

"A road map on how to meet legal obligations and further the good work of the charitable missions that are an essential part of the fabric of American life." Chuck Grassley, United States Senator, Iowa

Nonprofit Law & Governance

FOR

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Jill Gilbert Welytok, JD, CPA
Daniel S. Welytok, JD, LLM
Foreword by U.S. Senator Chuck Grassley

*Tips for best
practices to comply
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***Nonprofit Law &
Governance For Dummies***

**by Jill Gilbert Welytok,
JD, CPA and Daniel S.
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Wiley Publishing, Inc.

Nonprofit Law & Governance For Dummies®

Published by

Wiley Publishing, Inc.

111 River St.

Hoboken, NJ 07030-5774

www.wiley.com

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Indianapolis, Indiana

Published by Wiley Publishing, Inc., Indianapolis, Indiana

Published simultaneously in Canada

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Library of Congress Control Number: 2007924229

ISBN: 978-0-470-08789-3

Manufactured in the United States of America

10 9 8 7 6 5 4 3 2 1



I can't imagine American society without nonprofit work, and I sure don't want to. Disaster relief, sheltering the homeless, feeding the poor, mentoring young people, and after-school programs are all in a day's work for charities and churches in every community.

Helping a neighbor is as ingrained in our culture as freedom of speech and the right to vote. Many spend precious leisure hours driving the elderly to doctor appointments or building houses for deserving families. And many Americans find an extra dollar for the Salvation Army kettle or cancer research. Some people can give more than others. Regardless, all Americans reap incalculable benefit from charities.

Reflecting these values, the federal tax code gives generous tax breaks to non-profit groups. Each year, the federal government foregoes the collection of about \$280 billion in taxes from non-profit groups.

For decades, Congress handed out these tax breaks without much thought. But then some headlines grabbed our attention. The foundation executive in Boston who dipped into the charity's funds to pay for his daughter's expensive wedding. Organizations that were charities in name only because they were used as tax shelters by self-enriching individuals. The car owner who deducted thousands of dollars for donating to charity his 1976 AMC Pacer that goes only in reverse. The well-traveled safari hunter who wrote off his entire trip to South Africa by donating a dusty stuffed ibex head to a museum that never cared to display its prize.

These abuses of American generosity — as reflected in the federal tax code — were outrageous. They threatened the good reputation of charities. They mocked honest taxpayers. Congress needed to act, and we did. We made clear that favorable tax treatment is a privilege, not a right. With this privilege comes a great responsibility — by both the government and individual nonprofit organizations — to safeguard the public trust. We need to protect donors by ensuring contributions are used appropriately. We need to protect taxpayers by guaranteeing that tax benefits given to public charities correlate with the benefits that public charities provide to society. Government officials fulfill this responsibility to both donors and taxpayers with effective oversight and with laws that minimize the potential for abuse while also providing incentives for charitable giving.

As chairman of the Senate Committee on Finance, I worked to reform the laws that relate to nonprofit organizations. In my current capacity as the senior-most Republican on the Finance Committee, I'll continue that work. We need to make nonprofit operations more transparent and improve nonprofit governance. Among all charities, of those that have failed their mission, I've found that poor board governance unites all of them. A vigilant and committed board is key to making sure charities stay focused on the goals that encourage people to give.

Nonprofit organizations play an important role in safeguarding the public trust. They need to be guided by the best practices in the charitable field. Those put forward by the Independent Sector's Nonprofit Panel and the Better Business Bureau Wise Giving Alliance are two good examples among many others. This book is another important resource for nonprofit organizations. It's a

road map on how to meet legal obligations and further the good work of the charitable missions that are an essential part of the fabric of American life.

Chuck Grassley United States Senator, Iowa

About the Authors

Jill Gilbert Welytok, JD, CPA, LLM, practices in the areas of corporate law, nonprofit law, and intellectual property. She is the founder of Absolute Technology Law Group, LLC (www.abtechlaw.com). She went to law school at DePaul University in Chicago, where she was on the Law Review, and picked up a Masters Degree in Computer Science from Marquette University in Wisconsin where she now lives. Ms. Welytok also has an LLM in Taxation from DePaul. She was formerly a tax consultant with the predecessor firm to Ernst & Young. She frequently speaks on nonprofit, corporate governance–taxation issues and will probably come to speak to your company or organization if you invite her. You may e-mail her with questions you have about Sarbanes-Oxley or anything else in this book at jwelytok@abtechlaw.com. You can find updates to this book and ongoing information about SOX developments at the author’s website located at www.abtechlaw.com.

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Dedication

To Tara, Julia, and Daniel Welytok

Authors' Acknowledgments

We would like to thank the following people:

Judith Steininger, nonprofit consultant. Judy is a professor emeritus at the Milwaukee School of Engineering and a former Peace Corps volunteer. She has served on numerous nonprofit boards, including Hoan Foundation, Patrick & Beatrice Haggerty Art Museum, Dominican High School, Girls Scouts, Milwaukee County Council, and Milwaukee Chamber Theater. Judy is a great philanthropist and a Milwaukee treasure, and her perspective on this book has been invaluable.

Amy Seibel, technical editor, attorney, CPA. Amy is an AV-rated attorney with more than two decades of experience in the nonprofit and corporate governance realm. We have been very fortunate to have her as a technical editor on this book.

Donna Mortara, school board member, community volunteer. Donna is one of those influential community members who quietly seems to be everywhere getting things done and balancing community interests. She is approachable with concerns and creative in addressing them. We are fortunate that she has shared here perspective with us as a responsive community volunteer over the years.

We would also like to thank **Ron Jones** and **Dan Steininger** for their kind words about the book. And we're especially grateful to **Senator Chuck Grassley** for taking time out of his busy schedule to write the foreword.

Publisher's Acknowledgments

We're proud of this book; please send us your comments through our Dummies online registration form located at www.dummies.com/register/.

Some of the people who helped bring this book to market include the following:

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Layout and Graphics: Claudia Bell, Carl Byers, Joyce Haughey, Laura Pence, Alicia B. South

Anniversary Logo Design: Richard Pacifico

Proofreaders: Laura Albert, Aptara

Indexer: Aptara

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Introduction

Welcome to *Nonprofit Law & Governance For Dummies*. This book takes you on a tour of the nation's nonprofits in the world of Sarbanes-Oxley and enhanced financial oversight. Whether you're a board member, officer, volunteer, employee, or donor, this book is for you. It's designed to tell you where you fit into the gears of the nonprofit sector (which incidentally employs one out of seven Americans).

Having the big picture straight in your mind helps ensure that you won't lose track of the mission of your organization in the details of daily administration or the pressure of public scrutiny.

About This Book

In the wake of the Sarbanes-Oxley Act, or SOX, questions have been raised about the overall health of the nation's nonprofit sector. In addition, in the wake of the September 11, 2001, terrorist attacks and Hurricane Katrina in 2005, questions have been raised as to the financial fitness and oversight of this important sector of our economy. The sector itself has taken an approach of proactively governing itself and working with legislators to bring about reasoned reforms.

The goal of *Nonprofit Law & Governance For Dummies* is to give you a helicopter view of the regulatory terrain, while giving you enough detail to spot the legal landmines within your own organization. This book is also intended to give you the level of insight you need for practical, cost-effective decision making.

For example, this book can help you do the following:

✓ **Understand what types of organizations make up the United States nonprofit sector:** The nonprofit sector of the U.S. economy is larger than the economies of many small countries. It consists of organizations ranging from informal community groups to private foundations and complex corporate structures with multiple divisions and subsidiaries.

✓ **Understand the role of the Internal Revenue Service:** The Internal Revenue Service, or IRS, is the primary federal organization that regulates nonprofit organizations. It wields the power to grant, deny, or revoke organizations' tax-exempt status.

✓ **Comply with state laws and regulations:** Even though the federal government is the primary arbiter of tax-exempt status, states take an avid interest in what types of entities are formed, how funds are solicited, and other activities that are conducted within their borders.

✓ **Avoid lawsuits and adverse regulatory actions:** This book, although not intended as a substitute for a good securities lawyer or certified public accountant, takes a hard look at the types of liability that board members, officers, employees, and other volunteers can incur when they're involved

in carrying out the mission of a nonprofit organization. It also gives you an idea of who incurs liability under SOX and how you can avoid having your company (or yourself) added to the list of litigants.

✓ **Anticipate future rules and trends:** Regulation of the nonprofit sector is constantly evolving, and it has gained momentum following the highly publicized scandals involving such organizations as the Red Cross and the United Way. This book takes a look at how new regulations and scrutiny may affect nonprofits at all levels.

Conventions Used in This Book

It's unfortunate, but true: Understanding the nonprofit sector and the laws that apply to these organizations means that you're going to run into lots of legal jargon and accounting minutiae. To give you a jump-start, we define some legal and accounting terms in this book and use *italics* to make such terms stand out a bit.

Also, so that they're easy to spot and easy to read, we have placed all Web sites (and there are plenty!) in monofont.

What You're Not to Read

We occasionally wander off-topic to discuss something historical, technical, or interesting (or, at least, interesting to us!). In these instances, we set the discussions apart by placing them in sidebars, which are the gray boxes that you'll see from time to time throughout the book. Because the text in sidebars is nonessential, feel free to skip it if it doesn't interest you.

What We Assume About You

In writing this book, we had to make a few assumptions about who our readers would be and what kind of information they'd be looking for. First of all, we assume that you want to understand the legal and regulatory issues facing nonprofits in a way that you can't achieve by suffering through the thousands of pages of statutes and regulations, including the Internal Revenue Code. We also assume that you want to keep up with the most important legislation and standards regarding nonprofits and that you want to figure out exactly how they affect your organization.

Whether you're a board member, executive director, staff person, volunteer, donor, or you head up a private foundation, this book is for you. Nearly everyone in the United States has some sort of stake in the vitality of our nation's nonprofit sector. This book helps you understand

some of the following issues, which are universal concerns to nonprofit stakeholders:

- ✓ How an effective nonprofit should operate
- ✓ The complex overlay of federal and state laws that apply to nonprofits, including IRS regulations
- ✓ What standards should be voluntarily adopted by your organization
- ✓ How to maintain an effective and smoothly functioning nonprofit board
- ✓ The best ways to stay true to the mission of your organization

How This Book Is Organized

Nonprofit organizations vary widely in size, mission, organizational structure, and practices. The index and table of contents can help you find your way to the parts of the book that are most relevant to your organization. The chapters in this book treat each topic independently without assuming you've read previous chapters (as a textbook might), so you can use them as references and jump around to find what you need. *Nonprofit Law & Governance* is divided into six parts, which we explain in the following sections.