CLIENT ALERTS & INSIGHTS

Lobbying by Tax Exempt Organizations - Part 2

JUNE 7, 2022

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Our advice is often sought about forming a charitable organization for personal reasons, corporate philanthropy or to house the charitable/educational activities of a trade association or a social welfare association. There are many considerations to explore when deciding whether to create a new organization, some of which we explore in this bulletin:

Formation

Charitable organizations can be organized as unincorporated associations, trusts or non-profit corporations but the preferred form outside of estate planning considerations is a corporation. A nonprofit corporation can be rather easily formed under state law, but tax exemption under the Internal Revenue Code ("Code") is much more difficult and time consuming to attain and maintain. The Internal Revenue Service ("Service") requires submission of an exemption application and certain accompanying documents to consider an exemption application, including a Code of Regulations and budget.

There are many different types of non-profit organizations, including but not limited to: 501(c)(6) trade associations, 501(C)(4) social welfare organizations, and 501(C)(3) public charities and private foundations.

Organizations which are exempt under Section 501(c)(3) of the Code are considered either public charities or private foundations. A public charity must have at least 1/3 of its support from government grants, grants from other public charities and/or gifts from a broad group of individual givers. When an organization fails to qualify as a public charity, it will by default be a private foundation. Private foundations are subject to complex operational and practical restrictions, and if a private foundation does not comply with these restrictions, it can not only be subject to taxes and penalties for failure to comply but could also potentially lose its tax-exempt status. Most corporate foundations are private foundations because they receive their support from a single corporation and/or people related to that corporation,

All public charities are further classified under Section 509 of the Code. One such classification is a "Supporting Organization" under 509(a)(3). Organizations which are considered supporting organizations under Section 509(a)(3) are considered public charities because of their close relationship to an organization that meets the public support test based on its income sources. This might include, for example, the establishment of a charitable or educational foundation by a trade association to carry out its educational and charitable work. Supporting organizations are considered separate entities and should be managed as such, although they be controlled by the supported organization.

Activities

Before forming a non-profit, we advise clients to carefully consider the types of activities in which they plan to engage, such as lobbying and political activity. No substantial part of the activities of an organization exempt under section 501(c)(3) can be spent on lobbying or other non-exempt activities, while a 501 (c)(4) organization may engage in unlimited lobbying activity and need not report donors. We cover this topic more broadly in Lobbying by Tax Exempt Organizations - Part 1. Many businesses and organizations opt to form additional affiliated non-profit entities to help achieve their goals, such as political action committees, charitable foundations, or social welfare organizations. The laws governing each are very different, and the strategy for selecting one over another is often nuanced. Further, accurate recordkeeping must be established when staff work for both organizations.

Fiduciary Duties

In addition to questions regarding whether and how to form a non-profit, we often provide guidance regarding board governance and fiduciary duties of board members. In general, the fiduciary duties of non-profit board members are those of care, loyalty, compliance, and maintenance of accounts. The duty of care is to be active in the affairs of the organization to ensure its mission is being accomplished.. The duty of loyalty reminds the board members to act in the best interest of the organization and avoid benefiting unfairly from their relationship with it. These duties should be recognized and honored independently if a board member serves in a dual capacity on an affiliated or supported organization, for example. Board trainings and policies can also be a tool to manage board member expectations.

Penalties

Tax exempt organizations are highly regulated “businesses” and failure to follow the tax rules can result in fines, penalties and additional taxes, but can also result in revocation of tax-exempt status where already granted.

Proposed Legislation

The Ohio Legislature is currently considering House Bill 556, which proposes to make changes to Ohio’s non-profit corporation statute. The bill, sponsored by Rep. D.J. Swearingen (R- Huron), was unanimously voted out of the House last week, during their last day of session before summer recess. Benesch’s Holly Gross, who serves as Vice Chair of the Ohio State Bar Association Nonprofit Corporation Subcommittee, and Marty Sweterlitsch, worked to advance two significant amendments adopted by the Committee, and also testified on the measure, which you can view here. The bill now heads to the Ohio Senate for consideration.

Consider contacting the Benesch Government Relations Team should you wish to be involved in the legislative process as the bill heads to the House floor and Ohio Senate for consideration.

Benesch assists not for-profit and tax-exempt clients in a broad array of matters, ranging from filing for not for-profit status and preparing federal and state tax exemption applications to training in not-for-profit regulatory compliance.

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