

THE UNITED STATES FIGURE SKATING ASSOCIATION

**INFORMATION GUIDE
for
U.S. FIGURE SKATING MEMBERS AND CLUBS**

**LEGAL AND TAX ISSUES
associated with
FORMATION OF A NONPROFIT ORGANIZATION
and
MAINTAINING NONPROFIT AND TAX-EXEMPT STATUS**

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I. INTRODUCTION

USFSA members frequently have questions about the legal and tax requirements, and the process, for the formation of a club. This Information Guide provides general information and guidance on such matters, with a focus on requirements to form a nonprofit corporation and to obtain tax-exempt status, as well as certain other related governance, tax and reporting matters. As such, this Information Guide highlights basic issues and cannot identify or explain all of the information, issues and requirements that may be faced by persons seeking to form a nonprofit corporate entity.

While the requirements of the Internal Revenue Code of 1986, as amended, will apply with respect to federal tax matters regardless of where a club and its organizers are located in the United States, state laws establish the legal requirements for the formation and organization of a nonprofit corporation. In addition, state and local laws may also have specific rules pertaining to various tax, business, employment and reporting matters. Therefore, while this Information Guide contains general information, it is recommended that organizers of a club consult with and obtain the assistance of professional advisors in their own state with respect to specific legal, tax and accounting matters.

This Information Guide may be updated periodically by USFSA. However, unless and until that occurs (which USFSA cannot assure), any changes in federal, state or local laws, regulations, rules or requirements (or judicial, regulatory or administrative interpretations of such provisions) may cause the general information and forms provided in this Information Guide to be out-of-date and/or inaccurate.

This Information Guide is provided by USFSA as a service to its members, but not for the purpose of giving specific legal, tax, accounting or business advice (and this Information Guide should not be relied on for any such purpose). It has been prepared at USFSA's request by its general legal counsel. While USFSA's counsel is a resource to USFSA and its members, it is not authorized to provide legal advice directly to USFSA members and clubs. Any questions for USFSA about the information contained in this Information Guide should be directed to USFSA's Executive Director at USFSA Headquarters.

USFSA Membership Rule 6.00 contains requirements for USFSA member clubs to maintain a duly adopted constitution and/or bylaws which contain suitable provisions for the election of officers and directors, a conflict resolution process and the conduct of its affairs in accordance with generally acceptable parliamentary procedures (*e.g.*, Robert's Rules of Order, Newly Revised). Membership Rule 6.00 also requires that a copy of the duly adopted constitution and/or bylaws shall be maintained at USFSA Headquarters.

II. CHECKLIST OF ACTIONS

Subject to varying considerations that may affect your situation, as generally discussed later in this Information Guide, and subject to provisions of applicable state and local laws, regulations and rules, the following are the actions typically to be taken in order to form a club and obtain nonprofit, tax-exempt status:

- 1. Incorporate as a nonprofit corporation — file Articles of Incorporation
- 2. Hold Organizational Meeting of Initial Board of Directors
 - (a) Accept Articles of Incorporation as filed
 - (b) Adopt Bylaws
 - (c) Elect Officers
 - (d) Establish authorization for banking and financial matters
 - (e) Authorize Officers to take other organizational actions¹
 - (f) Ratify actions of incorporator
- 3. Apply to IRS for Federal Tax Employer Identification Number
- 4. Apply to IRS for Recognition of Tax-Exempt Status
- 5. Apply for necessary or available state and/or local tax licenses, registrations and exemptions (including, for example, property tax exemptions, if available, for owned facilities or equipment; registration to engage in charitable solicitations)
- 6. Apply for special nonprofit postal rates, if available
- 7. File required annual tax returns for exempt organizations
- 8. Properly document, acknowledge and disclose contributions. In connection with fundraising activities, review state laws regarding charitable solicitation registration requirements
- 9. Properly classify workers as employees or independent contractors and account for and remit necessary employee withholdings
- 10. Check all applicable state and local laws and consult with professional legal, tax and accounting advisors

¹ This Information Guide only briefly addresses insurance needs or requirements. Evaluating the need and cost for, and obtaining, insurance for club facilities and operations (including directors' and officers' liability insurance) is very important.

III. GENERAL INFORMATION

A. FORMATION OF A NONPROFIT CORPORATION

Existing and operating as a member club of USFSA involves many types of activities, including volunteer service as well as the conduct of a "business." Business activities can be conducted on a for-profit and a nonprofit basis and in different forms of legal entities. Such entities range from sole proprietorships to unincorporated associations, partnerships, joint ventures, corporations and, more recently, what are known as limited liability companies.

Given the actual, potential, real or perceived risks and liabilities of doing business, and of dealing with and serving third parties, people usually decide to do business by means of an entity that is designed to limit personal liability associated with the activities of the business. The generally accepted (but not exclusive) approach to doing so in the nonprofit context is through a nonprofit corporation formed under the laws of a particular state. Therefore, this Information Guide deals only with nonprofit corporations. If you desire information about other entities and, in particular, limited liability entities, you should consult with an advisor in your own state.²

Nonprofit corporations are creatures of state law. They are generally formed pursuant to the provisions of the "Nonprofit Corporation Act" of a state and come into existence by reason of filing Articles of Incorporation with the appropriate state official (typically, the Secretary of State). The process of organizing a nonprofit corporation then involves holding or documenting an organizational meeting of the initial Board of Directors, at which various actions are taken or authorized to be taken, including the adoption of Bylaws, election of officers, authorization to apply for tax-exempt status from the Internal Revenue Service (the "IRS") and other business and tax-related matters. *See* the following sections of this Information Guide for additional information and forms. Keep in mind that forming a nonprofit corporation does not, in and of itself, mean that the entity is a tax-exempt organization — forming the nonprofit corporation and obtaining IRS recognition as an exempt organization are separate, but importantly inter-related processes.

The following summarizes the incorporation process:

1. Incorporation — Articles of Incorporation

The Articles of Incorporation is the basic and overriding organic document of the nonprofit corporation. It establishes the name, purposes and initial Board of Directors for the nonprofit corporation, as well as setting forth important provisions to be followed in the event of the dissolution and liquidation of the nonprofit corporation. A form of Articles of Incorporation containing minimum information needed to incorporate and a form containing more detailed tax provisions designed to demonstrate to the IRS that the purposes, powers, activities and procedures for dissolution of the nonprofit corporation

² Appendix 3 to this Information Guide contains certain information pertaining to conducting activity in a form other than as a nonprofit corporation and/or conducting certain activities separate from one another.

meet the requirements of Section 501(c)(3) of the Internal Revenue Code for charitable, tax-exempt organizations, are available from USFSA Headquarters.³ See the information on obtaining tax-exempt status, below.

2. Organizational Meeting of Initial Directors

After filing Articles of Incorporation, most state nonprofit laws require that the initial directors of the nonprofit corporation hold a meeting to take various organizational actions, which focus on the following:

(a) Bylaws. The Bylaws establish the basic internal governing procedures for the nonprofit corporation. If the nonprofit corporation has voting members, their rights and privileges are set forth in the Bylaws. In addition, procedures for holding a meeting of the members, electing and holding meetings of the directors, electing officers, voting, committees and indemnification are, among other things, advisedly contained in the Bylaws.

(b) Other Actions/Documents. The election of officers, establishing authorizations for banking activity, applying for recognition of tax-exempt status and filing for a tax identification number are important organizational actions. See the information below regarding tax-related matters.

A form of Organizational Consent Resolutions and form of Bylaws, containing optional provisions and notations to deal with differing circumstances, is available from USFSA Headquarters.³

B. OBTAINING TAX-EXEMPT STATUS

While it could be the case that a club might want to do business as a for-profit venture under the ownership of certain individuals, given the purposes and objective of most clubs and the interest of individuals to be members in support of those objectives, it is most often the case that nonprofit, tax-exempt status is desired and appropriate.⁴ Clubs will most likely fall into one of three categories of exempt organizations: (1) a "charitable" or amateur sports organization qualifying under Section 501(c)(3) of the Internal Revenue Code (the "Code"); (2) a social welfare organization qualifying under Section 501(c)(4) of the Code; or (3) a social or recreation (sports) club qualifying under Section 501(c)(7) of the Code.

³ The forms are based upon the Colorado Revised Nonprofit Corporation Act and should not be used, as such, for nonprofit corporations formed in any other state. The nonprofit laws of the particular state of incorporation should be reviewed, and professional advisors in that state consulted, for applicable requirements and provisions.

⁴ Note that USFSA Bylaw Article V, Section 1A, refers to Member Clubs as clubs which "foster figure skating" and that Section 2, *Member Clubs*, refers to a club "fostering figure skating."

While the net income for all three types of organizations is generally not subject to tax,⁵ the clear advantage is to be a 501(c)(3) organization, as contributions are generally tax deductible by supporters and donors, whereas they are not in the case of a 501(c)(7) organization.⁶ However, the restrictions and limitations on the activities of a 501(c)(3) organization are greater than for (c)(4) and (c)(7) organizations and, as described herein, the nature, purposes and activities of such organizations have a different focus. Therefore, it may be difficult, if not impossible, for a club to meet the requirements of a 501(c)(3) charitable organization. *See* IRS Publication 557, *Tax Exempt Status for Your Organization*, for detailed information and guidance on these and other related issues.

1. Charitable and Other Organizations — Section 501(c)(3); IRS Form 1023

An organization may qualify for exemption from federal income tax if it is organized and operated exclusively for certain enumerated purposes, including charitable and educational purposes, or to foster national or international amateur sports competitions.⁷

(a) Charitable organizations must demonstrate that they are organized and operated for purposes that are beneficial to the public interest.

(b) Educational organizations must show how they carry on educational and training activities.

(c) Amateur athletic organizations are of two types. The first fosters national or international amateur sports competitions, but none of its activities involve providing facilities or equipment. The second, known as a "qualified amateur sports organization," is operated exclusively to foster national or international amateur sports competition and to support and develop amateur athletes for that competition (for which it may provide athletic facilities and equipment).

The assets of a 501(c)(3) organization must be permanently dedicated to its exempt purposes. Therefore, upon dissolution of the organization, its assets must be distributed for an exempt purpose. In addition, no part of the net earnings of the

⁵ Even though an organization is recognized as tax exempt, it still may be liable for tax on its unrelated business income. For additional information, *see* IRS Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*.

⁶ *See* the discussion below on requirements and procedures regarding charitable contributions.

⁷ An organization may exist for one or more exempt purpose. However, each type of activity has very specific criteria, the detail of which is beyond the scope of this Information Guide. It is advisable to consult your professional advisors for additional information and specific assistance to determine as to which type of organization your club may qualify.

organization may inure to the benefit of or be distributed to its members, directors, officers or other private persons (provided, however, that the organization may pay reasonable compensation for services rendered) and no substantial part of the activities of the organization shall be attempting to influence legislation (*i.e.*, lobbying).⁸

Exempt status is obtained by filing with the IRS an Application for Recognition of Exemption on IRS Form 1023. The Application is generally required to be filed within 27 months after the end of the month in which the organization was formed. The Application is very detailed, requiring a description of the organization's activities and operations, detailed financial data and inclusion of the organization's Articles of Incorporation and Bylaws. A user (filing) fee and related IRS documents must accompany the Application. After processing the Application, the IRS will issue a Determination Letter if it concludes that tax-exempt status will be granted. If so, exempt status will be retroactive to the date of the organization's formation. The advice and assistance of professional advisors is highly recommended in preparing and filing the Application and responding to any questions of the IRS.

2. Social Welfare Organization — Section 501(c)(4); IRS Form 1024

An organization may obtain tax-exempt status if it is organized and operated only to promote social welfare. Evidence of such will include that the organization will operate primarily to further (in some way) the common good and general welfare of the community, which may include the sponsorship of community sports activities or leagues. Examples of such organizations include civic and community associations. If social activity is the primary purpose of the organization, it should not file for tax-exempt status as a social welfare organization, but rather should file for exemption as a social club under Section 501(c)(7), as described below.

As contrasted with "charitable" organizations, donations to these types of organizations generally are not deductible as charitable contributions by the donor. However, as with "charitable" organizations, private inurement of net earnings to the benefit of any person having a personal and private interest in the activities of the organization is prohibited and the assets of the organization must be dedicated to exempt purposes.

Recognition of exempt status is obtained by filing with the IRS an Application for Recognition of Exemption Under Section 501(a) on IRS Form 1024, which must be filed within the same time frame described above for Form 1023. IRS processing of Form 1024 and the procedures and timing to issue a determination letter are similar to that applicable to Form 1023. Form 1024 is also quite detailed and must be accompanied by specific information and documentation. Therefore, professional assistance is advised.

⁸ The second form of Articles of Incorporation referred to in footnote 3 contains provisions designed to have the organization meet these requirements.

3. Sports Club — Section 501(c)(7); IRS Form 1024

An organization may obtain tax-exempt status if it is organized and substantially all of its activities are for pleasure, recreation and other similar nonprofit purposes. Such organizations typically include recreation clubs, amateur sport clubs, country clubs, garden clubs and hobby clubs. These organizations are generally supported solely by membership fees and dues, but exemption will not be denied or lost if the club raises revenue from members through use of club facilities or in connection with club activities. As contrasted with "charitable" organizations, donations to these types of organizations are not deductible as charitable contributions by the donor. However, as with both Section 501(c)(3) and (c)(4) organizations, the prohibitions on private inurement and requirement that assets be dedicated to exempt purposes apply. In addition, discrimination in membership on the basis of race, color or religion is prohibited.

Recognition of exempt status is obtained by filing Form 1024 with the IRS. *See* the last paragraph of Section 2, above, for information and cautions which are also applicable in this regard.

C. OTHER TAX APPLICATIONS AND LICENSES

Nonprofit, tax-exempt organizations must (in some cases) and should (in others) apply for and obtain certain other designations or licenses, as follows (provided, however, that this information is not intended as an exhaustive list of items, particularly as may apply in any particular state):

1. Employer Identification Number

Every exempt organization must have an employer identification number (EIN), whether or not it has employees. The EIN is obtained by filing with the IRS an Application for Employer Identification Number on IRS Form SS-4. The organization cannot submit IRS Form SS-4 with IRS Form 1023 when filing for tax exempt status -- it must have an EIN prior to filing IRS Form 1023.

2. Sales Tax Exemptions

Many states have sales taxes that are imposed on the purchase of goods and, in some cases, services. Tax-exempt charitable organizations may in some states apply for and obtain an exemption from paying such taxes. While this Information Guide cannot address the laws of all or any other states, it is advised that a club obtain advice as to whether such exemptions are available in your state.

3. Property Tax Exemptions

Nonprofit organizations may qualify for personal and real property tax exemptions under state or local law, for facilities and equipment which they own. As this Information Guide cannot address state and local law, a club should seek advice from an attorney or tax advisor as to whether such exemptions are available in your state.

4. Special Mailing Rates

Nonprofit organizations may also qualify for special postal rates, known as "Nonprofit Standard Mail Prices," from the United States Postal Service. PS Form 3624 is used to apply for these rates and includes eligibility information and application procedures.

5. Fundraising and Charitable Solicitations

If an organization will engage in fundraising activities, there are typically state and/or local registration or licensing requirements that must be met. *See* the information in Section E below for additional information.

D. ANNUAL TAX RETURN OF EXEMPT ORGANIZATION - IRS FORM 990

Every organization exempt from federal income tax must file an annual information return on IRS Form 990, Return of Organization Exempt From Income Tax. While certain exceptions to this requirement exist, the exceptions are based on the type and purpose of the organization (none of which would apply to a USFSA member club), provided that an exempt organization having gross receipts in each tax year that normally are not more than \$50,000 is also not required to file IRS Form 990. Gross receipts mean total receipts, not net of expenses.

A shortened version of the 990, IRS Form 990-EZ, Return of Organization Exempt From Income Tax - Short Form, may be filed by organizations that have gross receipts during the year of less than \$200,000 and the total assets which at the end of the year are less than \$500,000.

However, there is an annual filing requirement for small tax exempt organizations that have annual gross receipts that are normally \$50,000 or less. Small tax-exempt organizations are required to electronically file IRS Form 990-N (e-Postcard), unless they choose to file IRS Form 990 or IRS Form 990-EZ (the only exceptions to this requirement are organizations that are included in a group return and churches).

The Annual Return must be filed by the 15th day of the fifth month after the organization's accounting period ends. A copy of the Annual Return must be available for inspection, upon request, for a 3-year period starting with the filing date of the Annual Return.

Any organization that fails to file for 3 years in a row will automatically lose its tax-exempt status and have to reapply to be recognized as a tax-exempt organization.

IRS Form 990 is very detailed and requires disclosure of a great amount of information, including information about:

1. The organization's governance structure, policies and practices (including whether the governing body or the organization has reviewed IRS Form 990).
2. Compensation of directors, officers and key employees (including how compensation is determined).
3. Transactions with interested persons (*i.e.*, between the organization and its directors, officers and key employees, and their family members).
4. Substantiation requirements for reimbursements.
5. Whether the organization has adopted a conflict of interest policy, a written whistleblower policy, and a document retention and destruction policy.

For additional information, *see* IRS Publication 557.

E. CHARITABLE CONTRIBUTIONS

In the case of 501(c)(3) organizations, the rules and requirements for soliciting, taking, documenting and acknowledging charitable contributions are increasingly complicated, both from the donor and donee perspective. The following general information attempts to highlight these matters:⁹

1. Soliciting Charitable Contributions

If an organization will engage in fundraising activities, there are typically state and/or local registration or licensing requirements that must be met. Examples include registrations to engage in charitable solicitations and licenses to conduct raffles or bingo games. Most states have enacted charitable solicitation statutes, which usually require an organization to register with the state before soliciting contributions. However, exemptions from registration exist in most states, typically based on the amount of annual gross revenue or the number of persons from whom the organization receives charitable

⁹ The rules in this area are very technical. The information contained in this Information Guide cannot address all relevant situations. Advice from professional advisors is highly recommended. For more information and details, *see* (a) IRS Publication 1771, Charitable Contributions - Substantiation and Disclosure Requirements, and (b) IRS Publication 526, Charitable Contributions.

contributions. The National Association of State Charity Officials (NASCO) website has links to state offices which regulate charitable organizations and charitable solicitations. Charitable organizations that solicit in multiple states may consider using the Unified Registration Statement form, which can be downloaded from the NASCO website and is accepted by many, but not all, states.

2. Substantiation Requirements

A donor can deduct a charitable contribution of \$250 or more only if the donor has contemporaneous written acknowledgment from the charitable organization. The donor is responsible for requesting and obtaining the written acknowledgment from the donee. If the donee provides goods or services to the donor in exchange for the contribution (a "*quid pro quo* contribution"), the acknowledgment must include a good faith estimate of the value of the goods or services. Although there is no prescribed format for the written acknowledgment, it must provide enough information to substantiate the amount of the contribution.

3. Disclosure Requirements

A charitable organization must give a donor a disclosure statement for a *quid pro quo* contribution over \$75. A donor cannot deduct a charitable contribution of \$250 or more unless the donor has a written acknowledgment, as referred to above. The required written disclosure statement must (a) inform the donor that the amount of the contribution that is deductible for federal income tax purposes is limited to the excess of any money (and the value of any property other than money) contributed by the donor over the fair market value of goods or services provided by the charity and (b) provide the donor with a good faith estimate of the fair market value of the goods or services that the donor received. Certain exceptions apply to these requirements.

4. Directed Contributions

In order for a contribution to a charitable organization be deductible by a donor, it must be for the direct use and benefit of the charitable organization. While a donor may restrict a gift for a specific purpose within the exempt purposes and activities of the charitable organization, the donation may not be "directed" for the use and benefit of a particular person, particularly a relative of the donor. "Directed contributions," as such, are not deductible. Within the terms of a permitted gift restriction, the charitable organization must have discretion and control over use and application of the donated funds. In the event a donor expresses a desire that any particular program or person(s) be the beneficiaries of a donation, it is advisable that the gift revert to the general funds of the organization in the event the program or person(s) cease to be a part of the organization, supporting a conclusion that the funds are irrevocably dedicated to the organization and its exempt purposes, not to the personal use and benefit of an individual.

F. EMPLOYEE/INDEPENDENT CONTRACTOR ISSUES

Every employer, including an exempt organization, which pays wages to employees is responsible for withholding, depositing, paying and reporting federal income tax, social security and medicare (FICA) taxes and federal unemployment (FUTA) tax, unless the employer is specifically exempt by law from these requirements.

The determination of whether someone is an employee and, therefore, how payments made for services are treated, depends on the business relationship that exists between the payer and the person performing services. The person performing services may be an employee (whether common law or statutory), a statutory non-employee or an independent contractor.

The IRS takes the position that anyone who performs services for the payer is the payer's employee if the payer can control what will be done and how it will be done, even if the employee is given freedom of action. Whether a person is an independent contractor depends on the facts and circumstances in each case. The general rule is that an individual is an independent contractor if the payer has the right to control or direct only the result of the work and not the means and method of accomplishing the result. According to the IRS, facts that provide evidence of the degree of control and independence fall into three categories: (1) behavioral control, (2) financial control and (3) the type of relationship of the parties. The IRS outlines the following as indicative of relevant facts in each of these areas:

1. Behavioral Control

- (a) Instructions the business gives the worker.
- (b) Training the business gives the worker.

2. Financial Control

- (a) The extent to which the worker has unreimbursed business expenses.
- (b) The extent of the worker's investment.
- (c) The extent to which the worker makes services available to the relevant market.
- (d) How the business pays the worker.
- (e) The extent to which the worker can realize a profit or incur a loss.

3. Type of Relationship

- (a) Written contracts describing the relationship the parties intended to create.
- (b) Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay or sick pay.

- (c) The permanency of the relationship.
- (d) The extent to which services performed by the worker are a key aspect of the regular business of the company.

For additional information and details, *see* IRS Publication 15, Circular E, Employer's Tax Guide, and IRS Publication 15-A, Employer's Supplemental Tax Guide.

G. ISSUES IMPACTING DIRECTORS AND OFFICERS

Service as a volunteer member of the Board of Directors, or as an officer, of a nonprofit organization is typically very rewarding, but also imposes certain duties and obligations. The nonprofit corporation laws of each state, while affording certain protections and limitations on the liability of directors and officers, also prescribe various duties and standards of conduct for directors and officers. In addition, these laws typically contain provisions dealing with how to handle conflict of interest transactions between nonprofit corporations and their directors and officers (and related persons).

Appendix 1 to this outline contains general information about these subjects. The laws of each state may vary as to specific terms and provisions in each of these areas. Therefore, you should check the laws of the state where your nonprofit corporation is incorporated to obtain information and requirements pertaining to your specific situation.

H. INSURANCE ISSUES¹⁰

1. Why purchase insurance -- to protect against the risks associated with the organization and its activities.
2. Types of Coverage:
 - (a) Commercial general liability
 - (b) Directors and officers liability
 - (c) Fidelity
 - (d) Property
 - (e) Coaches/Instructors
 - (f) Workers' compensation
 - (g) Sports accident
3. Cost
4. Use of Waivers and Releases

¹⁰ The area of insurance, coverages and costs is important and complex. The information contained in this Section of this Information Guide is only a summary reference to issues that should be considered. Advice from professional advisors is highly recommended.

IV. CONCLUSION

It is hoped that this Information Guide provides valuable information to the members of USFSA regarding certain basic legal and tax issues associated with the formation and organization of a nonprofit, tax-exempt corporation. Users of this Information Guide are reminded that it serves only as a summary of information and issues and that it should not be relied upon as exhaustive of the many issues and circumstances which will be faced when forming a club. The requirements and process of doing so involve a myriad of federal and state legal and tax matters, not to mention issues in such areas as accounting, finance and employment. Use this Information Guide as an educational tool and resource — not as a definitive source. The advice, counsel and assistance of local professional advisors is highly encouraged. Good luck in forming and maintaining your club!

FORMS REFERENCE GUIDE

A. CORPORATE FORMS

- ▶ Articles of Incorporation
- ▶ Bylaws
- ▶ Consent to Corporate Action: Organizational Meeting of Initial Directors

B. IRS TAX FORMS AND PUBLICATIONS

- ▶ IRS Form SS-4: Application for Employer Identification Number
- ▶ IRS Publication 557: Tax-Exempt Status for Your Organization
- ▶ IRS Publication 598: Tax on Unrelated Business Income of Exempt Organizations
- ▶ IRS Form 1023: Application for Recognition of Exemption (501(c)(3) organizations)
- ▶ IRS Form 1024: Application for Recognition of Exemption (other organizations)
- ▶ IRS Form 990: Return of Organization Exempt From Income Tax
- ▶ IRS Form 990-EZ: Short Form, Return of Organization Exempt From Income Tax
- ▶ IRS Form 990-N: e-Postcard
- ▶ IRS Publication 1771: Charitable Contributions — Substantiation and Disclosure Requirements
- ▶ IRS Publication 526: Charitable Contributions
- ▶ IRS Publication 15, Circular E: Employer's Tax Guide
- ▶ IRS Publication 15-A: Employer's Supplemental Tax Guide

C. OTHER FORMS

- ▶ Application for State and Local Sales Tax Exemptions
- ▶ Unified Registration Statement for Charitable Organizations (various state requirements)
- ▶ United States Postal Service Form 3624: Application to Mail at Nonprofit Standard Mail Prices

APPENDIX 1

ISSUES IMPACTING DIRECTORS AND OFFICERS

Responsibilities, Liabilities, Standards of Conduct

- A. Liability to Third Parties — The directors, officers, employees and members of a nonprofit corporation are not, as such, personally liable for the acts, debts, liabilities or obligations of a nonprofit corporation.

- B. General Standards of Conduct for Directors and Officers:
 - 1. Discharge duties, including as a member of a committee of the Board:
 - (a) In **good faith**:
 - (i) Business judgment rule creates presumption that director acted in good faith
 - (ii) Honesty of intention, openness and fair dealing
 - (iii) Objective means of determining
 - (b) With the care an **ordinarily prudent person** in a **like position** would exercise **under similar circumstances**:
 - (i) Standard of **due care**
 - (1) Diligence and attentiveness
 - (2) Active interest and reasonable familiarity with corporation's affairs
 - (3) Come to meetings prepared to inquire about material matters and issues
 - (ii) Ordinary prudence
 - (1) Exercise sound and practical judgment
 - (2) Employ common sense
 - (3) Reach informed conclusions
 - (4) Not guarantors of the success or rightness of each decision

- (iii) In a like position, under similar circumstances
 - (1) Directors viewed as generalists
 - (2) But those with special expertise are expected to use such knowledge in exercising their duties
 - (3) Evaluate a director's actions by facts known at time a decision is made
- (c) In a manner reasonably believed to be in the **best interests** of the nonprofit corporation:
 - (i) Business judgment rule creates presumption that director acted in best interests of nonprofit corporation
 - (ii) Conduct must at all times further the organization's goals and not personal goals
 - (1) Area of close scrutiny
 - (2) Handle conflicts of interests with great care
 - (iii) Acting in the best interests emphasizes a person's primary allegiance to the corporate entity and not in the interest of another organization with which the person is associated
- 2. Courts generally reluctant to second-guess directors' decisions in matters involving business judgment.
- 3. Entitled to rely on information, reports or statements (including financial statements and other financial data) if prepared by:
 - (a) Officers or employees of the nonprofit corporation whom the director reasonably believes to be reliable and competent in the matters presented;
 - (b) Legal counsel, a public accountant or another person as to matters the director reasonably believes is within such person's professional or expert competence; or
 - (c) A committee of the Board of which the director is not a member if the director reasonably believes the committee merits confidence.
- 4. A director is not acting in good faith if the director has knowledge concerning the matter in question that makes reliance otherwise permitted by paragraph 3 above unwarranted.

C. Fiduciary Duty:

- 1. Stand in a special relationship of trust, confidence or responsibility
- 2. Stewardship -- in the nonprofit context

D. Limitation on Certain Liabilities of Directors and Officers:

1. If so provided in the nonprofit corporation's Articles of Incorporation, the nonprofit corporation may eliminate or limit the liability of a director **to the nonprofit corporation** for **monetary damages** for **breach of fiduciary duty**, except that any such provision shall not eliminate or limit the liability of a director for:
 - (a) Any breach of the director's **duty of loyalty** to the **nonprofit corporation**;
 - (b) Acts or omissions not in **good faith** or which involve intentional misconduct or a knowing violation of law;
 - (c) Approval of unlawful distributions; or
 - (d) Any transaction which the director directly or indirectly derived an **improper personal benefit**.
2. No director or officer shall be personally liable for any injury to person or property arising out of a tort committed by an employee unless such director or officer was personally involved in the situation giving rise to the litigation; or unless the director or officer committed a criminal offense in connection with such situation.

E. Confidentiality:

1. Nature of information provided or available
2. Proprietary - internal v. publicly available
3. Fiduciary duty and duty of care
4. Damage to the nonprofit corporation

F. Conflicts of Interest:

1. A "conflict of interest transaction" means a contract, transaction or other financial relationship between a nonprofit corporation and a director (or between the nonprofit corporation and a party related to a director or between the nonprofit corporation and an entity in which a director is a director or officer or has a financial interest).
2. A conflicting interest transaction is not void or voidable, or shall give rise to an award of damages or other sanctions if:
 - (a) The material facts as to the transaction are disclosed or are known and the transaction is authorized or approved in good faith by an affirmative vote of a majority of the disinterested directors (even though they are less than a quorum); or

- (b) The transaction is fair as to the nonprofit corporation -- must show "intrinsic fairness," based upon strong evidence.
 - (i) Fairness to the nonprofit corporation deals with:
 - (1) Whether the terms of a proposed transaction are at least as favorable to the nonprofit corporation as might be available from other persons or entities.
 - (2) Whether the proposed transaction is reasonably likely to further the nonprofit corporation's business activities.
 - (3) Whether the process by which the decision is approved or ratified is fair. The fairness of the transaction is judged from the viewpoint of the nonprofit corporation and those interested in the transaction.
 - (ii) These concepts also impose on the person a duty to disclose information known to the person that is material to corporate decisions.

3. Representational conflicts.

G. Federal Volunteer Protection Act of 1997:

This Act preempts laws of any state to the extent such laws are inconsistent with this Act, but it will not preempt state law that provides additional protection from liability relating to volunteers or to any category of volunteers in the performance of services for a nonprofit organization.

- 1. Volunteer protected from liability if:
 - (a) Acting within scope of his/her responsibilities;
 - (b) Is properly licensed, certified or authorized to act, if such is appropriate or required;
 - (c) Harm was not caused by willful, criminal or reckless misconduct or gross negligence; and
 - (d) Harm not caused by volunteer operating motor vehicle, vessel, aircraft or other where the state requires operator's license and insurance.
- 2. Exceptions to liability protection:
 - (a) Requirement that a nonprofit organization adhere to risk management procedures;
 - (b) Laws that make a nonprofit organization liable for acts or omissions of volunteers to the same extent an employer is liable for acts or omissions of its employees.
 - (c) Provisions that render the immunity inapplicable if an officer of state or local government brought civil action; and

- (d) Provisions that limit the applicability of immunity to nonprofit organizations that provide a "financially secure source of recovery," such as insurance.
3. Exceptions to limitations on liability:
 - (a) Any misconduct that constitutes a crime of violence or act of international terrorism;
 - (b) Hate crimes;
 - (c) Sexual offense;
 - (d) Violation of federal or state civil rights law; and
 - (e) Acts committed under the influence of alcohol or drugs.
 4. The Act does not prohibit lawsuits against volunteers. Its effect is to "immunize" certain volunteers from liability under certain circumstances.
 5. How to Minimize Volunteer Liability:
 - (a) Provide clear direction to volunteers (includes defining scope of volunteer's authority);
 - (b) Supervise volunteer staff closely; and
 - (c) Terminate volunteer whose continued service creates an unacceptable level of risk.

H. Good Samaritan and State Volunteer Immunity Statutes:

Some states may have good samaritan and volunteer statutes which encompasses the following:

1. Volunteer Services - Any volunteer shall be **immune from civil liability if**:
 - (a) Act in **good faith**;
 - (b) **Within scope of official functions and duties**; and
 - (c) Damage or injury not caused by **willful and wanton misconduct**.
2. Immunity for directors and officers of nonprofit organizations:
 - (a) Acting within scope of **official functions and duties**;
 - (b) Unless **willful or wanton** act or omission; and
 - (c) Does not diminish duty volunteer has to the nonprofit organization.

3. Good Samaritan:
 - (a) Not deemed to have assumed a duty of care when perform act without expectation of compensation-not liable for **civil damages** for acts or omissions **in good faith**.
 - (b) No director of a nonprofit organization shall be liable for actions taken or omissions made **in performance of duties** except for **wanton and willful** acts or omissions.

I. Sarbanes-Oxley Act of 2002:

1. The Sarbanes-Oxley Act of 2002 was passed by Congress in order to improve the standards of corporate governance following several scandals on the corporate scene.
2. Sarbanes-Oxley can be described as the United States Government's attempt to bring honesty, clarity and speed to corporate financial reporting, requiring overhauls of budgeting, reporting and decision-support systems.
3. Ten basic governance principals associated with the Sarbanes-Oxley Act include:
 - (a) The board of directors must participate in independent, active and informed oversight of the organization's activities.
 - (i) In such a manner to assure effective and ethical management.
 - (ii) Determine optimal size, composition and operating procedures of the board of directors that will assist it in fulfilling its oversight responsibilities.
 - (iii) Evaluate independence of board members – what factors could adversely affect board of directors and board member objectivity.
 - (b) Directors who hold analysis and information in connection with the oversight and decision-making responsibilities of the board of directors are obligated to disclose that information to the board of directors.
 - (c) Nominating/governance committees, composed of directors not directly involved with the management team, should be utilized.
 - (i) Focus on core governance and board composition issues.
 - (ii) Help set the tone of corporate governance, including recommendations for corporate governance policies and reviewing the board's and the organization's governance structure and documents.
 - (d) A procedure should be adopted whereby performance of the board of directors and each board committee are annually evaluated. The board of directors should also enact a review/evaluation process for the chief executive officer on an annual basis.

- (e) The board of directors is responsible for overseeing corporate ethics and should consider the following:
 - (i) Adopting a conflict of interest policy.
 - (ii) Adopting ethics-related criteria in employee qualifications and reviews.
 - (f) Organizations should be annually audited by an independent auditing firm.
 - (i) Consider establishing an audit committee with responsibility for overseeing selection and work of the auditors and reviewing draft financial statements.
 - (ii) Purpose is to assure financial integrity of the organization.
 - (g) The chief executive officer and the chief financial officer should review IRS Form 990 and any other annual information returns filed with state and federal agencies. An officer must sign IRS Form 990 certifying that to the best of his/her knowledge and belief, the information contained therein is true and correct. In 2008, IRS Form 990 was redesigned to focus on the following principles:
 - (i) Enhancing transparency to provide the IRS and the public with a realistic picture of nonprofit organizations; and
 - (ii) Promote compliance by accurately reflecting nonprofit organizations operations so the IRS may efficiently assess the risk of noncompliance.
 - (h) Attorneys providing legal services to organizations who learn of evidence indicating material breaches of fiduciary duty or other violations should report evidence to the chief executive officer and then to the board of directors.
 - (i) Organizations should develop a written policy which sets forth standards for document destruction, retention and integrity.
 - (j) Organizations should develop a written policy which allows and promotes employees to alert managers and the board of directors to potential violations of law and ethical issues, including possible financial, accounting or other legal violations.
4. The Sarbanes-Oxley Act has no actual effect on nonprofit organizations, other than requirements for adoption of document destruction/retention and whistleblower policies. It is becoming apparent, as time passes and the Sarbanes-Oxley Act is interpreted and implemented, that its purpose and concepts will likely be applied to nonprofit organizations and are being viewed as "best practices" to be adopted by nonprofit organizations. Consistent with the concepts outlined above, the focus is on accountability, transparency, independence and fiduciary duty.

J. Exempt Organization (Tax) Issues:

1. Section 501(c)(3) limitations (Internal Revenue Code):
 - (a) No part of net earnings inures to the benefit of private individuals
 - (b) Serve a public rather than a private interest
 - (c) Focus on "insiders" — directors, officers, major contributors (*see* disqualified persons, below)
2. Articles of Incorporation - restrictions upon powers and use of assets
3. Sanctions and penalties in the Internal Revenue Code:
 - (a) Imposed by IRC Section 4958 - "intermediate sanctions"
 - (b) Excise taxes imposed on an "excess benefit transaction" between exempt organization and a "disqualified person"
 - (c) Tax may be imposed on an "organization manager" who knowingly participates in an excess benefit transaction
 - (d) Disqualified person:
 - (i) In a position to exercise substantial influence over the affairs of the organization (includes family members and entities controlled by such persons)
 - (ii) May go beyond directors and officers (*e.g.*, members, substantial contributors and highly compensated individuals)
 - (iii) Persons having substantial influence (*e.g.*, organizational founder; substantial contributor; voting members; president; CEO; COO; treasurer; CFO; managerial authority; key advisor)
 - (e) Organization manager — any officer, director or trustee (or a person having similar powers and responsibilities)
 - (f) Knowing participation — know a transaction is an excess benefit transaction; aware it violates the law; negligent failure to try to determine if it is an excess benefit transaction; participation is voluntary, conscious and intentional
 - (g) Excess benefit transaction (captures concept of private inurement to insiders):
 - (i) An economic benefit is provided by the nonprofit organization directly or indirectly to a disqualified person

- (ii) The value of the benefit exceeds the value of the consideration (including performance of services) received by the nonprofit organization
 - (iii) IRS compares fair market value of the consideration provided by both parties
 - (iv) Compensation for services considered excessive only if "unreasonable" — would not ordinarily be paid for like services under like circumstances; measure when contract made; includes cash and non-cash compensation, all earned and vested deferred compensation and all other benefits, taxable and non-taxable (e.g., expense allowance)
 - (v) Create rebuttable presumption by following corporate approval procedures — approved by independent body, relying on appropriate data, adequate concurrent documentation as to basis for determination; *see*, conflict of interest transactions
 - (vi) How to handle/identify disqualified persons; establish procedures to control transactions; plan on how to meet rebuttable presumption; care in preparation of IRS Form 990
- (h) Penalty taxes:
- (i) 25% tax on the excess benefit received
 - (ii) 200% tax on the excess benefit if disqualified person fails to return the excess benefit before IRS mails a deficiency notice
 - (iii) 10% tax (up to \$10,000) on the organization managers who participated in the transaction knowing it to be improper

K. Ethics - *See Appendix 2*

APPENDIX 2

ETHICS:

IT'S ROLE IN NONPROFIT ORGANIZATIONS and THE SITUATIONAL MODEL

In today's intense and highly competitive environment, persons responsible for governance and management of nonprofit organizations feel increasing pressure for both organizational and personal success. Whether one serves as a director, officer or as staff of a nonprofit organization, a clear duty is owed to the nonprofit organization and to fulfillment of its purposes and mission. However, there are many circumstances in which the organizational interests and personal interests (or interests of those with whom one has personal or business interests) are allowed to converge and create the situation (or, some may believe, the opportunity) for deviation from what should be the clear choice of action.

Whether it is obvious or oblique, today's societal norms are shifting in a manner that appears to increasingly tempt people into rationalization to justify a compromise of organizational duty to personal interest. While good still prevails overall, it is apparent that individuals, whether in the nonprofit or for-profit sectors, are more prone than ever to apply ethics on a situational, rather than consistent and true, basis.

We all must react to environmental factors and act based on the circumstances at hand, yet ethics, as with morals, should be a constant in our conduct and, therefore, be consistently applied. Further, while the statutory duties imposed on directors and officers of nonprofit organizations do not speak to ethics *per se*, the underpinning of such duties is a standard of conduct that implicitly includes ethical behavior.

With this in mind, consider the following concepts and issues:

-
- ethics: principles of conduct;
dealing with what is good and bad and with moral duty and obligation
 - situational: being placed in relation to the surroundings;
relative position or combination of circumstances at a certain moment
 - situational ethics: the adoption of principles of conduct;
taking into consideration moral duties and obligations,
depending on the relative combination of surroundings and
circumstances at a certain moment

-
- standards of conduct: act in good faith;
act in a manner believed to be in the best interests of the organization;
act in a manner that a reasonable person would under like circumstances
 - fiduciary duty: position of trust
 - duty of loyalty: faithful allegiance
 - conflicts of interest: avoid or deal with properly

-
- ego: the conscious part of the personality that, through contact with reality, mediates the demands of the self v. the external world
 - mediate: to intervene in an attempt to reconcile differences

-
- societal norms: principles of action binding on a society or community and serving to guide or regulate proper and acceptable behavior

The foregoing inevitably resulting in a **BALANCING OF INTERESTS**:

- what: is the situation
are the interests to be considered
- who: have interests to be considered or favored
- why: are there competing interests
- how: are they to be resolved

Each of the foregoing involves a reconciliation of duties to the organization and the intervention of self-demands, all set in the context of societal norms.

The **SITUATIONAL MODEL** suggests that the interests are indeed balanced and resolved situationally rather than necessarily being reconciled on a consistent basis. The result is based on the fact that ethical judgments made each day differ based upon what part of the ethical and common moral code the individual finds the most important under the circumstances. There no longer is a "true north" in the application of ethics – rather the compass moves depending on the path and outcome the individual desires to achieve, and not necessarily with only the organizational duty and interest in mind.

Loyalty, trust and conflicts of interest are typically considered, but are often compromised because personal interest factor in the equation in some form or another. Individuals rationalize their actions in order to justify the means and outcome of action taken, purportedly on behalf of the nonprofit organization.

It is time to decide if **SITUATIONAL ETHICS** is acceptable or tolerable. Will nonprofit organizations permit the application of **SITUATIONAL ETHICS** to occur or perhaps to prevail? A tendency exists to "turn the other way" when faced with the application of **SITUATIONAL ETHICS**, which must be jettisoned from nonprofit leadership and management mentality. This mentality occurs more than you think (or perhaps want to acknowledge).

Codes of conduct and ethics have become more popular for adoption in nonprofit organizations. However, these codes seem to be applied more so to discipline "misconduct" rather than to guide, or be applied to, decisions or actions that involve ethical considerations. Admittedly, ethical considerations and the application of **SITUATIONAL ETHICS** is many times veiled or easily hidden behind other considerations. Nonetheless, sensitivity and willingness to address these situations is critical.

Consider when and how **SITUATIONAL ETHICS** have been applied in your nonprofit organization and whether you are willing to allow this to continue. I urge the leadership of nonprofit organizations to face this increasing problem with vigor, for the moral high ground and integrity of nonprofit organizations is at stake.

APPENDIX 3

INFORMATION PERTAINING TO DOING BUSINESS AS AN UNINCORPORATED ENTITY AND RELATED ACTIVITIES

- A. In some cases, members engage in organized skating-related activity, including fundraising, without forming a nonprofit corporation to do so. The Information Guide contains information regarding legal liability protection afforded by incorporating. With the advent of limited liability companies, it may be possible to form a nonprofit entity as a limited liability company rather than as a corporation and still obtain legal liability protection. Issues pertaining to limited liability companies are beyond the scope of this Information Guide. If incorporation or formation of a limited liability company is not done, the activity will likely be deemed to be engaged in by the involved persons as an "unincorporated association" (*i.e.*, an organized body of people who have an interest in common). While not affording the participants and organizers limited liability (and therefore potentially exposing their personal assets to the liabilities and obligations of the activity), the activity nonetheless will typically involve elements of "engaging in business," including generation of revenues (whether by fundraising or charging of fees), incurring expenses, use of facilities and/or equipment and related agreements (whether or not in writing) and bookkeeping/accounting for the activities. Therefore, while the activity may be viewed as limited or informal in its scope or nature, issues such as tax reporting and insurance are still relevant. For example, an unincorporated association must have or use a federal tax identification number. If a separate number is not applied for and obtained, it may be necessary to use the social security number of one of the individuals involved in the activity. This is not a recommended approach, as it causes reported matters to be attributed to the individual, with potential unintended tax, financial or liability consequences. Therefore, while an unincorporated association may appear to be a simple and informal means to engage in an activity, it should be done with knowledge of its nature and potential consequences. Refer to the Information Guide for information about the formation and use of a nonprofit corporation in your activities.
- B. In other cases, a club that exists as a nonprofit corporation may have different programs and activities that are conducted and/or managed separate from one another. An example could be a synchronized skating team. These activities may have separate decision-making "boards" or committees, separate fundraising groups, separate programs or events, separate travel schedules and arrangements, separate fees, separate use of facilities, etc. If so, they may (and typically do) have different risks and obligations associated with their activities. Therefore, it is generally advisable that clubs with such activities evaluate the relative benefits and risks of engaging in differing activities under the umbrella of one nonprofit entity since, under such an arrangement, whatever are the risks of one activity will expose the other programs and related assets of the club to those risks. While insurance is intended to cover the various activities, it may be advisable to separately incorporate certain activities so as to insulate various assets and programs from others. Of course, to do so will involve formalizing separate governance activities that will have resulting organizational, management, expense and political issues. The point here is not to advocate that separate incorporation of major, yet differing activities, be necessarily done, but rather to sensitize member clubs to the issues so that you may evaluate whether separate incorporation is advisable under the circumstances of your organization and its activities.