an understanding of the types of nonprofit organizations; how to get exemptions; what are the requirements for maintaining them; the importance of state laws and some alternatives. Moving on to slide 4, there are actually 14 different classifications under IRS Code Section 501(c) for organizations that, to receive tax exemption. I've selected for you here today 3 of those categories which would most likely fit the types of organizations that you represent in the Byways Association. And we're going to spend some time going over these, the differences in how to obtain a tax exemption.

The first one, as you can see, is 501(c)(3); the most commonly known or one that is often talked about is for organizations to receive tax exemption as either charitable, religious, educational, or scientific. And actually, along with those, there is a couple of other categories that are fairly specific. But organizations such as yourself would most likely fall either under the charitable or educational components. And I want to just take a minute and read for you what those requirements are. One of the handouts that I have for you today includes a PDF on purpose and dissolution clauses. I'm just going to read for you what the definition of charitable is and you can see perhaps how you might fit into that category. The generally accepted legal definition of "charitable" includes relief of the poor, the distressed or underprivileged; advancement of religion; advancement of education or science; erecting or maintaining public buildings, monuments or works; lessening the burdens of governments; lessening neighborhood tensions; eliminating prejudice and discrimination, defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency. Those are certainly not in any way limiting the types of things that could qualify under "charitable" to give you a general sense of the types of organizations and categories that you may want to fall into. And in reviewing those and in considering the Byways Association, certainly erecting or maintaining public buildings and monuments or works would be one category that should fit very nicely into the "charitable" classification.

Also under 501(c)(3) is the category of "educational" and it may actually find that this is a more appropriate classification for Byways Association. In reading through the IRS instructions and again, there are many resources here, Publication 557, one of the attachments talks about the tax exempt status of organizations and defines the section for educational organizations. And reading just a brief excerpt out of that section, the term "educational" relates to the instruction of the public on subjects useful to individuals and beneficial to the community. And they go

on to describe some of the different types of qualifying organizations and some of those that they use, examples are a museum, a zoo, a planetarium, a symphony orchestra, or other similar organizations. And my understanding of Byways Association, and some that have obtained a tax exemption, this very clearly is a category that many of you maybe able to fit into. And the importance and the application, of course, is demonstrating to the IRS how your organization's mission or purpose would meet those definitions. 501(c)(4) and (c)(6) are two other classifications under the IRS Code Section.

But these classifications, for some reasons I've been describing a little bit are much easier to obtain and would be easier for your organization to justify how you might fit or be classified under those categories. Again, reading out of Publication 557, the definition of "social welfare," it says to establish that your organization is organized exclusively to promote social welfare, you should submit evidence with your application showing that your organization will operate primarily to further in some way the common good and general welfare of the people, the community such as by bringing about civic betterment and social improvements. And I think we probably, in discussion, could talk about how many of your byway organizations could meet that definition. And finally, there's a category called 501(c)(6) and as I know in talking with some of you, often, your organizations are either as closely associated with or sponsored by Chambers of Commerces and this would be a typical category that those organizations would fit under. But again, reading out of Publication 557, it describes a business league, in general, is an association of persons having some common business interests, the purpose of which is to promote that common interest and not to engage in regular business of any kind ordinarily carried out for profit. Trade associations and professional associations are considered business leagues, and they use specifically a Chamber of Commerce as an example of a nonprofit falling into that category.

Moving on to slide 5, I wanted to highlight some of the significant differences between these 3 categories, as well as some of the significant requirements that you have for each of these. The most notable one of course is charitable contributions and because the 501(c)(3), and the classification which is most sought after is the only classification that, where the donor, in making contributions to the organization can receive a tax deduction. A personal, whether it be a person or an individual or many private foundations are required by their IRS laws to give only money to 501(c)(3) organizations. So, that is often a requirement in order to receive certain types of foundation funding, to be a (c)(3) organization. Because of this, this is one of the most significant distinctions between a (c)(3) and, of course, the (c)(4) and the (c)(6) organizations.

The second difference or something to note as a requirement is lobbying. And lobbying is a word that is often misunderstood and loosely applied to many things. But in terms of the definition as it relates to the Internal Revenue Code, it is an attempt to influence State or Federal legislation. And it can, in some cases, apply down more at the local level, but the definition has to do with State and Federal legislation. (c)(3) organizations are allowed to perform some types of lobbying, but, of course, there are limits on that. And the IRS has provided certain safe harbors for certain types of (c)(3) organizations that do lobbying in order to define or better, or provide calculations of what those lobbying limits might be. Under the (c)(4) and (c)(6) organizations, there, those limits do not exist. There are certain laws that would create an excise tax on the organization if they have certain types of lobbying and so forth. But the amount and extent of that activity is not limited in any way. Political activity is another area that's sometimes misunderstood, but for a 501(c)(3) organization, it's not allowed in any way, in any measure, in any form of expenditure or any publication or any way to be involved in any type of political activity. And political activity in this case is described as supporting a candidate for public office or supporting a party position or a party affiliation. And the (c)(4) and (c)(6) organizations can be involved in political activity; often they form separate organizations commonly known as PACs, Political Action Committees, and there is IRS Code Section 527 that governs those types of activities. As I understand from the American Byways Associations, many if not all would not be involved in any of this type of activity and the lobbying activity can occur at some level if you have certain interests in zoning laws or other sorts of things that might create concern for, for the byway or its operation. And attempting to affect an administrative rule such as a zoning or something that is local, that is not Federal legislation or State legislation, but solely something that's determined administratively is not considered lobbying. Private nearment is an overall condition that applies to nonprofits broadly and this is, this is to state that an organization that receives tax exemption

cannot be for the personal benefit of individuals. And this is threaded through out most of the Code Section and throughout many of the regulations that follow that your organization cannot be set up to personally benefit certain individuals, for instance, individuals on the Board of the Directors or certain groups of individuals; that has to do with compensations, loans and a number of regulations that govern that area.

Purpose and dissolution clauses are important particularly with 501(c)(3) organizations because they're both required for exemption for a 501(c)(3) and I have included in your handouts examples of both of those that would be required in your applications for exemption, and actually required to be in your bylaws or organizing documents. And the public versus private benefit is an important overarching concept that you have to be aware of certainly as you're applying for exemption because that the IRS will be looking for this during the application process. But certainly, as you continue in your operations, is to think about the operation and the organization, that are we benefiting the public as a whole, and this is particularly or mostly important with 501(c)(3) organizations versus, you know, are we benefiting a select of group of individuals or businesses. So, understanding the difference between those is important during the application process. Moving on to slide 6, and talking about obtaining exemptions, and one of the handouts that we have here is an application guide. It provides some overall things to consider as you're applying for a tax exempt status. And you need to be either incorporated in a State in which you reside or at a minimum, the organization needs to have certain articles of organization. This is a little known fact, but you actually do not need to have a formal incorporation. You can actually be a limited liability company or commonly known as "LLC," an unincorporated association or trust can also apply for tax exempt status. So, incorporation is not required but often is the most common form of organization because of many states, the type of organizing documents required by that commonly fit into the classification that the IRS is looking for. You know, a benefit certainly of incorporating in a state is, many states have limits of liabilities of volunteer board members personally, not to the organization, but under certain circumstances, board members can be indemnified by the organization and do not bear personal responsibilities for decisions of the organization. And probably most importantly is, there's certain wording as I discussed earlier with the purpose of dissolution clauses that the IRS is looking for in those organizing documents. In fact, the IRS, in Publication 557, had sample articles of organization, not necessarily incorporation but the sample articles of the types of things that they're looking for in organizing documents.

You're going to prepare a file of an IRS Form 1023 or 1024; 1023 applies to 501(c)(3) organizations only and the 1024 would apply to all the other 13 classifications. And the filing fee for this will be \$750 typically, unless your gross receipts are normally not more than \$10,000, you can apply for only a \$300 fee. The process typically takes 3 to 6 months; it depends on how well it was prepared at the front end and thought out. I have seen them actually get through slightly less time than that, and I've seen them certainly take much longer than that if the IRS has some concerns. The concept of a group exemption letter, something I just thought about and I'm including for this presentation today, something that the American Byways Association might consider, may not be appropriate but something, you know, for you to, at least, be aware of is that certain national associations or large groups of organizations that have individual chapters or state affiliations can apply for a group exemption, meaning that there is only one application for exemption and then all of the chapters of the affiliated organizations are assumed to have similar exemption based on, upon the overall group exemption. There needs to be general supervision and some type of control over those affiliates. So, based on that, that this may not be appropriate in the situation, but it certainly is something to consider.

Moving on to page 7, I want to talk a little bit about the application for exemption for (c)(4), (c)(6), because this may actually be valid alternative for some of the byways associations. Interestingly, generally, you're not required to file this, for this exemption, because it can always be retroactive. So, you could be in business for 10 years, operate like a nonprofit organization even though you don't have your tax determination letter and decide that you want to get the official IRS determination letter, apply for exemption and have that be retroactive back to the start of the organization's existence. So, because of that, you know, unless there is some outside organization requesting to know that you're a nonprofit organization, it is not necessarily required. It's completed by filling out Form 1024. It's a form that is only 19 pages long; it has only 5 pages of instruction and of those 19 pages on the application, 14 is for one of each of the different classifications. It was last revised in 1998, so it's something that the IRS does not spend

a lot of time monitoring. And that the form itself is fairly simple and self-explanatory. You might be asking me why, well, why would we file for exemption if it was not required. Well, there sometimes is a perceived benefit of having a determination letter and a public recognition of that status. I know for instance in many of the states in the United States allow 501(c)(4) organizations, for instance, to receive sales tax exemption. Well, in order to have that, you have to prove to the IRS that you have that determination letter and so, it will be well worth filing for that exemption in order to get sales tax exemption.

Moving up to slide 8, the 501(c)(3) applications by far are more complex. It has a number of pitfalls and things that you can fall into as you're going through this, intended by the IRS to weed out organizations that they deem not worthy of the classification. And because the IRS receives many, many applications because of the desire to receive charitable contributions and certain other advantages that (c)(3) organizations enjoy, it is carefully monitored and scrutinized. There are 26 pages in the actual form itself; there are 38 pages of instruction; the IRS regularly revises that form. In fact, the last one was June of '06. However, as you can see there, if your organization normally did not receive more than \$5,000, you can be presumed as long as you're operating within the confines of what the IRS Code Section says that a (c)(3) organization should operate under. If your gross receipts are under \$5,000, you're not required to file and you're presumed to be tax exempt 501(c)(3) organizations. Churches are also exempt in entirety from filing for that exemption. And one of the things to consider is that, that often (c)(3) organizations can also be membership organizations. So, during your original organizing period, one of the things to consider carefully is whether you will be a membership-driven organization, meaning, the memberships are created and the membership elects the Board of Directors and makes decisions about amendments to Articles of Incorporation and so forth, or whether or not the organization is controlled by an independent board that elects itself and replaces itself through a nomination process. The form 1023 needs to be filed within 27 months of the forming of the organization. And this is because a (c)(3) status is not granted retroactively back to the date that you were formed. The original deadline for application is 15 months after the date of incorporation and then there's an automatic 12-month extension that you can apply for when you fill out the form. As I've talked to some of the byway organizations and I've certainly gone out to some of the websites and looked at many of your organizations, it's at least my opinion that there is no reason why the majority of your organizations cannot be a 501(c)(3) organization if the application is done right and appropriately worded. And often, these, the trouble begins when the form is filled out without knowledge about the background of what the IRS requires and as the reviewer at the EO Division, Exempt Organization Divisions reviewing the application is they become confused during the application process of who you are what you're trying to do, that may cause delays and further problems. I have many examples of experiences when organizations have come to me and they've prepared their own applications and they've had two and three go-arounds with the IRS providing more information and so forth and the IRS is either denying or confused about what is going on. And they come to me, asking to help work through the situation. And what typically happens, this is sort of a lesson-for-me situation is that as the application is completed and in that application, you put down everything that you possible thing that you plan or dream that you'll ever want to do. So, it is kind of a strategic plan of what you want to do in the future. And that may weave in and out of different things that some might have some questions by the IRS and then the IRS will ask about some of those activities because they're not quite certain what you're trying to accomplish with that, and then ask you to respond. And in those responses, sometimes a response is given that's much different than the original application. And then, what happens is the reviewer of the IRS becomes confused as to who you are and what you're really trying to be. And it kind of sometimes will spiral out of a, kind of a mess of communication and so forth. Whereas, if the original application had been very concise, described in detailed terms, of course, why you're either charitable or educational and how you attempt to accomplish that mission through the means that you're required to do by following a Code Section. You know, often, these things can get passed through very quickly. That, of course, requires you to engage either an expert who's a volunteer or a professional help from the outside. But at least, based on what I know so far of your organizations, I wouldn't see any reason you wouldn't, in most normal situations, be able to obtain a 501(c)(3) status. We'll talk a little bit at the end why one status, what the particular advantages and disadvantages might be in going through this route.

Moving on to slide 9, maintaining an exemption and there's also, again, another handout and enjoy all these handouts and this reading but I'm going to try to summarize this stuff for you, and talk--which is really a compliance

guide. So, once you receive tax exempt status, of course, the IRS is interested in the fact of whether or not that you can maintain that. And that the filing of forms and so forth are designed for them to determine that you're not lobbying with, you're lobbying within certain parameters, that there is no political activity going on, and private benefit is being avoided. Some other things, of course, there is a number of rules for the (c)(3) organizations, requiring documentation and how you communicate with the owners. For instance, if you receive contributions, you're required to remit back to the donor the amount of the contributions and statements indicating that there was no value received in exchange for those contributions. Know also that there's a significant amount of public disclosure required as part of maintaining your (c) exemption; that the actual application form 1023 and 1024 forms are public disclosure documents and you're required to, upon request from anybody in the public to give them a copy of that, if your organization was formed after July 15, 1987. Sarbanes is actually a term you might be familiar with, but a number of laws and regulatory oversight is occurring as people in Congress and legislators have had some concerns about the ability of nonprofits to self-govern themselves, and these laws were designed to protect the public and their contributions. And so, there's a lot more to be said than we have time today about some of those requirements, but realize as you get into that, knowing that there is a cost to compliance for your organization is importance.

Moving on to page 10, I want to just spend a few minutes because some of you may already have 501(c)(3), (4) or (6) organizations and have an understanding of some of the new filing requirements is important. But this, this is new for 2007, actually, and 2008, but there's a new form, 990N. Many of you may be organizations that are less and have gross receipts less than, and the slide is mislabeled, actually not "gross revenues" but "gross receipts," so that's actually cash received, not receivable or in kind, or less than \$25,000, you were not required in the past to file an IRS Form 990. And now, beginning with your 2007 calendar years, a 990N is required. This form, it's fairly simple. It's an electronic notification. You're required to go out on, out to the IRS website and complete certain limited information which is actually non-financial: who's on your Board of Directors, an affirmation that your receipts were less than \$25,000. This is so the IRS can begin to get a handle on the multitude of organizations out there that have tax exempt status, that aren't filing forms. It's required, there's a Form 990-EZ and this will be important because this is a much simpler form. There's a phase-in period where organizations with a million dollars and less in '07 can file a 990EZ; half a million or less in '06, or '08 and then '09, \$200,000. The benefit of that, of course, is there's also a new 990 form that will be due, a format which will be required for organizations beginning with the 2008 calendar year, which is substantially greater in scope than anything that's been previously required. We'll talk about that in few minutes, but this form is due 4 and a half months after the year-end. You can get 2, 3-month extensions and this is extremely important to file this form on time. There are penalties of either \$20 a day or \$50 a day for larger organizations. And while I have a, I had a considerable amount of experience with the IRS in attempting to get those penalties waived for a multitude of reasons, and for the most part, they have been accepting of that, it's, generally, my feeling is it's best to avoid late filing situations.

Moving on to page, slide 11, there are new 990 forms coming out for 2008. And this is important for those of you who are, whose gross receipts are more than, let's say at this point it will be a million dollars and then it will phase down to \$200,000; a number of changes on that form have to do with questions about governance. This has to do, again, with concerns nationally that nonprofits are not adequately governing themselves. And the questions that this forms have are intended to give the IRS a better sense how you are governing. There's questions in there now that were never asked before such as, do you have term limits and does the Board of Directors have a whistle-blower policy and, you know, are there conflict-of-interest policies; does the Board of Directors review the IRS Form 990 before it's filed with the IRS. Now, interestingly, there's nothing said anywhere in the IRS Code Section right now saying that you have to have a conflict-of-interest policy. So, the bottom of the IRS being involved in oversight to a point of asking you questions about your organization has nothing to do with the requirements is quite interesting to me. But what they're attempting to do is to get to what are the best practices for nonprofit organizations. And if the organization has a predominance of no responses to some of these new questions, that may give the IRS a greater cause of, not to tax or anything like that, but might give them a greater indication that your organization would be a good one to audit. So, that, you know, solely the intent there I think is to put organizations on notice that the IRS is looking at this also.

Moving on to slide 12, all 990s are available publicly for public display. So, if you are interested in what your peers are doing and what their 990s look like, you can go to www.brightstar.org. The purpose of this website is really for donors, primarily to have a greater understanding of the organizations that they're giving to. And it really is a good opportunity for you to present your organization in its best light. So, that IRS form 990, which was always presumed to have been only filed at the IRS is now publicly available to anybody at any point in time. I just want to make you aware of the fact that in some situations and they probably are not a lot with each of you, but you may find some of these situations where the types of activities you're involved in may be taxable. And not sure that I really know of any, but, you know, if you did get involved in a retail operation, a gift store or something like that, then certainly, there is strong possibility or potential that the profits from that activity could be taxable. That's not necessarily a bad thing except that if those activities become substantial to the rest of your organization, it can potentially jeopardize your tax exempt status. The next 5 slides here are just to highlight for you the importance of being aware of the State that you're organized in, having its own regulatory requirements. And I got a list of attendees here and noticed that there's about 20 States represented and we have people anywhere from Alaska to Florida, 3 from Michigan, I see here. So, I just selected Michigan and I'm from Wisconsin and so I know the laws here very well. I don't practice in a lot of other States and Michigan, I haven't had a whole lot of experience with it so, in preparation for this, I thought, well, let's see what happens in Michigan with nonprofits. What you need to do is just check with your, either it's going to be the State Attorney General's Office, it's a good place to start. Or there may be a Department of Regulation, Licensing, some oversight body for nonprofit organizations in your state of residence. In communicating with Michigan, I determined that there was a form that you need to file with them to receive a license to solicit donations in the State of Michigan, its form DAG 09-05, and that form needs to be filed within 30 days of starting to fund raise.

And moving on then through the, to slide 15 here, I'll jump ahead a little bit. That form needs to be filed annually and it needs to be filed 5 months after the year-end. You can request extension, so if they're require you to have your books in order enough that you can file a financial statement with them within 6 months after the year, year-end. Further, it requires a review by a CPA if your receipts are more than a \$100,000 and audit if they're more than \$250,000. Moving on to page 6, you know, I talked about them, the sales tax exemption issue and there is a form application that you have to complete in the state of Michigan. Interestingly, this is a state that will provide a sales tax exemption for any 501(c)(3) or (c)(4) organization. So, if you do not receive the (c)(3) exempt status, you can also be sales tax exempt for (c)(4) status. If you collect sales, if you sell tangible personal property, a gift shop example, again, or if you have a big sale or a cookie sale, you're selling books or something, you, and those sales are greater than \$5,000, in the State of Michigan, you may still need to collect sales tax from those taxable item sales and remit them back to the State.

On page 17, you can see that you also annually have to file a corporate report to maintain your corporate status. I point these things out because regulatorily, you know, once you decide that it's worthwhile to, for whatever reason, to officially organize or come out of the umbrella of another organization, there is a number of regulatory things that you need to be aware of to comply. And some of these may be somewhat burdens on, especially to small volunteer organizations. And fortunately, you can see from some of the size limits that I've mentioned here today, even some fairly small organizations can come under the watchful eye of either the Federal or the State regulatory authorities. You know, in light of that sort of a segue to sort of a final comment that I wanted to make as regards to obtaining tax exempt status is that there are alternatives and the primary one being the consideration of fiscal sponsorships. And I suspect that some of you that are listening here today are probably already in these relationships and it's an important one to see them alternatives, and then secondly, for you to really understand what some of the requirements are, or the needs. More likely, you're sponsoring organizations yourselves, but so that they're structured properly. If you're considering a byway activity, looking for a government unit or another nonprofit to sponsor your activities is often a good way to avoid many of these regulatory concerns that I've been talking about. As I mentioned, I think some of you are either spin-offs or were originally formed as parts of Chambers of Commerce and maybe are still closely aligned with those or a part of those organizations. Perhaps the issue with that is many of those Chamber of Commerces are not (c)(3) organizations, they're (c)(6) organizations. But there actually is many instances where a (c)(6) organization can actually have a (c)(3) organization within its corporate structure. And that is fairly common and certainly well within what the IRS allows, so you can have a charitable fund or an educational

fund or a byway activity that would be deemed that activity within the corporate structure of a (c)(3) organization. If you do not have an organization like that currently, looking for one that's closely aligned to your mission, the benefit of that is the substructure and oversight. The fact that there's already a Board of Directors and there's IRS reporting and so forth going on; and also the advantage certainly of low cost. And, you know, some organizations will provide the service for free, especially if what you're doing is closely part of their own mission, what they're accomplishing and often, I see fees of anywhere from 5 to 10% of gross receipts collected or gross expenditures; some kind of a formula like that is fairly common.

Moving on to, and maybe I'll skip here on to page 19, is that, you know, these relationships are fairly common. I see lots and lots of these, cause there's many, many small organizations that otherwise do not want to go through the business of forming officially. And most typically, and I see it for some different reasons but the most typical reason would be because an organization wants to begin a project and receive charitable deductions, the donor wants to receive the ability to make charitable donations, and they want to run that through an organization that has a tax exempt status. Just so you know, and this may already be known to most of you, but a governmental, any governmental unit can receive a charitable contribution. And obviously, governmental units don't file like these 501(c)(3) organizations. But in the IRS Code Section on the deductibility of contributions or contributions to the Federal government or State agency or local government, any unit that's defined as being a governmental unit is tax deductible. So, being part of a city planning department or a rec department or whatever might be appropriate, you would be able to receive charitable contributions, that donor would be able to deduct that. And so, that's often the most common reason to set up those relationships. So, a less common reason is just because organizations really need somebody to maintain the checkbook or handle funds and disbursements and the organizational aspect of things.

Moving out to slide 20, what unfortunately happens is sometimes they're not set up right. And the term "fiscal agency," meaning, generally, if one small organization goes to another organizations and say be my fiscal agent, handle my contributions, typically what they want to have happen is have those contributions run through that organization and back out to the smaller organization. And the IRS really does not care for that level of oversight very well. You know, obviously, the fiscal agent or should be the fiscal sponsor does not have a whole lot of control over how those funds are expended. And so, what we're suggesting here is that there be, you know, written agreements of fiscal oversight. You know, certainly, accountability is important in those situations so that the sponsoring organization, the fiscal agent can be reasonably assured that the charitable contributions that were received were expended appropriately. Page 21, so how you do this right is maybe you run those contributions through the sponsor organization or governmental unit. And that government units sub-grants through written agreements back to your organization or the organization that's going to carry out the program and there would be part of that grant agreement written reports required or expenditure reports, that sort of thing. In some cases, that entity may be required to file certain tax forms and so forth.

But on page, slide 22, you know, another way is for the sponsoring organization just to run your activities through just another program or project of the sponsor. And so, all of that activity is reported to the IRS if it's a nonprofit organization or if a governmental unit it's part of the normal governmental affairs, it's important that your activity or your mission fits the exact purposes of that organization. In kind of wrapping up some of my thoughts, I, you know, I thought about what might be some of the advantages or disadvantages of this exemption or incorporation concepts. And so, beginning on slide 23, I listed out, you know, some of the reasons why it would be important for you to consider such an activity, and probably the most compelling is the deductibility of contributions. And usually, this is the area that forces many organizations to even begin to consider this because a private foundation or a granting organization has promised or would like to support the activity, but it needs to be to a 501(c)(3) organization or there are individuals who would like to support the organization but certainly paying for that with a tax deductible contribution is far more advantageous. So, that typically drives a lot of the decision-making here. But a couple of thoughts is, one of the things that the incorporation does as well is it formalizes your organization and its governance. And I talked a little bit about a concept of liability; it is sometimes a concern for those in governance. And there may be other certain exemptions and so forth that you may qualify as part of that tax exemption. And so, that certainly

those are some ideas or thoughts or considerations for that sort of thing. Some of the disadvantages and you probably heard a lot of this from me today is, of course, the regulatory oversight by the IRS and others. And where-- and this is probably coming out a little stronger for me today only because we're just seeing sort of an acceleration of oversight of these sorts of things -- the new 990 form, you know, is probably the most significant re-write of that particular form since I've been practicing in 25 years. And that seems to be going in a direction that just continues with more regulation. And certainly, the increased cost for compliance, I'm often asked sort of what would it cost to incorporate and get your 501(c)(3) status, which I'm going to stay with that organization. And I think on the low side with the \$750 application fee and some let's say pro bono or cheaper attorney or accounting fees, you might be able to get that done for \$1500 or \$2000 with certain volunteer time and so forth. And with the full turn-key effort, you know, with the firm that, a law firm or accounting firm that understands nonprofit organizations and to be successful in obtaining that tax exempt status, you might, you might end up spending as much as \$5,000 in total for all that. And for a smaller organization, that certainly is a substantial investment in forming and obtaining your tax exempt status. And you may have to maybe question yourself a little bit for what, you know, what overall purpose, especially if you're able to find fiscal sponsorships that work. More record-keeping, you know, there's potential for tax filings which require accounting assistance and bookkeeping and so forth, and for a largely volunteer organization, you know, what is that going to cost or who's going to do that, you know, I have thought of, actually that I thought about this, applying for tax exempt status and one way to maybe minimize cost would be to find a byway organization that had been successful recently in tax exempt status, obtaining tax exempt status. And mimic their application, you know, either they would perhaps voluntarily provide that to you or those forms are actually required to be public disclosure documents. And the few that I talked to, I think that the primary focus, when the applications were written in a way that describes and enhance the educational nature of what you do, those are probably the ones that have the greatest likelihood for success in the (c)(3). So, focusing on that I think is probably a key to being successful with this.

On page 25, I've added some resources for you. These, most of these have come quite frankly directly of the IRS website; I find them helpful. They're fairly concise and I think they describe the IRS' position in sufficient detail, I think, that you can understand what's going on. There's a couple of other guides there that were part of the attachments. And finally, our website, Wegner CPAs, we have a large practice with nonprofits. We have a special section, as you can see from the website, why nonprofit, and in there are resources. We have a sample accounting policies and procedures manual, sample whistle-blower policy and conflicts of interest. There's an article in there on fiscal sponsorships which might be helpful to you. And certainly, feel free to contact me. I see that I've already received some e-mails here and I'm looking forward to a discussion with each of you shortly. But in the coming weeks or months, I'm happy, each and every one of you, if you have any questions, the best way to get a hold of me is by my e-mail that was at the beginning of the presentation, and I would be happy to respond to any questions that you have. It has been a pleasure being with you here today. I hope that this presentation has been helpful to you, and I look forward to a question-and-answer session. And with that, I'll open up for questions first if we don't have any verbally, then I will tackle some of these that I received by e-mail.

This Laura, from Alaska. I've got a question. Right now, I'm with the Chamber of Commerce. So, we're a 501(c)(6)...

Okay.

And I need to complete in the 990 and in the section where 501(c)(3)'s have to break out the fundraising and marketing costs, I don't remember if it's in Part 2 or not, 501(c)(6) says they're still exempt from that; where we can put in our expenses simply as a single number. Do you anticipate that changing since we're not incorporated yet to go the direction of a 501(c)(6) in order to reduce some of those reporting requirements. If the future trend is that you'll require that of all tax exempt organizations, that might not be yet a tactic to follow.

Well, I'm glad you asked the question about a (c)(6) having a (c)(5) fund. And this actually another strategy that you can come up with is that if you are in a (c)(6), there isn't any reason why a (c)(6) can't have a (c)(3) fund. And

actually, the fund itself does not have to separately incorporate. It can, it's got to have to apply for exemption if your normal receipts for those contributions are less than \$5,000. If they're normally more than \$5,000 and you could file a separate 1023 application just for those (c)(3) activities; and then you would file a separate 990 for the (c)(3) activity.

Yes, I have a question about...

Did that answer your question?

It did. Thanks.

Okay.

Our organization has not filed for (c)(3) status yet. However, I think that we probably will. If we have people who have made donations during that 27 months that we have to file the Form 1023, can they show that as a charitable contribution on their taxes? Or did that...

Well, that's a good question. So, if you do not file that application for exemption within 27 months after those first contributions are received, you know, will those donors lose their charitable contributions, is that the question?

No. Actually, if, I mean, we would plan to file within that 27 months but of course, taxes will be due, you know, by donors.

Oh, yeah. More, yes.

Are they worth it?

Yes, I understand now. The donor can rely on any representations that you make, that you're a (c)(3) organization with a status currently applied for? And that has not jeopardized your charitable contribution?

Okay.

Now, if it is subsequently, you subsequently do not receive your tax exemption, then I do not believe that they would lose their exemption because you would currently have been filing for (c)(3) status.

Okay.

And they relied upon that representation from you.

Okay. Very good. Thank you.

Yup.

This is Mike Workwood for Volcanic Legacy [INDISTINCT], California. Can you go into the public benefit and private benefit a little bit more? And specifically, is there a comparison chart that would give us an outline of the differences between a public benefit and a private benefit (c)(3)?

Yeah. Well, (c)(3) can only benefit the public as a whole. And so, when you talk about the exemptions under (c)(3), and I think this is the challenge that some of them faced with if you're part of a business league, business group that the concept there is that the Chamber of Commerce is benefiting the businesses that it represents in that community versus a byway may have a greater or broader public benefit to education, to anybody who is visiting through that,

that byway. And so, while the Chamber is organized for the benefit of its members, the byway may organize for the benefit of the general public in terms of understanding more about the history of the byway, how to better learn about sites, points of interest along the way. I looked at 3 websites of 3 current byways and all 3 based on those websites would clearly, in my mind, qualify for (c)(3) status. The key component to that is education. And education of the public, the general public would be an example of a benefit to the public versus let's say education to a private club. I don't have a chart. If you go to Publication 557, the (c)(4) definition is on page 47 and the (c)(6) definition is on page 48. And when they talked about, generally, there about promoting to the greater good of the community and so forth, that's a distinction versus the (c)(6) has to be for the greater good of the public as a whole. I'm not sure if I answered your question, but I don't have a chart. If you'd like to e-mail me, which is smart...

That's all right.

Mike, if you want to e-mail something, I might be able to send you a maybe a little bit better explanation. I did have an e-mailed question about political activity. Political activity is an endorsement of a candidate for office. So, that would be any presidential campaign, congressional campaign, local legislative campaign, local sheriff campaign, any campaign for public office. A (c)(3) organization cannot in any way participate, endorse, use funds for the benefit of any political candidate. A (c)(4) or (c)(6) can run those activities through their entities with some restrictions, often they set up a separate political action committee or a political fund in order to handle those sorts of things. But the restriction on political activity and for the person asking that question is just to the (c)(3) organizations. Other questions please?

That the--and the materials that was sent out, the purpose, dissolution clauses and the fiscal sponsorship article, those two, I couldn't, when I, when I clicked on the link.

No, I couldn't. I couldn't open them either.

Can you tell me where those come from, so we can...?

The fiscal sponsorship article is actually on our website, so if you go to our website and under which it has a link right there to go to articles and this fiscal sponsorship article was there.

Okay.

And what I'll do is I'll put the purpose and dissolution clauses out there.

Okay.

I have sent these to Chelle in a PDF form, but I think they decided to send those two in a different format.

And I think we included those outputs, you know. Sometimes the--sometimes that we found out today that technology does not work as well as we liked it to. So, I also have those and I will be e-mail everybody. It's coming in a large batch, but you can either e-mail Scott or if you're going to e-mail me separately, I'll forward another e-mail to you with everything attached. No problem.

Okay, thank you.

Thank you.

Can you spend a little bit more time talking about the fiscal sponsorship issues? You know, you were stating that they're often done wrong and what the difference is between those?

Sure. What was quickly done wrong is the small organization is going to receive a large charitable contribution or a grant from a foundation or for a fundraising campaign and they don't have the (c)(3) status and the donors or the private foundation is asking for that. So, they go often, they find a sponsoring organization to be their fiscal, what is termed "fiscal agent." And the done wrong part I usually see is that the fiscal agent, the sponsoring organization typically had very little oversight or control over what goes on. And that represents a fair amount of risk to the fiscal agent or sponsor. So, in some situations it sounds like your Chamber of Commerces might be a fiscal sponsor or agent for your activities. And if they were to say, well, that's fine. You go ahead and you can use our tax exempt status and go off and do your good things and have no oversight of the checkbook or the expenditures or how you received money or compliance with laws and regulations; that puts the sponsor at significant risk. The better way to handle that would be to have either a written agreement between the sponsor and recipient outlining a specific grant, as I talked about in there. The article has a little bit more information about that. And/or actually have the sponsor itself maintain the books and the record-keeping and so forth, so there is that oversight. And that somebody in that organization can determine that the activities and who's being paid the funds and how the funds are being spent are within that exact purpose. I think that done wrong part is often somebody will loan their exempt number to an organization and then there's nothing else. It happens. A good question.

I got a follow-up question, the one you answered a little bit earlier, those regarding the political activity. I'm just curious you mentioned that that is related to a person in office. What about another type of election whether it's more of like a vote for an increase on a tax, a levy, a bonding issue. Does that qualify as political activity?

Nope. That would fall under the definition of lobby. And lobbying would be an attempt, very specifically to influence through pulse legislation. Now, if you were, if you knew that there was something related to this issue going on and you were, to your members, to give them some general background and information about the issues related to what you just stated, that's not considered lobbying from the IRS' definition. Now, clearly, you're attempting to influence people's votes or help people may perceive of an issue but you didn't specifically contact the legislator or somebody in public office in an attempt to get them to make a decision either for or against a proposed legislation. And that could be even at the local level too. So, there's no prohibition in terms of educating the public about issues that are important to your agency. And so, if you're contemplating the (c)(3) and you're concerned about the lobbying limits, you know, be very careful about how lobbying is defined because the thing that you might want to do might not even fall within the definition of lobbying. By the way, (c)(3) organizations can elect to be, there's each election to be treated as a lobbying organization which sets fort certain limits that that organization can have in terms of its lobbying expenditures without risk of revocation of its tax exemption. As long as you fall within those limits, you're generally fine. And we're probably talking something in the range of 20% of expenditures. Looking at your byway websites and so forth, it didn't appear to me that your organizations do a whole lot in the way of lobbying. At least that's according to your websites.

This is Twayla. I have a question regarding the liability issue for the officers and Board of Directors. Is that totally defined by the State then?

Correct. So, what you want to do is contact an attorney within your State or whoever governs the State statues, but for instance, in Wisconsin, here, we have a State statute within the statutes that protect the liability of volunteer Board Members and volunteers in organizations. It's somewhat called The Good Samaritan Act, so if you're carrying out your activities not in your own interest but in the interest of the public and something goes wrong, you can't be held personally liable for decisions that that organization makes. There's one exception to that and that has to do with organizations that have employees, pay Federal taxes and in some cases, Board Members of nonprofits have been held personally liable for payment of taxes, not payment of individual taxes.

You might want to continue talking to your State attorney or your local county authority because they've given a lot of free advice to byways at least up here in North Dakota.

Thank you.

Yeah. I think that is an issue and I know more and more states have moved towards, you know, limiting the liability of volunteers. And if you incorporate this, that will provide them more liability protection. It is important, but what typically we're finding especially if you have Board Members who may be higher income or net worth individuals, is often they are looking for some type of Directors and Officers liability policy before they would serve on that Board. And that's another option for you. I know some directors will not serve on Boards without such a policy. And they can range a thousand to a couple of thousand dollars.

This is Cheyenne Valley, North Dakota.

Okay.

And we are planning on filing for 501(c)(3). I was wondering under Purpose 4, Articles of Incorporation and By-Laws. Would you recommend that we listed the whole charitable, educational, religious and scientific purposes or I've noticed that some other byways have just said charitable and educational or charitable and educational or charitable and conservation purposes. Would you suggest, do you think the IRS would rather all four be listed?

I'm typically seeing them not being limited. So, you would say, just as the handout says, is organized, and the important words here is exclusively for charitable, religious, educational and scientific purposes. There's absolutely no penalty for listing all of them or limiting to certain things. And so, when they look at in your application and the things that you're filing in there, they're not looking specifically then for your religious activities. You're just saying, you know, it's organized exclusively for those under that Code Section. So, I would not limit that.

Thank you.

Yup, sure. And good luck on that. I have read a few of the laws and stuff on this and I know some of the organizations passed previously have some difficulty getting (c)(3) status and were advised to get (c)(6) status. And my feeling about that and in the websites that I've looked at, and in the limited understanding that I have of all your organizations, is there is absolutely no way that you shouldn't otherwise qualify as a (c)(3). And some of it really boils down to how well-written the application is. And so, even if you're working on it yourself and you do a lot of it, the verbiage and stuff yourself, you know, make sure you go to an attorney or a CPA who's well-versed in nonprofit stuff because so often, it's a matter of intonation and the words you use. And, you know, for instance, if I was involved in this, I certainly would stress the educational component of what you do as being probably the primary objective of that. And then make sure that your programs and the things that you plan and decide to do are also aligned with that. I've had seen some organizations where the application that was, you know, broadly written that everything that they ever thought of or thought that maybe they could do. Well, you know, and that's really not advisable. I would limit it to being very specific about the things that fall under the exemption, limit the things that you're going to do and how you're going to raise that money. And if you decide to have a visitor center, you know, 5 years from now, certainly, you can tell the IRS about that in your 990 that you filed down the road. But don't put all those things in there in that first application because the technical reviewer at the EO Division is going to look at that, all those things that they have to consider each and every one of those different programs and services. So, keep it very simple and very focused on, either on the educational part or the charitable part. And if you read in the purpose here, one of the definitions here under Purposes is erecting or maintaining public buildings, monuments or works. Well, I think that that would be a roadway, certainly a public works. And part of what you're doing is helping maintain, if that's that is. I'd probably also focus the exempt application around that concept as well. One other piece of advice on the application, and I've seen this applications go wrong this way, as well is you'll send it in and if you're really lucky, if it's well-written, you won't get any questions but you know, typically, you'll get half of those in questions back about different things. Make sure that when you respond to those questions that are very consistent with how you first stated the original application, I've seen organizations get into trouble that they get written questions back from the IRS and then they go into a tangent on some of the things that weren't in the first application. And then the reviewer, the EO Division, you know, it feels like, we'll, now we've kind of opened up Pandora's Box. This

organization's going to do this and that, this and this and that wasn't in the original application. And, you know, now they're starting to get maybe confused about who you really are and what you're going to do. And you want them to have a very, very clear understanding of who you are and what you want to do. Having copies of brochures and materials that you sent out solicitations for fundraising, the maps that you have and all of these sorts of things, like those things will give the reviewer at the EO Division a really very clear idea of who you are and what you want to do. And that's extremely important. I like the one website with the trailways. I think the Seattle that had lots of, they had lots of educational components and was all over their website. And then certainly, obtaining the application of another byway that recently had received tax exemptions. And obviously, they have set something right along the way that the EO reviewer understood why it would be (c)(3) organization.

Chelle, in relation to this. This is Dawn Higman, from the Minnesota River Valley. Did you collect that at the resource center, samples of applications, I know there's certain things on the network, people looking for those. Do you have a collection of those?

Chelle just stepped out. I can't answer that right now. I don't, she might have a better handle on that but I'll definitely forward the question to her and maybe she can provide a rough response to the group here.

Thank you.

Please give that response to the entire group.

Certainly.

Yes.

Is there anybody on the line right now that applied for (c)(3) status that was denied at this point? That you're willing to admit? You know, I've, typically it's probably and this is just a professional opinion but this is probably based upon how the application was written, not what you're doing. We might, my limited understanding of what your organizations do would clearly, in my opinion, at least fall into the (c)(3) category.

This is Sandy from [INDISTINCT] Juan de Fuca in Washington. When we sent our application in, we have had a few other byways around us that have recently applied and have had some problems not, again, like you said, not with what they were doing but how they stated they were doing and they told us to watch out for, don't use certain words and include this or don't talk about that and you don't tell your dreams, tell them what you're doing. And we did have a legal organization that was giving match to our grant that year to do that part of our process for the organization. And I think they overspend their pro bono commitment by about 400% to get that out for us, but they did a good job and we didn't even have any questions when it came back. But a lot of that was because we talked to other byways ahead of time to find out what some of the pitfalls were.

Well, that I think yours would probably be a model application then, right?

It could be.

You know, some trip-offs that I just think about, if you talk about promoting businesses along the byway or the businesses along the byway became members and they had sponsorship fees and that sort of thing, then all of a sudden to me, when the IRS person, I'm looking at the same. Well, this isn't really about the public benefit, this is about benefiting the businesses and, you know, the things along the way.

And we are a member organization and that we have a lot of free memberships. They're not necessarily paid memberships, this is people being a member of the group, but our very, very strong point in the application was education and that's what we intend to do with everything. We're educating the traveling the public but we're

educating the local people as well because that is then a benefit of to the traveling public, it's a benefit to the community when more people know the history and the culture and the things about our area, know how to, where public access is to water and recreation and that sort of thing.

Uh-hmm.

So, our main goal in our organization is education of everybody; educate people at home so that they have ownership; educate them so that they can help the businesses; educate the businesses so they can help the traveler; and educate the traveler so they want to come here and so that they'll bring other people back here. So, that wasn't a pretty easy thing for us because even though we have this membership, we don't have an overriding concern for the membership. The membership is there for education. So, it all sits together pretty well for us.

Right. Well, and I would think that that would be a very universal byway concept, which you just stated.

Uh-hmm.

That that would be clearly the purpose of the majority if not all of the byways. So, you might get yourself tripped off in the application if you steer away from that a bit and talk about how you're going to raise money and, you know, how you're going to benefit members and that kind of stuff.

Uh-hmm.

That was one thing we were told. This is Bobby of Cheyenne River Valley; is that do not use education as baseline because another byway went through hell in order to get their 501(c)(3) because they've used the word education too often.

Uh-huh.

Huh?

It surprised us.

Yeah, I'd disagree with that. But, you know...

They got, they got turned down and they specifically scared us, you know, about that area because that's where they ran into the most trouble when they had their review.

Huh?

[INDISTINCT] who didn't, you know, it isn't just a canned cut and dried for everybody.

No.

How would you differentiate or how do you--most of the byways are looking at doing promotion and we want to attract people to travel to byway to take in sites and including businesses. So, how do you look at promotions with regard to--and it involves education and it is trying to get them to stop into, you know, attractions and businesses along the byway. How do you differentiate between the two?

Well, I think if somebody asked me earlier about the definition between a public and private benefit, the problem with a little bit of what you said would be the private benefit to the businesses along the byways. And so, having promotion itself isn't bad but from the promotional, from the standpoint, as what the woman said earlier, you know,

from an educational point of view, because otherwise and you might look like a Chamber of Commerce. And that may be how some of these have fallen as if they've fallen into more service members versus the greater public benefit good.

Scott, I have a question.

Yeah, sure. Martin, in Marshall, Michigan. Our byways is a State heritage route and it's totally contained within one political jurisdiction, a city. So, we have been running our grant moneys through the city so the grants are to the city.

Uh-hmm.

And then we are working with a 501(c)(3) historical society to improve their museums and then we're working with out Chamber of Commerce on the promotion and website designs and visitors center or visitor activities. And our main street director who's quasi-public. And I guess I don't really see a need for us having a separate nonprofit to promote the byways.

Well, Martin, I would agree that the city, by definition of being a governmental unit, contributions to the government are tax deductible.

Uh-hmm.

So, if the primary motivation for a 501(c)(3) is deductibility of contributions, you've already accomplished that with your relationship with the city.

Right.

And so, then, the secondary advantage that I talked about is organization and governance. And the only other reason maybe they think about a separate (c)(3) or entity as if you felt like you couldn't function from a governance point of view within the city or within...

I could certainly see that if, if the byways travels through several political jurisdictions, it would be difficult to operate without a separate organization.

Do you have this as a city of point people to your work for instance?

They have designated the planning commission to be the oversight group and then I function as a part-time coordinator.

Right. So, the reason to be separately incorporated would be as if you wanted to move out from under that umbrella and the influence of the political process...

Right.

And I, you know, sometimes that can be a barrier to some of the things that you're trying to do. Sometimes it's a positive thing. I mean, you can leverage up, you know, your city relationship to free up funds to support what you're trying to do versus if you were separate. It might be much harder to get support from the city.

Yeah. I'd be interested to hear of any others function in that same manner.

Anybody else controlled significantly by the political process, either as a benefit or a detriment to what you're trying to do?

Ask a question? Maybe everyone signed off. It's after 1 o'clock.

Well, no. We are not, so, either way about that.

Yes.

You know, Mark, I think that that might be one--I mean, that's certainly something to consider. And of course, you might have a little bit of a battle depending of what the city, depending upon their approach to it.

Uh-hmm.

But clearly there are many, many, many public and private relationships between government units and organizations that support, you know, the public good. You know, in Wisconsin, here, we have a number of zoos that are owned by private nonprofits but the land is owned by the city, for instance, or the county and the botanical garden or museum or other sorts of things. There's many examples of that. And in some cases, it makes sense for the local government unit to detach itself a bit from, you know, the organization because if the organization is separately formed, it actually, typically can raise, is better able to raise money because that is not seen as a city function or a city benefit. You know, people would say, "We already pay taxes to pay the byway," right?

And probably easier to recruit volunteers too.

And easier to recruit volunteers, right, versus if you were separately organized and people say, well, we need money because we're not supported by the taxpayer dollars.

Right.

Scott, are you getting the e-mails that we're still sending in here?

I did not, have not received any e-mails for half-hour here.

Oh, because I just sent in 3. I don't know why...

Okay, let me go look. Yeah, here. I guess I've just gotten 3, okay.

And I was a little concerned that if we actually get cut off here at hour and a half...

Sure...

Or it may only be a couple of minutes, but...

Yeah, I'll just respond privately to these 3 e-mails.

Okay, that would be great.

So, I'd be happy to do that.

Okay.

I'll go ahead and do that.

Are there members that are still on the call that would be willing to provide their applications to Chelle, to share with the group?

I think, I think we've had a few people sign off. But we can certainly, I think probably post an e-mail to all the participants and see if they'd be willing to share that.

Yeah. I think if a few could, if it would be of any interest to you. So, you know...

And we are coming up at 1:30, so I don't know if you want to wrap up with one more question or...

Sure. I'll take one more question then at this point.

Or not, if there's none, you can either...

Okay.

As the speaker, at least I apologize for the poor audio quality of the presentation.

Oh, that wasn't your fault. That's just happens sometimes.

But it was a pleasure speaking with all of you and really, good luck.

Okay, I'll look forward to your answers to the e-mail when you get the chance.

Okay, great. Thank you very much.

And thank you.

Thank you.