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PubPol 671:

# Policy & Management in the Nonprofit Sector

Lecture 4: Legal and Regulatory Overview

Neel Hajra



# Report from the Field

- **Citizens United vs. F.E.C.**
  - Bars limits (via PAC rules) on express advocacy and electioneering communications
  - Impact on nonprofit sector?



# Report from the Field

- Lee: Replicating the Harlem Children's Zone



# Notes

- First paper assignment will be posted by this weekend (see lecture 2 slides for general options)



# Recap of Previous Class

- Economic: Three Failures Theory
- Political Theories
- Re-Valuing the Sector

# Re-Valuing the Sector: Rankings!

| Group                        | All | Some | None |
|------------------------------|-----|------|------|
| 4. Social Services           | 3   | 1    |      |
| 8. Philan. Intermediaries    | 3   | 1    |      |
| 9. International             | 3   | 1    |      |
| 10. Religion                 | 3   | 1    |      |
| 5. Environment               | 2   | 2    |      |
| 6. Housing/Devel             | 2   | 1    |      |
| 2. Education / Research      | 1   | 3    |      |
| 7. Law / advocacy / politics | 1   | 3    |      |
| 1. Culture/Rec               |     | 4    |      |
| 3. Health                    |     | 3    | 1    |
| 11. Biz, prof. associations  |     | 3    | 1    |



# Re-Valuing the Sector: Reasons!

| #  | Reason                          |
|----|---------------------------------|
| 16 | Market Failure                  |
| 16 | Experimentation                 |
| 16 | Historical                      |
| 14 | Diversity / Pluralism / Freedom |
| 13 | Subsidies                       |
| 12 | Government Failure              |
| 10 | Free Riders                     |
| 9  | Categorical Constraint          |
| 7  | Consumer Control                |
| 6  | Political                       |
| 5  | Solidarity                      |
| 1  | Voluntary Failure               |



## Knight Foundation Article from last class

- Collapse of “traditional” media, reformation within nonprofit sector
- What does this reveal about the role of the nonprofit sector?



# This Class

- Understand the general legal framework for domestic nonprofits
- “Kitchen sink” approach!

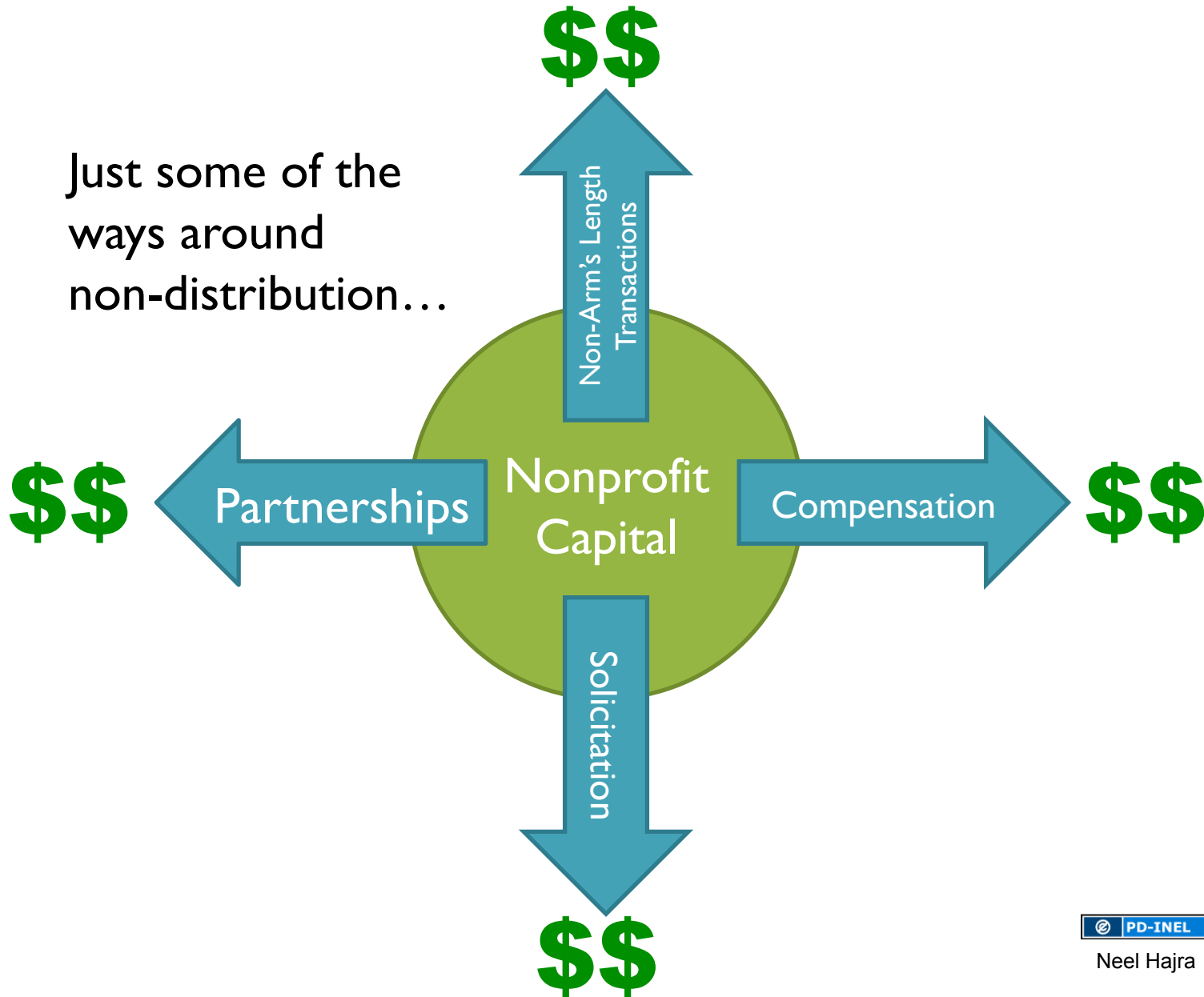


# Why Important?: Management

- Operating in compliance with law
- Understanding rights and limitations
- Effecting policy reform

# Why Important? Enforcement

Just some of the ways around non-distribution...

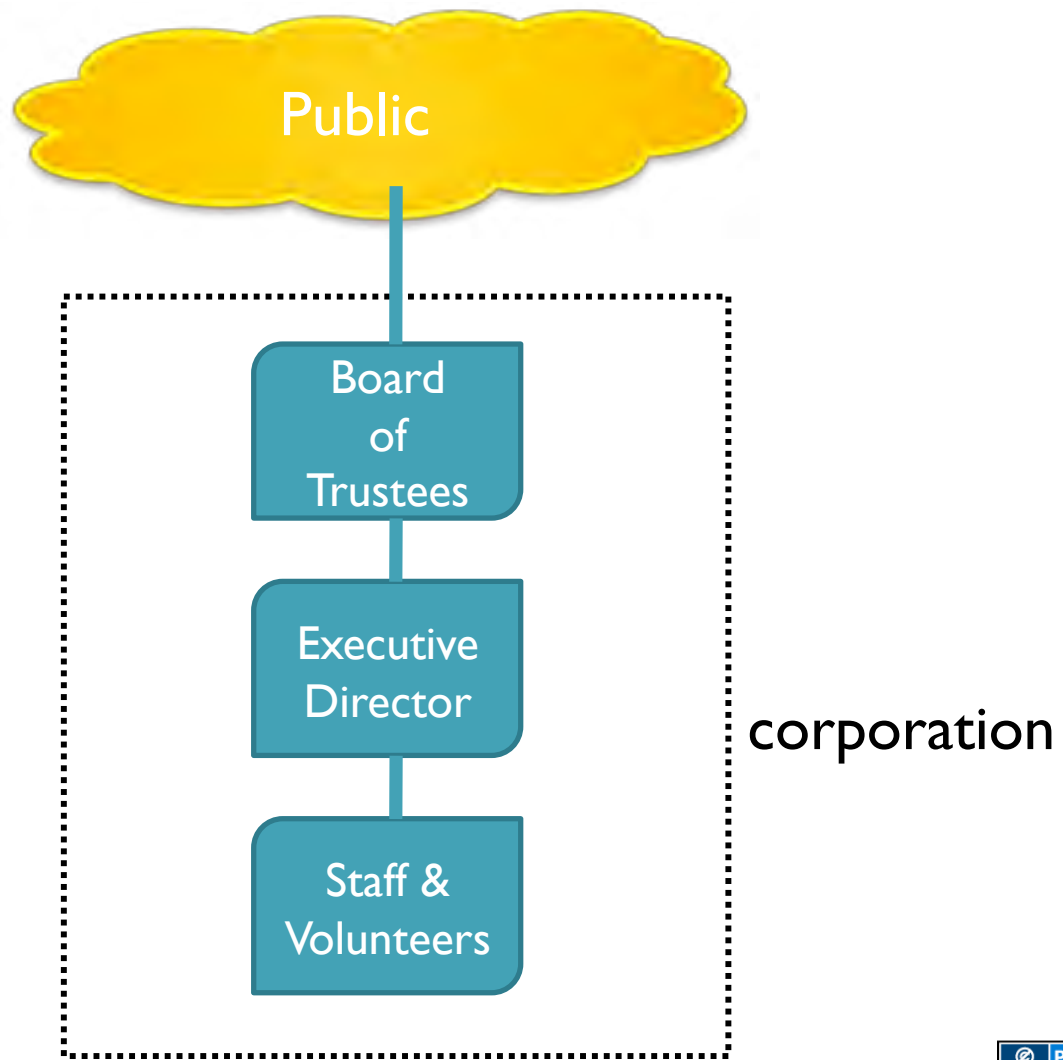




# Regulatory Pathway

- State: Corporate form
- Federal: Federal tax exempt status – 501(c)(3)
- State: State tax exemptions
- Local: Property tax
- 501(c)(3) nonprofit is a state nonprofit corporation with federal tax exempt status

# Corporate Form





## Recap: Benefits of Corporate Form

- Limited liability
- Perpetual existence
- Employee benefits
- Formality and structure
- For state: regulation!





**Next:**  
**State Regulation**



# State Corporations Acts

- Nonprofit corporation created under state law
- Variance from state to state, but no major disparities



# Articles of Incorporation

- Basic characteristics
- Filed Articles = corporation created
- Standard Articles for Michigan



# Articles of Incorporation

- Name
- Mission
- Basis, Assets, Budget, Governance
  - Non-stock vs. Stock
  - Simple assets & budget
  - Directorship vs. Membership



# Articles of Incorporation

- Location of Office
- Incorporators
- (extra) Include IRS restrictions
- (extra) Protect board & volunteers
  
- Note –
- indemnity, nonprofits, risk management



# Bylaws

- Internal regulation and management
- Adopted at first meeting by the new board



## Bylaw requirements and recommendations (for MI)

- Purpose: “As stated in the Articles of Incorporation.”
- Number of Directors: Must have three. Recommend at least five.
- Term for Directors: Must be at least one year. Recommend at least two years and staggered terms.
- Board Meetings: Must be at least annual, recommend monthly during first year.



## Bylaw requirements and recommendations (for MI)

- Officers: Must have President, Secretary, and Treasurer. Recommend Vice-President as well.
- Quorum
  - Must have at least a majority when Board is  $< 7$
  - Must have at least  $1/3$  when Board is seven+
  - Recommend majority





# Director Fiduciary Duties

- Loyalty
  - Care
  - Confidentiality
- 
- (much more about this in Lecture 6)



# Charitable Solicitation License

- Required by every state
- Based on amount requested, not amount received
- One year licenses



# Attorney General

- Main agent for enforcing nonprofit regulatory compliance
- Often lax and/or uncoordinated regulation



# **Next: Federal Regulation**



# Internal Revenue Code

- Section 501c is primary section for nonprofits
- 501(c)(3) is for charitable nonprofits
- Within 501(c)(3):
  - Private foundation
  - Public charity



# Organizational Test

- Articles of Incorporation
  - Exempt purpose
  - Assets irrevocably pledged to charitable causes



# Operational Test

- Engaged primarily in exempt purpose activities
- Unrelated activities must be “insubstantial”

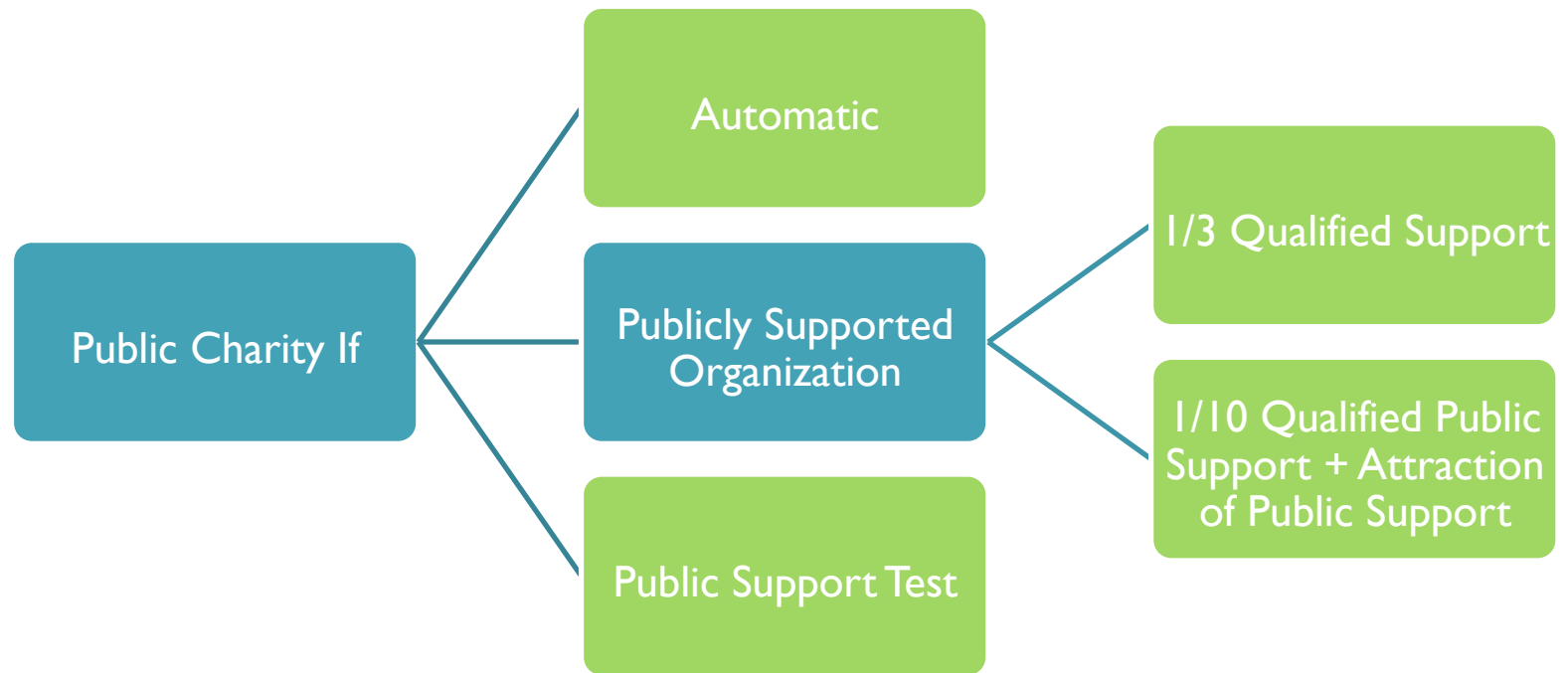


# Unrelated Activity

- “Commercial”
- UBIT
- Exceptions
  - Voluntary work
  - “convenience” businesses
  - Sales of donated goods
  - Etc.

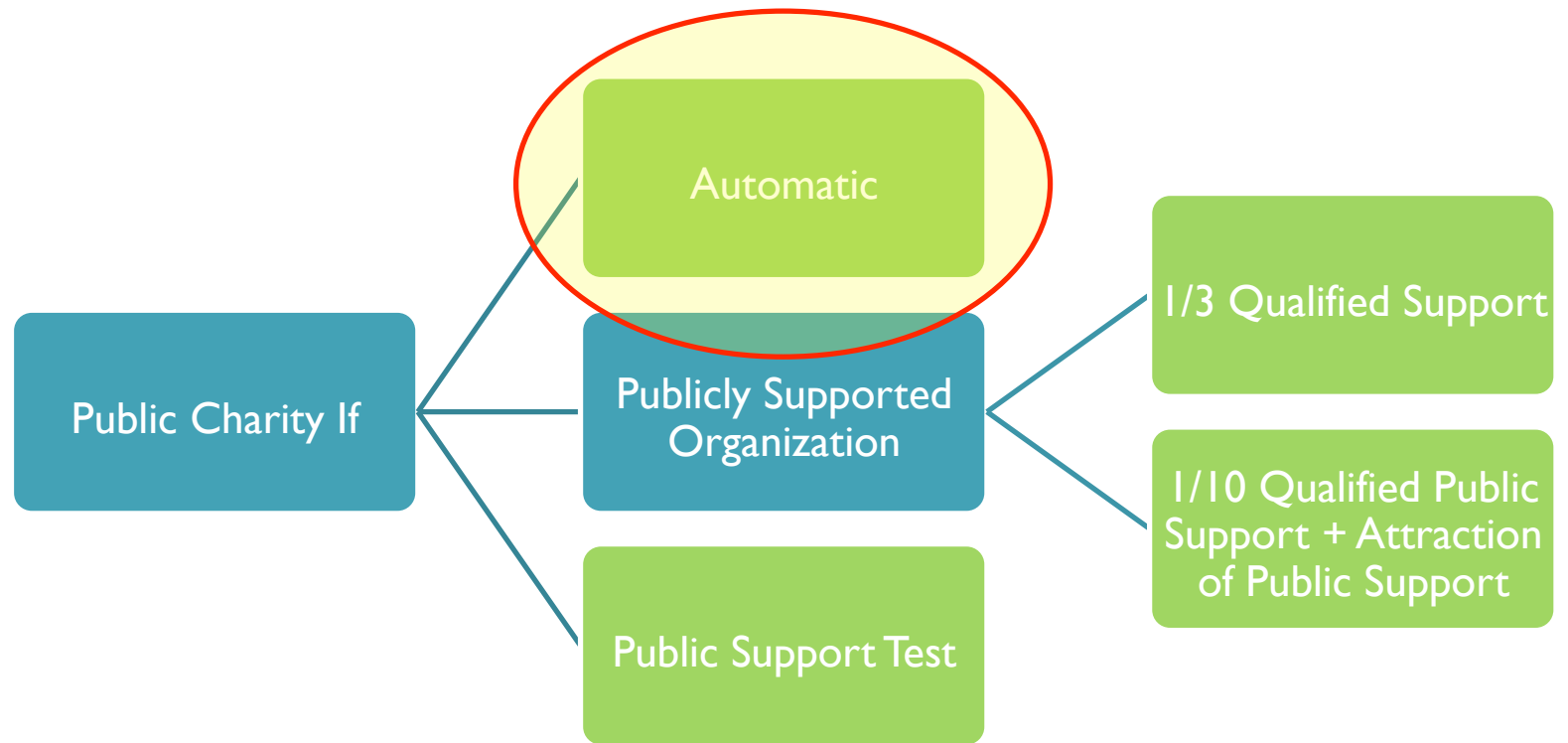


# Public Charity Qualification: Four Ways to Qualify



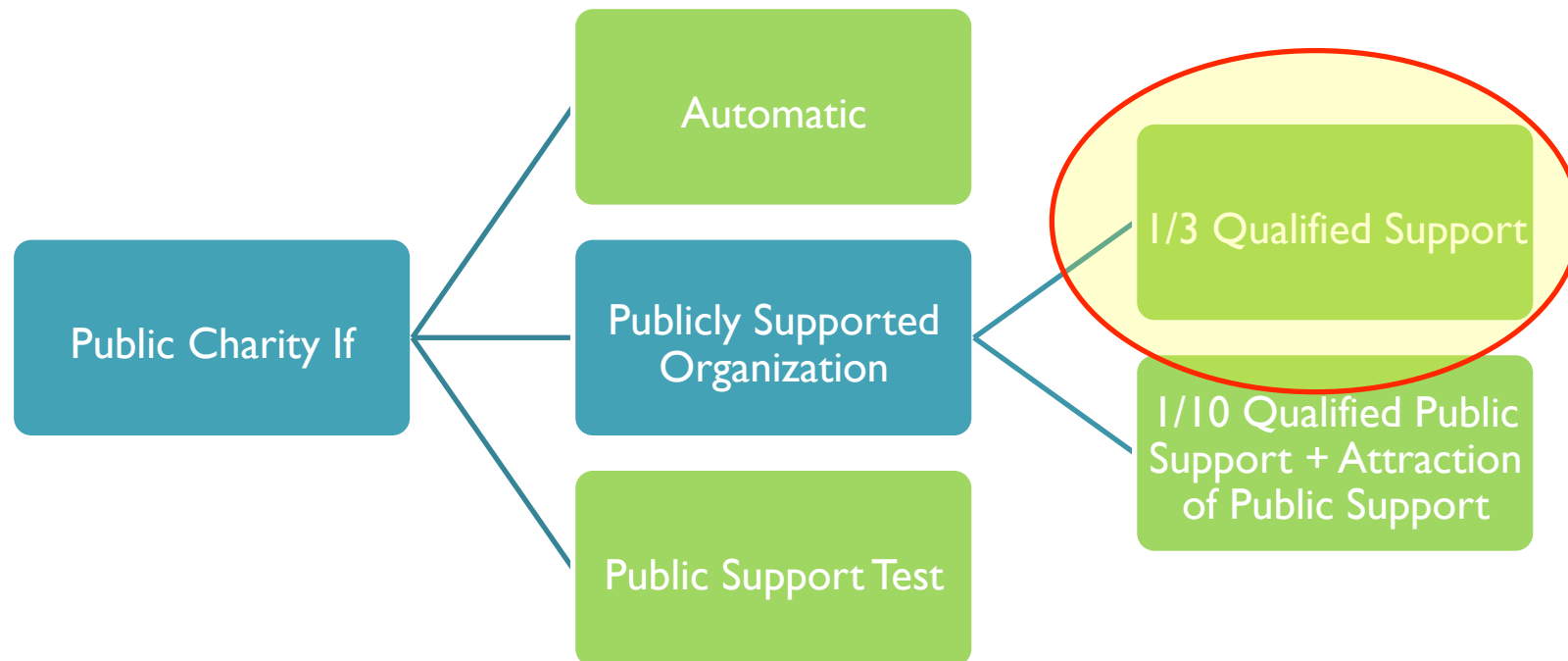
Very important to be cognizant of this rule,  
especially for young nonprofits

# Public charity test I



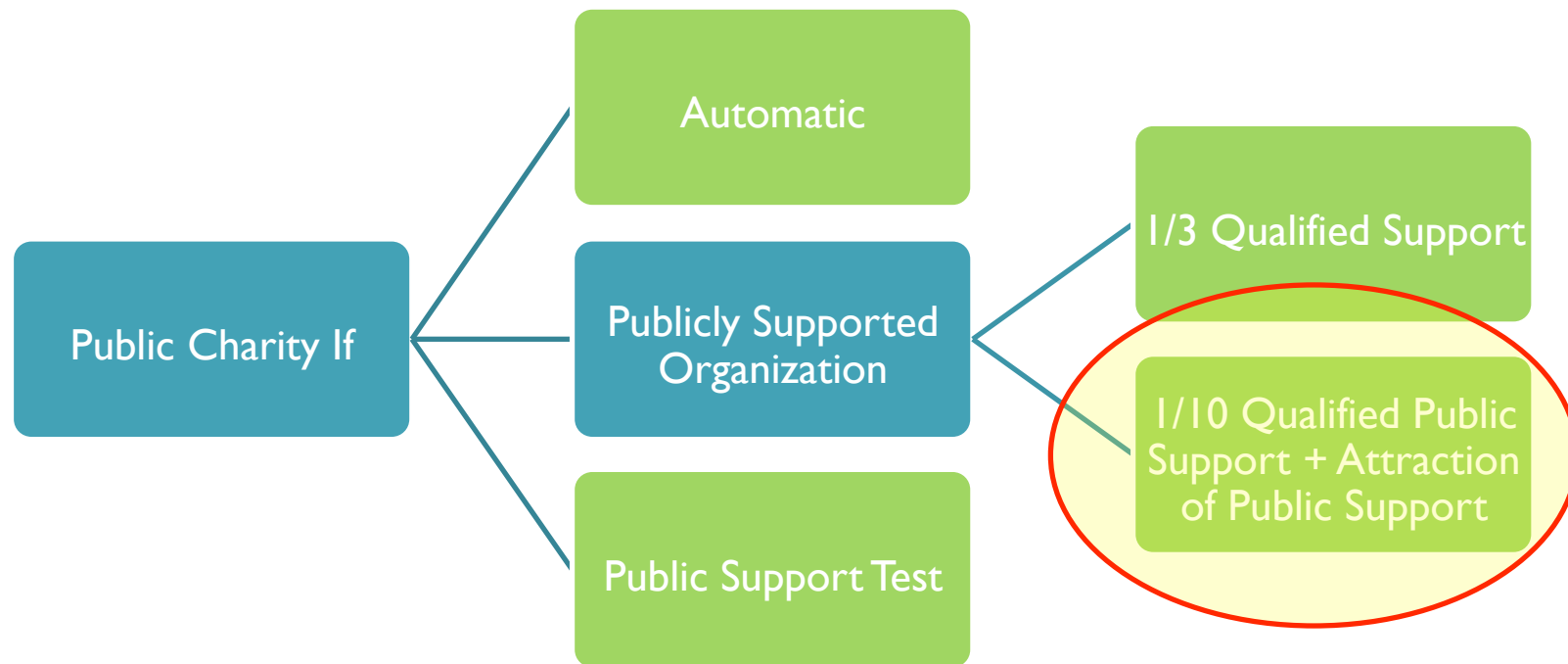
**Automatic qualification:** Churches, institutional schools, hospitals/medical research organizations, public safety organizations, governmental organizations, supporting organizations

# Public charity test 2a



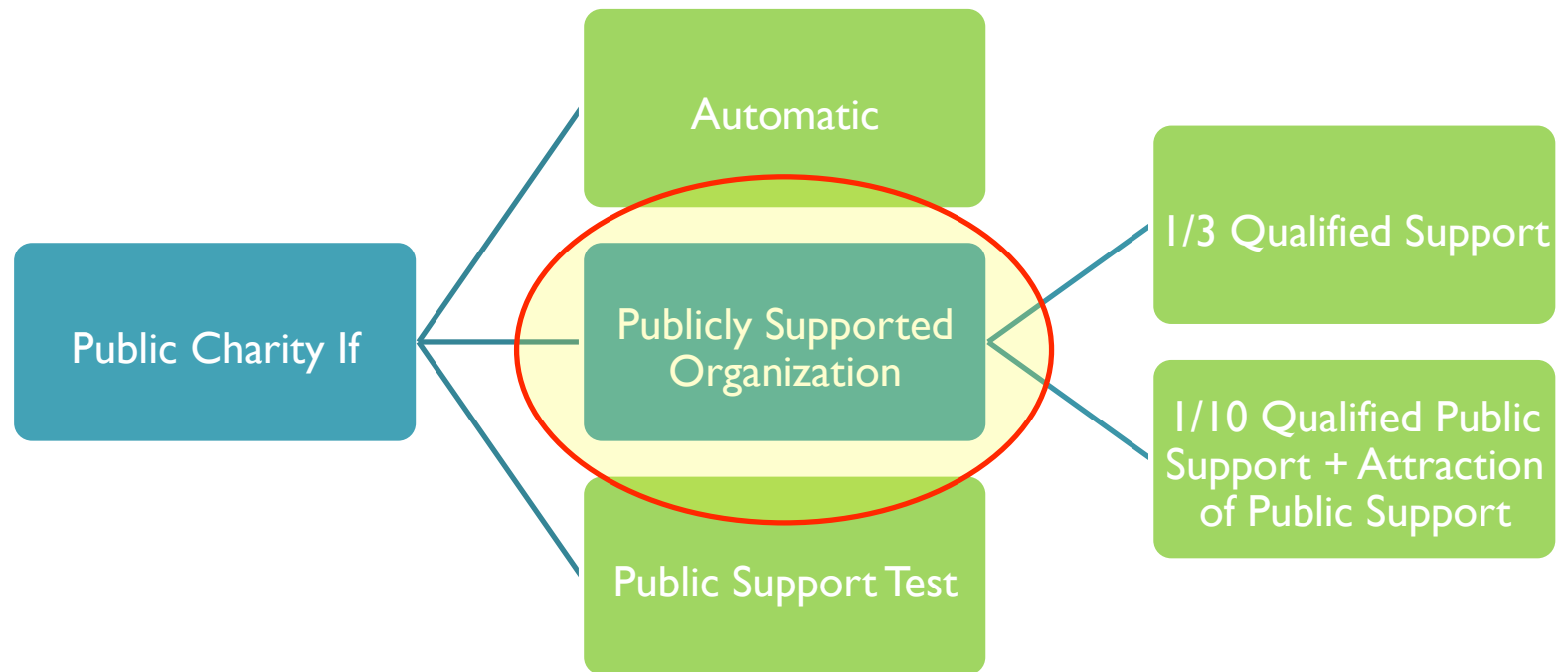
- 1/3 of total support from “qualified support”
- “Qualified support” – includes no more than 2% of total income from any single donation
- Exceptions for large single donations, “unusual grants”, and donations from publicly supported groups

# Public charity test 2b



- 1/10 of total support from “qualified support”
- “Attraction of public support” considers number of factors: Continuous solicitation of funds (required), percentage of support, support from representative group, representative governing body, availability of service to public, held accountable by other public funders

# Public charity test 3



**Normally receive 1/3 of support from combination of:**

- Qualified support and
- Gross receipts from activities related to exempt purpose



## Reich: “Anything Goes”

- 99% approval rate!
- What does this say about:
  - Standards?
  - Regulation & Oversight?
  - Bureaucracy?



# Lobbying

- “Not substantial”
- Issues vs. Legislation
- 501(h) - clear standard!:
- 20% of the first \$500,000
- + 15% of the next \$500,000
- + 10% of the next \$500,000
- + 5% of the remaining
- = the overall lobbying limit



# Elections

- Bright line prohibition!
- (have you seen violations of this?)