

**Non-profit Law and Ethics CLE**  
**Ramsey County Bar Association**

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## **Non-profit Law and Ethics CLE**

### **Summary**

An overview of the basic law and ethical issues regarding the incorporation, operation, management, fundraising, taxes, and reporting requirements for non-profit corporations in Minnesota. The CLE is for lawyers either advising non-profits or for those who serve as board members or officers.

## **Instructor Bio**

David Schultz is Hamline University professor in the School of Business where he teaches non-profit law and ethics. He also holds an appointment at the Minnesota Law School where he is a senior fellow at the Institute of Law and Politics. Professor Schultz is the author of 25 books, 12 legal treatises on eminent domain, and more than 80 articles on various aspects of law, ethics, public policy, and the media and politics. He has served as a board member or officer for numerous non-profits, including the Ramsey County Bar Association, and has provided training or advice to several hundred non-profits.

## Non-profit Law Quiz

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1. Under Minnesota law, non-profit board members cannot be paid. (T/F)
2. Once a non-profit has been incorporated, it is exempt from all taxes. (T/F)
3. Under federal law, some non-profits may consider the religion of individuals when considering them for employment. (T/F)
4. Name three legal duties of non-profit board members.
  - A.
  - B.
  - C.
5. All donations to non-profits are tax-deductible. (T/F)
6. Non-profits may engage in political activities. (T/F)
7. If a non-profit lies in a fundraising campaign, the First Amendment protects it from being sued for fraud. (T/F)
8. A Minnesota non-profit may use its articles of incorporation and bylaws to change the state law that applies to it. (T/F)
9. Completion of the Minnesota short-form to incorporate as a non-profit meets the requirements necessary to become a 501 c 3 tax entity. (T/F)
10. It is unethical to pay a non-profit fundraiser on a commissioned basis? (T/F)
11. According to Minnesota law, what are two required officers all non-profits must have?
  - A.
  - B.
12. Under federal law, non-profits are required to pay minimum wages to its employees? (T/F)
13. Could a member of a non-profit board be sued if they do not read board minutes? (T/F)
14. If a Minnesota non-profit wishes to fundraise more than \$25,000, what must it do?
15. To be considered a public charity under Minnesota law, an organization must provide services at a reduced cost. (T/F)
16. Competitive bidding is a good way to avoid intermediate sanctions. (T/F)
17. If a non-profit has an income producing activity it will be assessed an unrelated business income (UBI) tax. (T/F)

**Non-profit Training Institute**  
**Non-profit Law and Ethics**  
**Training Exercises**

1. You decide to set up a non profit that will provide shelter and support services for run away youths, ages 10-18. The basis of the program will be running a “Runaway Café,” where you will have the youths you serve operate a restaurant. At the Café, youths will work for \$4 per hour, cooking, serving, washing dishes, etc. The Café’s employment will teach real work skills and the proceeds from the sales will pay for training, education, and any other services you provide. To start up the non-profit café, you seek out a dozen investors who will give you start up money and then you will pay them dividends on their initial investment. To simplify matters, you deposit the investors’ money in your personal bank account and will use it to operate the business. **Assess this business plan.**
  
2. You wish to create a new non-profit that you plan to call “La Libertad,” a group that will seek to empower single Hispanic mothers to become more employable. You will run this organization with one other individual, with both of you serving as the sole board of directors members. **What steps do you need to take to realize your vision?**
  
3. You want your non-profit to be tax exempt and allow for contributions to your group to be tax deductible. Your group will be providing nutrition programs to the elderly. To help pay for the program, you plan to buy a office building, rent out space, and also sell ads in a monthly newsletter. **What steps do you need to take to accomplish the above and are there any issues you need to address or consider as you are seeking to be come tax exempt?**
  
4. You create a non-profit with your sister. The two of you are advised by some friends who also run a non-profit that you should just simply complete the default Articles of Incorporation and skip the bylaws. They tell you both are simply formalities and you can change or adopt either of them when you get around to it or think that it is necessary. The main think is simply get the non-profit up and running so you can do some good deeds. **Assess this advice.**
  
5. You run a small non-profit in need of money. You cannot hire a fundraiser but instead opt to hire one on a commissioned basis. This means she will keep a percentage (25%) of all money raised. In soliciting funds for your group, the fundraiser tells potential donors that almost all of the money donated to the organization goes towards program.
  
6. One of the great things about running a non-profit is that you can do whatever you want and not be tied to the corporate bottom line or be subject to the type of accountability the government is. All you need to do is incorporate once and that is it. No other forms to file, paperwork to complete, or annual reports with which to bother. **Do you agree?**
  
7. You hate George Bush in the worst way and think he is lower and slimier that a snake’s behind. As a 501(c) (3), you think it is ironic that you can take the government’s faith-based initiative money and then advocate for issues that the Bush administration opposes. In fact, you thought it was great

four year's ago that you could use that money to encourage people to vote against him in an election. **Is American this great and can you do all this?**

8. As a real estate developer, you have been asked to serve on a non-profit housing board simply to round out the body count and complete the quorum. You are told that you need not worry about attending meetings or, if you do, you do not have to worry about preparing for them by reading the minutes, etc. Just show up and do not worry about. You do show up to a meeting and the executive director asks you to vote for a new housing program to build several low income units on a parcel of land that is being offered to the organization for a small price. You think this land would be a great place for your company to build condos and sell to rich individuals. You decide to vote against the proposal and plan to offer the seller of the property 2x for the land. While fumbling for your cell phone at the meeting you decide not to vote on another board proposal that would decline to pay a vendor because your group was short of funds and because the owner of it also did business with a rival. **Please assess your behavior, indicating what, if anything, you did wrong.**

9. You are an attorney serving on a non-profit board. You are regularly called upon to offer legal advice and to provide free legal advice. **Assess some of the legal issues associated with performing this role.**

10. You are an attorney serving on a non-profit board. You are asked to provide legal services to the organization at market rates. The Board and you vote to award you a no-bid contract. **What are some possible concerns with this action?**

11. You are an attorney serving on a non-profit board. You are asked to present the organization in a law suit against it for breach of contract. **Should you undertake the representation?**

12. You are an attorney serving on a non-profit board. Your non-profit is a 501 c 3 and it is very interested in the outcome of the 2008 presidential election. They ask you for advice on how they may support their candidate of choice. **What advice do you give them?**

13. You are an attorney serving on the board for your religious institution. They would like to adopt a policy barring the employment of gays and lesbians. **May they do so? Can you advise them to adopt such a policy?**

## **Non-profit Law and Ethics**

### **I. Introduction**

- A. Goal of the Seminar
  - 1. Overview of the basic legal and ethical issues affecting non-profits
- B. Legal issues
  - 1. Legal environment of non-profits
  - 2. What is a non profit?
  - 3. It's all about passion. . .and planning
  - 4. Incorporation
  - 5. By laws
  - 6. Corporate structure
  - 7. Board governance and duties
  - 8. Employment
  - 9. Volunteers
  - 10. Tax status
  - 11. Fund raising and donor intent
  - 12. Accountability and filing
  - 13. Political activity
  - 14. Risk Management and SOX
  - 15. Conclusions
- C. Ethical issues

### **II. Legal environment of non-profits**

- A. Non-Profits are not exempt from the law
  - 1. Laws affecting non-profits
    - a. MINN. STAT. Chapter 317A
    - b. MINN. STAT. Chapter 309 Minnesota Charitable Solicitation Act (MCSA)
    - c. IRS tax laws
    - d. State and federal minimum wage laws
    - e. Workers compensation laws
    - f. Other labor laws
    - g. Most anti-discrimination laws
  - 2. Other laws and rules may also be important
  - 3. Some non-profits may also be part of larger organizations and subject to the rules of these organizations

### **III. What is a non-profit?**

- A. The terms non-profit, nonprofit, and not for profit are interchangeable
- B. MINN. STAT. 317A.011. Subd. 6.

- C. “Corporation” means a corporation that is governed by this chapter. A corporation may **not**:
  - 1. be formed for a purpose involving pecuniary gain to its members, other than to members that are nonprofit organizations or subdivisions, units, or agencies of the United States or a state or local government; and
  - 2. pay dividends or other pecuniary remuneration, directly or indirectly, to its members, other than to members that are nonprofit organizations or subdivisions, units, or agencies of the United States or a state or local government.
- D. One can create a non-profit for almost any charitable, educational, or social welfare purpose.
  - 1. Minn. Stat 317A.101. A corporation may be incorporated under this chapter for any lawful purpose, unless another statute requires incorporation for a purpose under a different law. Unless otherwise limited in its articles, a corporation has a general purpose of engaging in any lawful activity. A corporation engaging in conduct that is regulated by another statute is subject to the limitations of the other statute.
- E. For an entity to be considered a charity it must offer its services at a cost below market rates.
  - 1. *Rainbow Child Care Center, Inc. v. County of Goodhue*, 741 NW.2d 880 (Minn. 2007).
  - 2. “Although each of these statements addressed the breadth of purposes that a charity may serve, the common thread was another element—one that is inherent in the common understanding of charity: that charity is a gift. Absent the element of a gift, we fail to see how an endeavor can be fairly characterized as a charity. . . By examining the extent to which “the recipients of the ‘charity’ are required to pay for the assistance received in whole or in part,” factor three assesses whether the organization's operation confers a gift. Therefore, if factor three is not satisfied, the organization cannot be found to be an institution of public charity.” (Citations omitted).
- F. Non profits compared to for profit corporations
  - 1. Similar structure
  - 2. May have similar purposes
    - a. Ex. HMOs v. for profit health care
  - 3. Similar corporate rules and processes for operation

#### **IV. It’s all about passion. . .and planning**

- A. Rod Stewart was right
  - 1. The importance of passion
- B. Translating passion into a plan
- C. Making a business and marketing plan

#### **V. Incorporation**

- A. Why Incorporate



1. Problems with not incorporating
    - a. Members of an unincorporated association personally liable for debts
    - b. Members of an unincorporated association are more likely to be sued personally
    - c. Tax problems and co-mingling of funds
    - d. Many grants and \$ not available to unincorporated non-profits
    - e. Corporate structure is readily understandable to banks, donors, etc.
    - f. May be easier to operate with a corporate structure
- B. How to Incorporate
1. Incorporation papers can be found on the Minnesota Secretary of State's Web Page.
    - a. <http://www.sos.state.mn.us/business/typeoffile.html>
  2. Incorporation is done via the Secretary of State's office
  3. What you need
    - a. Incorporator (Person or persons who will file the Articles of Incorporation) (need not be a lawyer)
    - b. Articles of Incorporation
    - c. Filing Fee
  4. Incorporators
    - a. Anyone can be an incorporator
    - b. Incorporator(s) take the steps to incorporate the non-profit
    - c. Incorporator may/may not elect to serve as the first board of directors
  5. Articles of Incorporation
    - a. Sample articles for a future 501 ( c ) (3)
      - (1) <http://www.mncn.org/info/samplearticles.pdf>
    - b. Articles of Incorporation must contain four provisions
      - (1) required provisions
      - (2) provisions that may be modified in the articles
      - (3) provisions that may be modified in the articles or bylaws
      - (4) optional provisions
    - c. Required provisions
      - (1) Corporate name in English language or English letters or characters
      - (2) Address of the registered office (and the name of the registered agent (if it has one))
      - (3) Name and address of the incorporators
      - (4) Statement that the corporation is organized under Chapter 317A.
      - (5) If seeking IRS tax exemption, other provisions may be required.
    - d. Provisions that may be modified in the articles
      - (1) This category refers to provisions of Chapter 317A that automatically apply to the non profit unless the articles state otherwise.

- (2) Five provisions of Chapter 317A may **only** be changed in the Articles and cannot be done in the bylaws
      - (a) The general purpose of a non-profit
      - (b) Power to repeal, amend, or adopt bylaws is vested in the board
      - (c) Cumulative voting for directors is prohibited
      - (d) Written action taken by the board without a meeting must be signed by all directors
      - (e) members of all one class
      - (f) If you do not change these in the articles, the state law acts as the default
  - e. Provisions that may be modified in the articles or bylaws
    - (1) 29 Provisions of chapter 317A may be modified by articles or bylaws.
      - (a) examples include: officers and duties, quorum, procedures for amending articles or bylaws
      - (b) State law only requires there to be a president and treasurer; you may create more officers as you wish.
    - (2) Again: if you do not change these, the state law acts as the default
  - f. Optional provisions
    - (1) Any other provisions you wish
      - (a) examples: powers and duties of officers; additional officers; term limits.
- 6. Filing Fee
  - a. \$70
- 7. Amending Articles
  - a. After incorporated, chapter 317A specifies procedures for amending articles
    - (1) Must be signed, filed, and fee paid with Secretary of State
    - (2) Filing fee is \$35 to amend
- C. The law protects you from the day you file for incorporation
- D. Post incorporation
  - 1. Organizational meeting required MINN. STAT. 317A.171
    - a. Directors meeting
      - (1) adopt bylaws
      - (2) elect officers
      - (3) Other business
        - (a) bank resolutions and signature cards
        - (b) approve budget and IRS tax application
        - (c) set fiscal year Meet to choose first board, etc.
- E. General advise
  - 1. Incorporation is easy
  - 2. Decide what you want in the Articles versus bylaws

- a. When it doubt, make it changeable in the bylaws

## VI. By laws

- A. Not required but a very good idea
- B. Sample bylaws for a 501 c 3
  1. <http://www.mncn.org/info/samplebylawswoutmembers.pdf>
- C. If addressed in the Articles, bylaws may modify some statutory provisions
- D. MINN. STAT. 317A.181 lists some permitted bylaw provisions
  - a. Examples such as officers, duties, elections, quorum.
- E. Recommendation
  1. Bylaws should include a conflict of interest provision (MINN. STAT. 317.A.255)
- F. Bylaws must be fair and reasonable
  1. *Brennan v. Minneapolis Society for the Blind, Inc.*, 282 N.W. 2d 515 (Minn. 1979).

## VII. Corporate Structure and Governance

- A. Required officers
  1. Treasurer and President
    - a. May create others as desired
- B. Executive Director
  1. Not required but it up to Bylaws and the director
- C. Board of directors
  1. Duties
    - a. fiduciary
    - b. loyalty
    - c. care
    - d. obedience
  2. Standard of conduct
- D. Minnesota Attorney General has a good sample booklet on directors' duties.
  1. Immunity for noncompensated directors, officers, agents, and volunteers
    - a. *Garry M. Rehn v. Barbard Fischley*, 557 N.W.2d 328(1997) (board immunity if not compensated)
    - b. Minn. Stat. § 317A.257, subd. 2(b) is a statutory immunity and not an affirmative defense.
  2. Corporate veil may be pierced if corporate structure is an alter ego, used to avoid the law, to prevent injustice, or if the entity is undercapitalized.
    - a. *Hok Sports v. Des Moines Menace Soccer Club*, 495 F.3d 927 (8<sup>th</sup> Cir. 2007).
  3. Error and omissions policy
- E. Setting up a bank account
  1. Need to obtain taxpayer ID from the IRS
  2. Minnesota Department of Revenue
    - a. Can get MN taxpayer ID

- (1) [http://www.taxes.state.mn.us/taxes/current\\_forms.shtml](http://www.taxes.state.mn.us/taxes/current_forms.shtml)
  - 3. Board must approve who gets to sign checks, secretary must sign off on the approval, and then can open the account
- F. Signature authority
  - 1. Checks and balances v. expediency
    - a. Who gets to sign?
    - b. More than one signature?
      - (1) dollar amounts for authority?
- G. Cash receivables and disbursements
  - 1. Idea to have two different people do this
    - a. Reality is hard for smaller groups
- H. Bookkeeping issues
  - 1. *Quickbooks* is a good software
  - 2. Have a good accountant
- I. Annual meetings are required to approve budget and officers
  - 1. Other meetings suggested and a regular schedule is a good idea
    - a. Minimum of four per year according to the Attorney General
  - 2. Telephone participation is ok if provided for in Bylaws
  - 3. Have an agenda in advance
- J. Member meetings
  - 1. Optional but see MINN. STAT. 317A 431-433 if you have them since the law addresses issues of time, manner, place, agenda, voting, etc.
- K. What factors make for an effective Board? What about for an effective Board member? If you had to list to attributes and traits of a good board member, what would they be? Is it the same for all boards, or does it vary with the organization?
- L. Should board discussion of a non-profit's business be encouraged outside of regular board meetings?
- M. What are the advantages and disadvantages of board member term limits?
- N. What role should or do committees have within a non-profit? Is their legal status different from the organizational status?
  - 1. What types of committees should you have?
    - a. Standing v ad hoc
    - b. Executive, compensation, legal, financial
- O. Legal Issues of non-profits
  - 1. Could a non-profit loan money to its director or board members? Should it? See 161. subd 20.
  - 2. Can or should directors be paid? See 211/257.
  - 3. What is the business judgment rule?
    - a. *Janssen v. Best & Flanagan*, 662 N.W.2d 876 (Minn. 2003)
      - (1) Rule gives deference to corporate directors to make good decisions
  - 4. What is a derivative suit and under what circumstances is it used?
    - a. What can members do if they do not like what the board is doing?
    - b. Suit belongs to board

- c. Trade off of nuisance suits versus how they benefit the board and the non-profit
- 5. *Jensen v. YMCA*, 688 N.W.2d 574 (Minn. Ct. App. 2004)
  - a. Minn State 317A.467
    - (1) members sue board for violations of state law
  - b. Minn. Stat. 317A. 411
    - (1) termination of membership
- 6. Could the non-profit indemnify its board for acting negligently? See 161. subd.21. Could it? What if a board member steals or commits a crime?
- 7. If a board member does not prepare for a meeting or does not read material given to her, what has she done wrong? See 241.
- 8. You think your non-profit is not acting properly but under pressure at a board meeting, you abstain in a vote. Later you are sued. Are you culpable? Legally or morally? See 241.

### VIII. Applicable Employment Laws

- A. Which laws apply?
  - 1. Title VII 1964 Civil Rights Act (15 or more employees)
    - a. Title VII
    - b. The statute provides that employers must not fail to or refuse to hire, or discharge, or otherwise to discriminate against any individual with respect to compensation, terms, conditions, or privileges of employment because of a person's sex.
      - (1) Excepted Employers
        - (a) Congress (since changed in 1994)
        - (b) Indian tribes
        - (c) private tax-exempt membership clubs
      - (2) Excepted Practices
      - (3) Pregnancy not a sex based classification according to the U.S. Supreme Court in *General Electric v. Gilbert* (1976)
        - (a) The Pregnancy Discrimination Act of 1978 overturned *General Electric*.
      - (4) Bonafide Occupation Qualification (BFOQ)
        - (a) Sex could be used if it were a BFOQ
        - (b) *United Autoworkers v. Johnson Controls* (1991) and lead poisoning to fetus.
      - (5) Sexual orientation excluded.
  - 2. ADA (15 or more employees)
  - 3. Age Discrimination in Employment Act (15 or more employees)
    - a. Age 40 or over
  - 4. Equal Pay Act (No minimum)
    - a. 1963 Federal Pay Act which mandates employers pay the same salaries to women and men for substantially equal work
    - b. Difficulty in establishing equal work

- c. Bennett Amendment
      - (1) Defenses
        - (a) merit
        - (b) production
        - (c) seniority
        - (d) factors other than sex
    - d. How to really determine if difference pay is the result of intentional discrimination or the product of "neutral" market forces?
  - 5. Immigration Reform and Control Act (4 or more employees)
  - 6. Pregnancy Discrimination Act (15 or more employees)
  - 7. State laws
    - a. *Doe v. Lutheran High School of Greater Minneapolis*, 702 N.W.2d 322 (Minn. Ct. App. 2005)
      - (1) (the Minnesota Human Rights Act does not prevent a religious organization from dismissing a gay pastor. Here, the Court ruled that because the duties of the pastor could not be separated into secular and nonsecular functions the First Amendment and Minn. Stat. § 363A.26(2) precludes review.
- B. Hiring practices
  - 1. Types of employees
    - a. Management and FLSA (Fair Labor Standards Act) exempt
    - b. Staff non-exempt
  - 2. Non-employees
    - a. Volunteers
    - b. Independent Contractors
- C. Who is an independent contractor?
  - 1. IRS 20 point checklist
- D. Question: Run a religious-based non-profit, could you make inquiries into religion in an interview
  - 1. What is a BFOQ? Bonafide Occupational Qualification
- E. Question: Run a non-profit with ten employees, do you have to pay federal minimum wage?
- F. Question: Run a non-profit and what do you need to do when hiring regarding immigration?
  - 1. FLSA
    - a. Applies if engaged in interstate commerce
    - b. Involved in production of goods for commerce
- G. EEO Principles
  - 1. Questions you may or may not ask
  - 2. The employment application
    - a. What may you ask?
- H. Compensation Issues
  - 1. FLSA and minimum wage
    - a. Includes benefits package

2. ERISA
  - a. Employee Retirement Income Security Act of 1974
  - b. Federal disclosure and tax treatment
3. Tax Withholding and Payroll Taxes
4. Tax deferred income (retirement)
- I. Employee Handbooks
  1. What should be in an employee handbook?
  2. Should you have a handbook?
  3. Legal status of handbooks
    - a. In Minnesota they have a quasi contract status
- J. Sexual Harassment
  1. The Case of Sexual Harassment
    - a. EEOC guidelines define sexual harassment as unwelcome sexual advances, requests for sexual favors, and other verbal or physical conduct of a sexual nature, occurring when:
      - (1) submission is either explicitly or implicitly a condition or term of employment; or
      - (2) submission or rejection of the conduct is the basis for employment decisions affecting the individual; or
      - (3) when the conduct has either the purpose or effect of substantially interfering with the individual's work performance or creating an intimidating, hostile, or offensive work environment.
  2. Title VII and Court did not originally equate sexual harassment with sexual discrimination.
    - a. The ground breaking work on this topic was done by Katherine McKinnon
  3. Two Types of Harassment
    - a. Quid pro quo
    - b. Hostile environment, *Meritor Savings Bank v. Vinson* (1986) with Rehnquist writing the opinion.
      - (1) Including actions, pornography, Web
  4. Application of "Reasonable Woman" standard
    - a. *Ellison v. Brady*
    - b. *Robinson v. Jacksonville Shipyards*
    - c. *Harris v. Forklift Systems* (1993)
      - (1) Need not show psychological harm so long as one could show that a *reasonable person* would find the conduct offensive or that it interferes with one's job performance
  5. Protection against retaliation
  6. State law protections
  7. Issue of employer vicarious liability for conduct of employee's actions
  8. What should non-profits do to:
    - a. Prevent sexual harassment?

- b. Protect themselves against it?
    - c. Does sexual harassment apply to same sex harassment?
- K. Discrimination
  - 1. *Roberts v. United States Jaycees*, 468 U.S. 609 (1984)
    - a. Court found them to be a public accommodation under state law and their diffuse membership did not override state interest in preventing sex discrimination
  - 2. *Boy Scouts of America v. Dale*, 530 U.S. 640 (2000)
    - a. Values central to mission would be compromised by the acceptance of homosexuals
    - b. Boy scouts not a place of public accommodation

**IX. Intermediate sanctions**

- A. Special tax on excess benefit transactions to a disqualified person
  - 1. Disqualified person is one who can exercise substantial influence over organization during last five years
  - 2. Giving more than fair market value
  - 3. Tax on disqualified person is 25% of excess benefit amount
- B. IRS can also impose special tax on those who approve the excess benefit
- C. Can show reasonableness by approval of disinterested board without conflict of interest

**X. Volunteers**

- A. What is the legal status of volunteers within organizations? How are they part of a non-profit?
- B. In order to increase volunteer involvement, a non-profit decides to provide free meals? Cab fare? Give a cash bonus for every 40 hours volunteered? Provide health benefits for those who volunteer 20 or more hours per week? Assess each of these ideas.
- C. Is it a good idea for a non-profit to have a lawyer on the board?

**XI. Tax status**

- A. Unless you are a church, you do not automatically get tax exemption and must file with the IRS
- B. IRS Tax code §501 lists many (21+) categories of tax exemption
  - 1. Most popular
    - a. §501 (c) (3) tax exemption and donations count as a charitable deduction.
    - b. §501 (c) (4) tax exemption but donations not a charitable deduction
- C. Obtaining Tax status
  - 1. Should file within 15 months after month organized (but do it sooner).
  - 2. Form 1023 may be obtained from the IRS
    - a. <http://www.irs.gov/charities/index.html>
    - b. A good workbook and instruction manual is found at the IRS site.



3. Not every non-profit qualifies as a §501 (c) (3)
    - a. 26 U.S.C. §501(c)(3).
      - (1) This section of the Federal Code governs the activities of tax exempt entities such as nonprofit organizations.
        - (a) As a condition of receiving tax exempt status an entity must be:
          - (b) “Operated exclusively for religious, charitable, scientific, educational [or other specified] purposes, . . . and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or opposition to) any candidate for public office.”
      - (2) 26 U.S.C. §501(c)(4). Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes.
  4. Which to be?
    - a. §501(c)(3) May do no partisan political activity
    - b. §501(c)(4) May do some political activity
- D. Minnesota tax status
1. If one qualifies for federal income tax exemption, one automatically gets it in Minnesota.
- E. Sales tax
1. No exempt from sales tax unless operating exclusively for charitable, religious, or educational purposes.
  2. Must apply for a sales tax exemption with the state (ST-16)
- F. Property Tax
1. Minnesota Constitution, Article X, Section I, and Minnesota Statutes § 272.02, subd. 7, offer property exemptions to institutions of purely public charity.
  2. Sixfold test to determine if public charity
    - a. *North Star Research Institute v. County of Hennepin*, 306 Minn. 1, 6, 236 N.W.2d 754, 757 (1975).
      - (1) (1) whether the stated purpose of the undertaking is to be helpful to others without immediate expectation of material reward; (2) whether the entity involved is supported by donations and gifts in whole or in part; (3) whether the recipients of the “charity” are required to pay for the assistance received in whole or in part; (4) whether the income received from gift and donations and charges to users

produces a profit to the charitable institution; (5) whether the beneficiaries of the “charity” are restricted or unrestricted and, if restricted, whether the class of persons to whom the charity is made available is one having a reasonable relationship to the charitable objectives; (6) whether dividends, in form or substance, or assets upon dissolution are available to private interests.

3. Payment of services critical to determination of whether an organization is a charity.
  - a. *Rainbow Child Care Center, Inc. v. County of Goodhue*, 741 NW.2d 880 (Minn. 2007).
    - (1) “By examining the extent to which “the recipients of the ‘charity’ are required to pay for the assistance received in whole or in part,” factor three assesses whether the organization's operation confers a gift. Therefore, if factor three is not satisfied, the organization cannot be found to be an institution of public charity.”
  - b. *See also*:
    - (1) *Afton Historical Soc. Press v. County of Washington*, 742 N.W.2d 434 (Minn, 2007)
      - (a) “Therefore, when real property is used for both commercial and arguably charitable purposes, the commercial use of the property will not prevent the property from being exempt from property taxation as an institution of purely public charity if the commercial use is incidental to and reasonably necessary in furtherance of the entity's charitable activities.”

## **XII. Unrelated Business Income (UBI)**

- A. Income generated that is unrelated to the exempt purpose is taxable
  1. The test
    - a. An unrelated trade or business that is regularly carried on, the conduct which is not substantially related to the corporation’s exempt purpose.
  2. Exclusions
    - a. rents
    - b. royalties
    - c. dividends
    - d. Work done by volunteers
    - e. Sale of donated items
    - f. Gain from sale of capital assets
    - g. Ok with sponsors if no substantial return benefit from use of logo or relationship.
      - (1) cannot advertise sponsor’s products.
  3. UBI

- a. Advertising in periodicals, newsletter, program
  - (1) acknowledgments are ok
- 4. Consult your accountant

### **XIII. Fund Raising**

- A. Registration
  - 1. State law requires charities and non-profits that solicit funds to register and report to the Attorney General's Office.
    - a. MINN. STAT. Chapter 309 Minnesota Charitable Solicitation Act (MCSA)
    - b. Exceptions to registration
      - (1) No paid staff or fund raisers and less than \$25,000 in contributions per year
      - (2) Religious groups that do not file 990s
- B. How to register
  - 1. Registration form can be obtained from the AG's web site
  - 2. [http://www.ag.state.mn.us/pdf/charities/A5/CharOrgRegStatmnt\\_5.pdf](http://www.ag.state.mn.us/pdf/charities/A5/CharOrgRegStatmnt_5.pdf)
  - 3. What to include:
    - a. Registration form
    - b. Articles of Incorporation
    - c. IRS determination letter for tax status
    - d. Most recent 990
    - e. \$25 filing fee
- C. Annual Reporting to the AG
  - 1. <http://www.ag.state.mn.us/pdf/charities/A5/AnnualReportForm.pdf>
  - 2. Must annually file 990 with the AG's office
  - 3. If total review in excess of \$350,000, an audited financial statement by an independent public accountant
  - 4. \$25 fee
- D. Professional Fundraiser must also register with the AG's office
- E. The ethics of commissioned fund raising
  - 1. Association of Fundraising Professionals
    - a. "Members shall not accept compensation that is based on a percentage of charitable contributions; nor shall they accept finder's fees."
  - 2. Minnesota Council of Non-profits
    - a. "Fundraising personnel, including both employees and independent consultants, should not be compensated based on a percentage of the amount raised or other commission formula."
- F. Donor intent
  - 1. Why is donor intent important?
  - 2. *In re Minneapolis Police Department Relief Association v. Wold*, 85 Minn. 302 (1902)
    - a. Donor can limit gift
  - 3. *Protestant Reformed Church of Edgerton v. Templeman*, 249 Minn. 182, 81

N.W.2d 839 (Minn.1957)

a. Court will not enquire into religious doctrine for purposes of ascertaining whether purpose or belief of non-profit has changed.

4. Property disposition

a. MINNESOTA STATUTES, § 317A.671

G. Cy pres

1. *In re Peterson's Estate. Swenson et al. v. Board of Christian Service*, 202 MN 31 (1938)

a. That is legislative recognition of the historical doctrine of judicial cy pres. Under it, the court is authorized to approximate the intention of the donor when his exact intention cannot be carried out for some reason. See *In re Estate of Lundquist*, supra.

b. That doctrine presupposes the existence of a valid gift, a trustee indicated in some manner, a definable charitable use or object, and a general charitable intent, Zollmann, *American Law of Charities*, §§ 123-125, 'and the particular mode prescribed for its administration has become illegal, inadequate, or inappropriate.' *Id.* p. 76, § 123. The typical case for its application, where a general intent is displayed, is where the particular charitable *use* or *object* cannot be accomplished.

2. *In the Matter of the Ruth Easton Fund, a Separate Fund of the Edelstein Family*, 680 N.W.2d 541 (MN Ct. Ap. 2004)

a. In petitioning for this authorization, the trustees relied on MINN.STAT. § 501B.31 (2002), the legislative expression in Minnesota of the doctrine of cy pres. Cy pres is an equitable doctrine designed to preserve, as nearly as possible, the general equitable intent expressed in a charitable gift when strict accomplishment of the terms of the gift has become impracticable, inexpedient, or impossible. This common law doctrine was legislatively enacted in Minnesota in 1927 to allow courts the power to approximate the donor's intention when the exact intention, for some reason, may not be carried out.

3. **§ 501B.31 (4) (b)** If a gift, trust, or devise has been made for a charitable, benevolent, educational, religious, or other public use or trust, or upon a condition, limitation, or restriction of any kind, the property given, entrusted, or devised may be used only for that use or trust and in accordance with the condition, limitation, or restriction. The grantee, devisee, trustee, or other holder of property may petition the court under section 501B.16 for determination of the legal rights and relationship of the holder, the public, the grantor, and the grantor's heirs, representatives, or assigns in and to the property.

H. Fundraising pitches

1. What can you say and do in fundraising?

2. *Illinois v. Telemarketing Associates*, 123 S.Ct. 1829 (2003)

a. Fraud issues

3. Minn. Stat. § 309.55

- a. Deceptive practices and member lists
- I. A note on Charitable Gambling

#### **XIV. Accountability**

- A. IRS tax form 990
  - 1. File with the AG and make available to the public
- B. State annual filing
  - 1. Must register yearly with the state (no fee unless late)
- C. Charities can be sued for fraud in fundraising
  - 1. *Illinois ex rel Madigan v. Telemarketing Associates, Inc.*, 123 S.Ct. 1829 (2003)

#### **XV. Political activity**

- A. Lobbying v. partisan activity
- B. §501 (c) (3)
  - 1. “Operated exclusively for religious, charitable, [or other specified] purposes, . . . and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or opposition to) any candidate for public office.”
  - 2. Do **not** cross the line or the consequences are loss of tax status
    - a. *Branch Ministries v. Rossotti*, 211 F.3d 137 (D.C. Ct. App.) (2000)
- C. Lobbying and advocacy
  - 1. For a §501 (c) (3) lobbying and advocacy cannot be a substantial part of your organization
  - 2. Can do some lobbying
    - a. Can spend up to 20% of \$500,000 for nonpartisan advocacy issues
    - b. From \$500,000 to \$1,000,000 can spend \$100,000 + 15% of excess over \$500,000.
  - 3. §501 (c) (4) can do more advocacy

#### **XVI. Risk Management and Sarbanes Oxley**

- A. Why do risk management?
- B. SOX and non-profits
  - 1. Two provisions apply to non-profits
    - a. Whistleblower protections
    - b. Document retention and destruction policy
  - 2. Best practices and SOX
- C. Conflict of Interest policies

#### **XVII. Special Legal Ethics Issues**

- A. Board memberships may produce legal conflicts of interest.
  - 1. *B.A. v. L.A.*, 196 Misc.2d 86, 761 N.Y.S.2d 805 (2003)
    - a. holding that guardian appointed for children was disqualified on ground that her professional judgment could be reasonably affected

given that wife's attorney was president of non-profit legal aid association that employed her.

2. Do your Board memberships, clients you serve, conflict with your clients in your legal practice?
  - a. *Iowa Supreme Court Attorney Disciplinary Board v. Johnson*, 728 N.W.2d 199 (Iowa 2007)
  - b. *Sorci v. Iowa Dist. Court for Polk County*, 671 N.W.2d 482, Iowa (2003)
    - (1) Potential imputed conflicts between being a prosecutor and then appointed a guardian ad litem.
- B. Quality of legal representation to a non-profit is no less because of its pro bono nature.
- C. Who is the client?
  1. Same rules apply to non-profits as to private corporations.
- D. Confidentiality and privilege
  1. Same duties as apply to any other corporate client
- E. Self-dealing
  1. Self-dealing is self-dealing and it may also arise to intermediate sanctions.
  - 2.
- F. If you are representing your Board should you have a written retainer agreement defining the scope of representation?

## **XVIII. Conclusions**

## **XIX. Resources**

- A. Minnesota Attorney Generals Office
  1. <http://www.ag.state.mn.us/charities/Default.htm#New%20Resources>
- B. Minnesota Secretary of State
  1. <http://www.sos.state.mn.us/state.html>
- C. Internal Revenue Service
  1. <http://www.irs.gov/charities/index.html>
- D. Charities Review Council of Minnesota
  1. [Www.crcmn.org](http://www.crcmn.org)
- E. Minnesota Council of Non-profits
  1. <http://www.mcn.org>

## **Incorporation and Tax Exemption Checklist**

Here are the basic steps to incorporate and get a non-profit tax status.

1. Determine what your mission and purposes are
2. Do you want to be a non-profit, for-profit, or both?
3. Do you wish to be a member or non member-based non-profit?
4. Contact Secretary of State for incorporation forms
5. Choose appropriate legal name for your non-profit
6. Select an incorporator
7. Draft articles
8. File articles
9. Draft bylaws
10. Decide if you wish to be a 501 c 3 , c 4, or c 6
11. Draft and file federal tax exemption forms (IRS 1023)
12. Get state tax exemptions such as for property or sales tax
13. File fictitious name request
14. File for bulk mailing request
15. Apply for other tax exemptions
16. Register to fund raise with Attorney General (if over \$25,000 per year)
17. Completing any other registration or reporting forms

**Statutory provisions that may be modified only in articles. The following provisions govern a corporation unless modified in the articles:**

- (1) a corporation has a general purpose of engaging in any lawful activity (section 317A.101);
- (2) the power to initially adopt, amend, or repeal the bylaws is vested in the board (section 317A.181);
- (3) cumulative voting for directors is prohibited (section 317A.215);
- (4) a written action by the board taken without a meeting must be signed by all directors (section 317A.239); and
- (5) members are of one class (section 317A.401).

**Statutory provisions that may be modified in articles or bylaws. The following provisions govern a corporation unless modified in the articles or bylaws:**

- (1) a certain method must be used for amending the articles (section 317A.133);
- (2) a corporation has perpetual duration and certain powers (section 317A.161);
- (3) certain procedures apply to the adoption, amendment, or repeal of bylaws by the members (section 317A.181);
- (4) a director holds office until expiration of the director's term and election of a successor (section 317A.207);
- (5) the term of a director filling a vacancy expires at the end of the term the director is filling (section 317A.207);
- (6) the compensation of directors is fixed by the board (section 317A.211);
- (7) a certain method must be used for removal of directors (section 317A.223);
- (8) a certain method must be used for filling board vacancies (section 317A.227);
- (9) board meetings must be held at least once per year and if the board fails to select a place for a board meeting, it must be held at the registered office (section 317A.231);
- (10) a director may call a board meeting, and the notice of the meeting need not state the purpose of the meeting (section 317A.231);
- (11) a majority of the board is a quorum (section 317A.235);
- (12) the affirmative vote of the majority of directors present is required for board action (section 317A.237);
- (13) a committee consists of one or more persons, who need not be directors, appointed by the board (section 317A.241);
- (14) the president and treasurer have certain duties, until the board determines otherwise (section 317A.305);
- (15) a certain method must be used for removal of officers (section 317A.341);
- (16) officers may delegate some or all of their duties and powers, if not prohibited by the board from doing so (section 317A.351);
- (17) a corporation does not have members (section 317A.401);
- (18) the board may determine the consideration required to admit members (section 317A.401);
- (19) all members are entitled to vote and have equal rights and preferences in matters (section 317A.401).



- 317A.401);
- (20) memberships may not be transferred (section 317A.405);
- (21) a corporation with voting members must hold a regular meeting of voting members annually (section 317A.431);
- (22) if a specific minimum notice period has not been fixed by law, at least five days' notice is required for a meeting of members (section 317A.435);
- (23) the board may fix a date up to 60 days before the date of a members meeting as the date for determination of the members entitled to notice of and entitled to vote at the meeting (section 317A.437);
- (24) each member has one vote (section 317A.441);
- (25) the affirmative vote of the majority of members with voting rights present and entitled to vote is required for action of the members, unless this chapter or the articles or bylaws require a greater vote or voting by class (section 317A.443);
- (26) members may take action at a meeting by voice or ballot, by unanimous action without a meeting, by mailed ballot, or by electronic communication (section 317A.443);
- (27) the number of members required for a quorum is ten percent of the members entitled to vote (section 317A.451);
- (28) certain procedures govern acceptance of member acts (section 317A.455); and
- (29) indemnification of certain persons is required (section 317A.521).

Business Plan Worksheet

<u>Area of Operation</u>	<u>Goal Identification and Rank</u>	<u>Goal</u>	<u>Who is Responsible?</u>	<u>How to pay for it?</u>	<u>When(time table)?</u>	<u>Measurement of Success</u>
<u>Governance</u>	1. 2. 3.					
<u>Financial</u>	1. 2. 3.					
<u>Operations</u>	1. 2. 3.					
<u>Staff/ Volunteers</u>	1. 2. 3.					
<u>Public Relations</u>	1. 2. 3.					