



# Mosherslaw Nonprofit Update

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## Board Development: Conflicts of Interest

All not-for-profit Board members have a responsibility to serve the best interests of the organization. Conflicts of interest arise when a financial interest or a business or personal relationship threatens to improperly influence a Board member's decision-making ability. Failure to adequately manage conflicts may result in IRS sanctions on both the organization and individuals involved, and even loss of tax-exempt status in certain cases. Accordingly, organizations and individuals must be vigilant in recognizing and addressing conflicts.

Conflicts are inherent in the life of a normal nonprofit organization. For example, a conflict may arise when a Board member's company has just the right services that the organization needs to use, and that person is even willing to provide the services at a discount. A conflict may arise when two differently skilled but both very capable persons who are married to each other are both needed on a Board. A conflict may also arise when a dedicated Board member wants to sell real estate to the organization that will serve it well.

Such conflicts may cause the Board member to violate one or more of his or her legal duties. Specifically, Board members have three duties recognized under Illinois and other states' law: the duties of loyalty, care, and obedience. A Board member may violate the duty of loyalty by putting his or her own personal interests before those of the organization, such as financial gain or pleasing a family member. The duty of care is violated when a Board member fails to act diligently in handling a conflict of interest issue, such as not addressing conflicts when they arise. And the duty of obedience, or faithfulness to the corporate mission, is violated when a Board member acts improperly to benefit a private interest to the detriment of the nonprofit organization.

None of the above conflicts are necessarily prohibited. Rather, appropriate safeguards must be carefully followed to avoid trouble. At a minimum, the Board should have a written conflict of interest policy with which it complies. In addition, a Board member should abstain from any discussion or vote on a matter in which he or she has a personal interest. The Secretary should maintain detailed minutes reflecting Board members' attendance and how conflicts are handled. The Board should conduct due diligence regarding contractor payments and employee compensation, such as getting work estimates and obtaining comparable pay data for similar employees and organizations. The Board should also utilize annual conflict of interest disclosure statements, so that all Board members have regular disclosure opportunities and the Board is kept informed of potential and actual conflicts. A sample disclosure form is available at [www.mosherslaw.com](http://www.mosherslaw.com).

Look for more guidance regarding conflicts of interest and other Board issues in the next Mosherslaw newsletter. For specific legal assistance, please feel free to contact an attorney in our office. ❖

### Mission Statement

**The legal professionals of Moshers & Associates are dedicated to serving the legal needs of both small and large charitable, religious, educational, and human service organizations as well as the larger philanthropic community.**



## International Grantmaking & Due Diligence

With the IRS' increasing scrutiny of tax-exempt organizations generally, international grant-making activities merit particular attention and care. Such activities are inherently problematic since the actual grant recipients are typically far from the grant-making organizations. The risk of an organization violating its duty to ensure that the grant serves an exempt purpose is thus higher than with many domestic grants. In addition, due to heightened anti-terrorism concerns, the IRS expects organizations to be extremely vigilant in making sure that no grants benefit terrorists. The best response to both concerns is in proper documentation.

The new Form 990 well reflects the IRS' increased scrutiny. Reporting organizations must list individually all grantees that received more than \$5,000. Even if no single grantee received \$5,000, the new Form 990 requires disclosure if the aggregate of gifts exceeds \$5,000. Form 990 also requires disclosure of all family relationships between grantees and substantial contributors to the donor organization.

To satisfy grant-making due diligence requirements, public charities should have the following documentation: (1) organizational documents of grant recipients as well as a description of their activities in English; (2) a written agreement outlining the donating charity's fiduciary duties and obligating the recipient to assure that it will use the money exclusively for exempt purposes; and (3) an annual accounting of the funds until spent. Additional recommended documentation are a corporate resolution that clearly describes international grantmaking procedures, a pre-grant survey of the organization, and an agreement requiring segregation of the grant funds. The level of caution may also depend on the grantor organization's familiarity with the recipient organization.

If your organization assesses any risk with a possible grant recipient or its affiliates, it may need to implement an anti-terrorism compliance program, which involves checking grant recipients against governmental terrorist lists. In the event that funds are diverted to a terrorist organization, a compliance program may avoid asset-blocking and prosecution from the government. In addition, donor confidence may well increase as responsible fiscal management is demonstrated.

In the next edition of our office's newsletter, we will address the related topic of procedural and tax issues regarding compensation of international employees. ❖

## Business Travel or Commuting—What's the Tax Difference

Recent technological advances, as well as personal factors, allow many employees to work remotely or to have "extreme commutes." What happens when employees pay for the travel expenses, either directly or indirectly? Without proper safeguards, an employee may face the unintended consequence of additional taxable compensation.

Consider the example of a nonprofit organization that recruits a new executive director named Sue from another state. She does not want to move and can easily work from her home. The nature of Sue's work necessitates some travel to locations other than the nonprofit's main office, and some of her work takes place in her home town at a local service site. Sue wants the nonprofit to pay for all of her travel to the other sites as well as her occasional trips to the main office.

Generally, money paid to or on behalf of an employee is taxable compensation unless the law provides otherwise, including payments for personal, living, or family expenses. The cost of commuting is a personal expense, but the cost of travel for employment duties is not.

If Sue uses her home exclusively and regularly as her *principal* place of business, then it may qualify as her "tax home." Consequently, all payment for her travel, whether

to the nonprofit's main office or to other sites – will be deductible or otherwise excluded from income.

However, Sue's home office must be maintained for the "employer's convenience." In other words, it should be well documented that Sue's home office is necessary for the nonprofit's functioning or to allow her to perform her duties properly. Thus, if 70% of her duties involve work at the local site, her tax home may properly be her home office. The IRS views both the relative importance of activities performed at home and elsewhere and the time spent at each place as relevant factors for whether a home office constitutes the requisite "tax home."

To ensure proper treatment of travel-related expenses, an employer should comply with the Internal Revenue Code's requirements regarding business expenses and have a written accountable business reimbursement plan. See Moshierlaw Nonprofit Update, 4<sup>th</sup> Quarter 2007, for information on reimbursement plans. In addition, an employer should consider having a written employment agreement memorializing the employee's required work location. More information regarding the essentials terms of an employment agreement will be provided in the next edition of the Moshierlaw Nonprofit Update. ❖



## Copyright Basics

Many tax-exempt organizations have intellectual property rights that warrant careful identification and protection. The law recognizes four basic types of intellectual property: copyrights, trademarks, patents, and trade secrets. This article is the first in a four-part series on copyright law and provides a brief overview of the law. Generally, the second and third articles will examine two important and often misunderstood copyright doctrines: "works made for hire" and "fair use." The last article will address practical considerations for licensing copyrighted works.

The U.S. Constitution gives Congress the authority to "promote the progress of the useful arts, by securing for limited times to authors, the exclusive right to their respective writings." This exclusive right has been expanded to a bundle of separate rights which enable the owner to control how the creative work is used. These include the right to reproduce the work, to prepare derivative works based on the original, to distribute copies to the public, and to perform and display the work publicly. Similar to ownership in land, copyrights can be leased, sold, donated, inherited, and divided into parts.

For nonprofit organizations, copyright ownership rights may exist for their informational literature, training materials, and even employees' speeches. More generally, copy-right protection is available for writings, music,

dramatic and choreographic works, motion pictures, forms of art, models, and diagrams.

The protection is secured automatically when an author fixes the creative idea in a tangible form of expression. Thus, publishing or registering the work is not required to secure a copyright. However, registering a work with the U.S. Copyright Office is often a prudent decision because it creates a public record, establishes notice of a claim of copyright, and allows the owner to file a claim for copyright infringement. If the copyright is registered within three months of the original publication date, or before infringement begins, the nonprofit can include claims for "statutory" damages and attorney's fees when enforcing its copyright. In addition, it may be beneficial to include the © symbol, year, name of the copyright owner, and the phrase "all rights reserved" on distributed works. Although this notice is no longer legally required, it identifies the copyright owner, notifies the public that the work is protected by copyright, and shows the year of first publication. In addition, a proper notice of copyright can override a defense of innocent infringement in the event that the protected work is infringed. Notably, copyrights are limited in duration - depending on how and when an original work was created-and all works will eventually become public domain materials. ❖

## Important Guidelines for Sharing Tax-Exempt Space



Illinois property tax exemptions are generally available for religious, educational, charitable, and other specific qualified uses, so long as certain requirements are met. Many nonprofit organizations allow other organizations to use their space with or without a charge. If your nonprofit organization is sharing tax exempt space, it should do so carefully and within the following parameters.

First, if the organization allows any non-exempt use, such use may disqualify property tax exemption to the extent of the property so utilized. Accordingly, if your church allows weekday use of its parking lot by the neighboring bank, it should physically segregate the parking spaces to be used. Such use may result in property taxes as well as possibly unrelated business income taxes on revenues if the property is debt-financed.

Second, if the organization is allowing another tax exempt organization to use the property, it should memorialize the arrangement in a space sharing agreement between the owner and the guest. Arrangements can be very long-term, occasional (e.g., Boy Scout troops), or even for a single use. At a minimum, an agreement should include the following information: (1) the parties' names; (2) the times of permitted use and whether the use is exclusive; (3) the space to be used with an accompanying floor plan; (4) any property belonging solely to the guest that will be kept onsite, and security measures therefor; (5) any financial contribution to be paid and why (e.g., for shared costs of utilities, maintenance, building wear and tear, landscaping, security); (6) insurance to be paid by the guest; (7) release and indemnification language; and (8) any applicable rules and regulations governing the property's use. Any fees paid should be termed "contribution," and not "rent" since this is a commercial term.

To accurately reflect a qualified exempt shared use, the agreement should state in its preamble that the shared use is consistent with the owner's qualified tax exempt ownership and use. In addition, the agreement should be structured to avoid any appearance of a prohibited "view to profit." To protect the owner's property tax exemption, the guest should provide documentation reflecting its own tax exempt status and activities. Last, the agreement should require the guest to pay taxes if exemption is lost because of the guest's use.

For further guidance, please see our website article on nonprofit property use or contact an attorney in our office. ❖

## About Mosherlaw Nonprofit Update



Mosher & Associates publishes a quarterly newsletter for distribution to its clients and other friends to provide helpful information regarding current legal issues affecting nonprofit organizations. Our articles address a wide range of areas including corporate, tax, employment, intellectual property and real estate matters. Some topics are covered sequentially through a newsletter series. Previous newsletters are available at [www.mosherlaw.com](http://www.mosherlaw.com).

If you have a topic or legal area you would like us to address, please send your suggestion via email to [vrehberg@mosherlaw.com](mailto:vrehberg@mosherlaw.com). This newsletter is intended to provide guidance of a general nature and is not intended as legal advice for reliance by individuals or organizations. For specific legal assistance, please feel free to contact an attorney in our office. ❖

## Nonprofit Q & A

### New Form 990-N Reporting Requirements



**Q- What is the IRS Form 990-N?**

**A-** The Form 990-N, commonly referred to as the “e-Postcard,” is the newly-required annual report for all tax-exempt organizations with \$5,000-\$25,000 in gross annual revenues. Note these small organizations did not previously have an

annual filing requirement. The e-Postcard was enacted in the Pension Protection Act to ensure that the IRS and potential donors have current information about small organizations.

**Q- What information is required for the e-Postcard?**

**A-** The Employer identification number (EIN); fiscal year;

site address if the organization has one; confirmation that the organization’s annual gross receipts are normally \$25,000 or less; if applicable, a statement that the organization has terminated or is terminating.

**Q- How and when does a small organization file?**

**A-** Small organizations annually file the e-Postcard on the internet at: <http://epostcard.form990.org> before the fifteenth day of the fifth month after the close of the organization’s fiscal year. Note small organizations cannot file the e-Postcard prior to the close of the organization’s fiscal year.

**Q- What if the organization is late in filing?**

**A-** Organizations that do not file an e-Postcard on time will be sent a reminder notice by the IRS and will not be assessed a penalty for late filing the e-Postcard. However, an organization that fails to file required e-Postcards for three consecutive years will automatically lose its tax-exempt status. The revocation will not take place until the filing deadline of the third year. ❖

## Mosher & Associates

The law firm of Mosher & Associates has developed over the past thirty years in the context of the charitable and philanthropic community. We have helped to successfully establish more than fifteen hundred tax-exempt organizations, many of which we still work with today. Our legal services also encompass a wide range of corporate, tax, employment and real estate issues affecting our tax-exempt clients.

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