Emerging Legal Questions in Today's Boardroom

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All too often, board members stifle their own potential to be great leaders by staying in the dark on important legal issues. Some of the current trends creating new risks for nonprofit boards and a stronger need for updated governance discussions in the boardroom include the increased attention to earned income and social enterprise, greater utilization of technologies and social media, heightened demands for transparency, and growing need for nonprofit advocacy. This article provides an introduction to some of the key legal principles and tips every board should consider in these areas in order to lead more confidently and effectively in today's nonprofit landscape.

Earned Income and Social Enterprise

Earned income has long been an important source of revenues for many nonprofits. As the National Center for Charitable Statistics estimated, nearly 70% of the $1.4 trillion generated by nonprofits in 2008 was from the sale of goods and services.[2] An increased attention to social enterprise and earned income strategies has resulted in part due to waning charitable contributions, grants, and government funding combined with increasing operating costs and demands for services. The *Giving USA 2011* report noted that donations dropped in 2008 and 2009 by the highest percentages in the past five decades and predicted donations may not reach pre-recession levels until 2016.[3] Another recent study reported that 7 in 10 Americans will give more sparingly in the remaining months of 2011 and only 2 out of 10 respondents would consider supporting an organization they had not previously supported.[4] Under such circumstances, it is not surprising that organizations are looking for untapped revenue sources. Rather than venturing into a completely unknown area, organizations are often advised to earn revenues by expanding existing areas of service (i.e., pursue the low-hanging fruit).

Related v. Unrelated Income

From a federal tax perspective, earned income of nonprofits is categorized as either related or unrelated income. A nonprofit organization should be concerned about the classification of its earned income for two main reasons:

1. The income may be subject to an unrelated business income tax (UBIT) that is equivalent to the corporate tax rates; and

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[2] The Urban Institute, National Center for Charitable Statistics, *Nonprofit Sector In Brief: Public Charities, Giving, and Volunteering, 2010*.

[3] The Center of Philanthropy at Indiana University, *Giving USA 2011: The Annual Report on Philanthropy for the Year 2010*.

[4] Durham+Company, "Two-thirds of Donors Plan to Cut Back On Charitable Giving Due to Economic Woes" (Aug. 23, 2011).

2. An exempt organization cannot engage in more than an insubstantial amount of unrelated business activity without risk of losing its tax-exempt status. No exact amount or percentage exists to define this threshold. While some advisors use a common rule of thumb that generating less than 20% of gross income from unrelated business activity is likely permissible, the more telling concern is the percentage of organizational resources (e.g., assets, time) devoted to the unrelated business activity.

An unrelated business activity is (1) any trade or business; (2) regularly carried on; (3) not substantially related to the furtherance of the organization's exempt purposes.[5] The third factor is often the more difficult factor to analyze and involves a highly fact-sensitive inquiry. To be substantially related, the activity must contribute importantly to accomplishing the organization's exempt purpose other than through the production of income.[6] This reinforces the underlying rationale of the rule in preventing unfair competition between taxable and tax-exempt entities.

There are exceptions for activities that may otherwise generate unrelated business income. Common exceptions include a business where substantially all of the work is performed by volunteers; a business carried on primarily for the convenience of the organization's members, students, patients, officers, or employees; and the selling of merchandise, substantially all of which has been donated.[7] There are also exclusions from unrelated business taxable income for certain items of passive income (e.g., dividends, interest, annuities, royalties, rents from real property, and capital gains).[8]

The Internal Revenue Service (IRS) has shown increasing concern that earned income is not being properly reported or allocated by organizations.[9] The IRS now requires exempt organizations to report whether it received more than $1,000 in gross unrelated business income on the Form 990 in order to flag the additional Form 990-T filing requirement.

Legal Form

Another consideration regarding earned income is whether to conduct the activities in-house or through another entity such as a subsidiary. This is a common consideration for unrelated business activity due to the risk of jeopardizing the organization's tax-exempt status. This may also be a relevant consideration for related activities that have a different risk profile from the core activities of the organization. Moving such business activities to a subsidiary can provide other benefits such as:

- Greater protection of the existing nonprofit from debts and claims involving the subsidiary and its activities;

[5] IRC Section 513; IRS Publication 598, *Tax on Unrelated Business Income of Exempt Organizations*.
[6] Treas. Reg. 1.513-1(d)(2).
[7] IRC Section 513(a).
[8] IRC Section 512(b).
[9] *See, e.g.*, IRS Exempt Organizations, *Colleges and Universities Compliance Project, Interim Report – May 7, 2010*.

- Better preservation of the existing nonprofit's organizational culture by keeping the subsidiary's activities outside of the organization; and
- Minimized association between the existing nonprofit's reputation and goodwill and the reputation and goodwill associated with the subsidiary's activities.

Traditionally, a nonprofit organization chose between forming a nonprofit or for-profit subsidiary. In recent years, new hybrid legal structures such as the Low-profit Limited Liability Company (L^3C)[10] and the Benefit Corporation[11] have emerged as new, but less tested, options. These hybrid organizations are generally taxable and can be formed by individuals and entities other than nonprofits. Hybrid legal structures have been met with mixed reviews in the sector. Some commentators and organizations, including the Council on Foundations, view these structures favorably as potential vehicles for social entrepreneurs and investors that offer greater liability protection for corporate directors pursuing double or triple bottom lines; some view these structures as competitors and threats that may "siphon off much-needed resources from effective existing nonprofits";[12] and others are hesitant or skeptical of these yet to be tested structures.

Certainly, the continuing developments in the social enterprise field are making decisions about earned income strategies all the more rich and complex. A board must exercise reasonable care in determining whether a business activity should be undertaken. The board should take into account both legal and non-legal considerations such as:

- The organization's mission (e.g., whether this significantly furthers the mission or creates risks for mission creep);
- Tax implications (e.g., sales, property, income tax);
- Potential private inurement or private benefit[13] issues, whether actual or perceived (e.g., joint ventures with a founder or director, individuals compensated by both the parent and subsidiary);
- Organizational capacity (e.g., experienced staff, volunteers, administration support for the business activity);
- Culture compatibility (e.g., whether the concept of earned income and the particular activities fit with the existing nonprofit's organizational culture or create cultural dysfunction);

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[10] The L^3C, also known as the "for-profit with the nonprofit soul," is a limited liability company that is legally required to have a primary charitable or educational purpose. Profit may not be a significant purpose and the L^3C may not engage in electioneering or lobbying. The L^3C has been promoted as a vehicle for tapping into historically underutilized program-related investments by private foundations. More information can be found at http://www.americansforcommunitydevelopment.org.

[11] The Benefit Corporation is legally mandated, among other requirements, to have a material, positive impact on society and the environment, as measured by a third-party standard, through activities that promote a combination of specific public benefits. More information can be found at http://www.bcorporation.net.

[12] AB 361 Assembly Third Reading (as amended May 19, 2011).

[13] The IRS "Inurement/Private Benefit – Charitable Organizations" webpage states in part: "A section 501(c)(3) organization must not be organized or operated for the benefit of private interests…. No part of the net earnings of a section 501(c)(3) organization may inure to the benefit of any private shareholder or individual. A private shareholder or individual is a person having a personal and private interest in the activities of the organization" (last visited Aug. 26, 2011).

- Directors' fiduciary duties (e.g., making reasonable inquiries, acting in the best interests of the existing organization, complying with applicable prudent investor rules); and
- Other costs (e.g., insurance, licenses, permits).

Technology and Social Media

Nonprofits are increasingly facing pressure to adopt new technologies to improve internal efficiency and streamline data management. Nonprofits have generally been considered slower than for-profits in this transition, many times due in part to cost barriers or low prioritization, and organizations that do embark on this road often face difficult, less familiar challenges such as protecting against electronic security breaches and privacy violations, implementing document retention and destruction policies for digital data, and handling the inevitable software or hardware malfunction. Social media, however, is one place that nonprofits lead the pack. A recent University of Massachusetts Dartmouth study reported that social media use by the largest U.S. charities continues to outpace for-profits and academic institutions and estimated that 97% of the charities surveyed have a Facebook profile, 96% have a Twitter presence and 64% have a blog.[14] The recent 2011 Nonprofit Social Network Benchmark Report published similar findings for nonprofits of all sizes, estimating that 92% of nonprofits, regardless of their size, are using at least one commercial social network such as Facebook, Twitter, or LinkedIn.[15] Other trends have also emerged in how nonprofits utilize technology for communication. Most organizational websites are also vehicles for soliciting charitable contributions, raising new questions for state charity regulators. Additionally, boards have increasingly used technology to facilitate board activity, especially when board members are geographically dispersed or meet infrequently, raising new questions about governance.

Social Media

Social media is often a double-edged sword for organizations. The access barriers are low and the potential for engagement is enormous; a social media presence can be created within minutes and information can be shared with millions of people with just one click. This informal and easy nature of social media, however, fails to reflect the potentially serious legal risks they present. All too often organizations are quick to join the frenzy without also taking the time to establish adequate policies or procedures[16]. Additionally, the greatest harm to a nonprofit organization may come in the form of negative press or public distrust rather than lawsuits. The media and public regularly scrutinize organizations in how they are portrayed online as well as how they handle adverse responses and potential public relations nightmares. Boards should consider how to:

- Minimize risks such as defamation, intellectual property violations (e.g., trademark), dissemination of inaccurate information, organizational or personal

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[14] The University of Massachusetts Dartmouth, Center for Marketing Research, *Social Media Usage Now Ubiquitous Among US Top Charities, Ahead of All Other Sectors* (Mar. 2011).
[15] NTEN, Common Knowledge, and Blackbaud, *2011 Nonprofit Social Networking Benchmark Report*.
[16] Nonprofit Law Blog, "Social Media Policy Resources for Nonprofits" (Sept. 29, 2010)

privacy violations, harassment, breach of confidential information, anti-trust violations[17], negative press, and the loss of public trust;

- Provide adequate training and education for individuals acting on behalf of the organization online, such as its staff or volunteers, on the organization's social media strategy; and
- Document policies such as terms of use/user agreements, disclaimers, listserv or blog moderation guidelines, and an emergency public relations plan.

Charitable Solicitation Requirements

The popularity of Internet solicitations is raising new questions about this often forgotten legal requirement. Currently, 40 states require registration by nonprofit organizations performing charitable solicitations within their jurisdictions[18] but their laws either fail to address Internet solicitations or do so in limited fashion. The Charleston Principles, a set of principles adopted by the National Association of State Charity Officials (NASCO) to provide guidance to state charity officials on Internet charitable solicitations, suggests that registration be required when the organization solicits contributions through an interactive website and either "specifically targets persons physically located in the state for solicitation, or receives contributions from the state on a repeated and ongoing basis or a substantial basis" through its website.[19] Whether a "donate now" button, for example, or a certain amount of contributions from a state's residents via Internet solicitations triggers a registration requirement is ultimately determined on a state-by-state basis. Accordingly, boards of organizations conducting Internet solicitations should address such potential registration requirements with appropriate advisors.

E-mail Voting

Most states have provisions that authorize boards to take an action without a meeting by written consent. Prior to electronic communications, directors signed hard copy written consent forms that were then filed with the corporate minutes. Today, it not uncommon to find boards using e-mail replies with "yes" or "no" as a means for taking board actions. However, many state laws either do not expressly authorize this practice or fail to address e-mail voting. Thus, it is unclear whether an e-mail reply can provide a valid form of written consent. A direct consequence of an invalid vote may be an invalid board action, which could result in any number of undesirable situations such as the unenforceability of contracts thought-to-have-been validly approved by the board or a recall election. Additionally, there is concern that the ease and expedited nature of e-mail voting may actually cut against improved board governance by discouraging thorough discussion that would otherwise take place through in-person or teleconference meetings and instead encouraging hasty decision-making through immediate e-mail replies.

Boards that utilize e-mail for taking board actions are recommended to:

- Check state laws;

[17] A concern that is more common for 501(c)(6) tax-exempt organizations.
[18] Multistate Filing Project, http://www.multistatefiling.org (last visited Aug. 26, 2011).
[19] NASCO, *The Charleston Principles, Guidelines on Charitable Solicitations Using the Internet* (approved Mar. 14, 2001).

- Establish clear, written guidelines for voting by e-mail;
- Use e-mail voting sparingly;
- Encourage rigorous discussion prior to conducting an e-mail vote; and
- Have directors return their signed written consents to be filed with the board minutes.

Transparency

Recent scandals and continued negative press have resulted in heightened demands for, and concerns about, transparency. A byproduct of this trend has been a growing number of charity rating organizations, demanding that nonprofits stay abreast of how to best provide relevant information to achieve favorable results under each evolving rating system.[20] Regulatory bodies have also intensified their efforts to address these concerns through more rigorous reporting and disclosure requirements. For example, the recent exempt status revocation of 275,000 nonprofit organizations by the IRS for failure to file an annual return for three consecutive years was a wake up call for the sector regarding the state of nonprofit governance.[21] Thus, nonprofits today not only struggle to keep up with regulatory demands such as the annual Form 990 filing requirement but also public demands for implementing best practices.

Form 990

The Form 990 underwent a major overhaul in 2008 when it was substantially revised for the first time in 30 years and expanded to include, among other things, new questions about governance policies and matters more commonly understood to be issues of state law. This makeover and subsequent change in law requiring small nonprofits to also file an annual return[22] placed the Form 990 in a bright spotlight under which many organizations have yet to adjust. The Form 990 is not simply an information return to the IRS. It has been the basis for many allegations of wrongdoing against nonprofits since its revision and is now considered a key public disclosure document (and marketing tool) that is increasingly scrutinized by the media, donors, potential funders and supporters, as well as adversaries. In today's environment, where distrust is high and the disclosures are increasing, every piece of public information provided by an organization should be treated with care. Improved organizational practices for the Form 990 may include:

- Reviewing the Form 990 for accuracy and consistency with other publicly available information (e.g., organizational website);
- Ensuring the Form 990 narratives are prepared by persons who truly understand those areas and can best communicate this information to the public;
- Reading the Form 990 from the perspective of a critic and addressing the areas that create ambiguities or risks for confusion; and
- Having the Form 990 reviewed by a variety of experts such as marketing, financial, and legal professionals.

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[20] *See, e.g.*, Charity Navigator, "Charity Navigator Expands Rating Methodology" (Jul. 1, 2011).
[21] IRS Automatic Revocation of Exemption List (as of Jun. 8, 2011).
[22] *See* Pension Protection Act of 2006.

Boards should also give discussion to the governance policies highlighted by the Form 990 even though such policies are generally not required under federal tax laws. Regular boardroom conversations on these topics not only keep boards current with potential future regulatory requirements but also encourage important discourse around the purposes served by these policies:

- Conflict of interest policy;
- Executive compensation approval process;
- Document retention and destruction policy;
- Gift acceptance policy;
- Meeting minutes documentation practices;
- Review process of Form 990 by the board of directors;
- Whistleblower policy;
- Expense reimbursement policy;
- Joint venture policy, if applicable; and
- Policies regarding chapters, affiliates, and branches, if applicable.

Executive Compensation

While executive compensation has always been a hot topic in the sector, as of late, it is also receiving increased attention from state regulators. For example, earlier this year, Massachusetts Attorney General Martha Coakley proposed legislation that would prohibit executive compensation by public charities unless it was approved by the state.[23] Additionally, New York Governor Andrew Cuomo recently created a special task force to investigate nonprofit executive compensation levels by organizations that receive state funding.[24] With the number of critics growing, boards should take extra precautions to ensure such compensation arrangements do not raise concerns of misconduct.

Public charities can provide reasonable compensation. Compensation is reasonable only if it is an amount that would ordinarily be paid for like services by like enterprises under like circumstances.[25] This is usually determined by the circumstances existing on the date the contract is made and includes all items of compensation such as salary, fees, bonuses, perks, severance payments, and all forms of deferred compensation.

The IRS can impose severe sanctions on an organization that provides excessive compensation. Under private inurement rules, the IRS may revoke the tax-exempt status of the organization. In addition to, or in lieu of, revocation, the IRS can impose excise taxes, also known as "intermediate sanctions," under the excess benefit rules, on the individual who obtained an excess benefit from the organization and on those who knowingly approved the abusive transaction.[26] An excess benefit occurs when the

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[23] The Official Website of the Massachusetts Attorney General Martha Coakley, "AG Coakley Determines That Compensation of Board Members at Non-Profit Health Insurers is Not Justified" (Apr. 14, 2011).
[24] Governor Andrew M. Cuomo Newsroom, Press Release "Governor Cuomo Orders Statewide Review of Executive Compensation at Taxpayer Supported Not-For-Profits" (Aug. 3, 2011).
[25] Treas. Reg. 53.4958-4.
[26] Treas. Reg. 53.4958-1.

corporation has directly or indirectly conferred an economic benefit on a disqualified person (any person who was in a position to exercise substantial influence over the affairs of the organization, including directors, presidents, treasurers, and any of their family members)[27] that exceeds the value of what the organization received in return.[28] The practice of compensating an employee for past services when an employee was "underpaid" may result in an excess benefit transaction in the year paid and may raise charitable trust problems in certain states.

Boards are encouraged to implement practices that satisfy the rebuttable presumption of reasonableness especially during current times when budgets are lean and scrutiny over compensation is high. Satisfying the rebuttable presumption of reasonableness shifts the burden from the taxpayer (to show no excess benefit transaction occurred) to the IRS (to show an excess benefit transaction occurred) if the IRS challenges the transaction. The three requirements to satisfy the rebuttable presumption of reasonableness are:

1. **Approval in advance by a disinterested board (or committee)** composed entirely of people who do not have a conflict of interest with respect to the transaction (a director with a conflict of interest can meet with the other directors to answer questions but should leave the room and not participate in the debate or vote on the transaction);[29]
2. **Appropriate comparability data** obtained and relied on by authorizing body or committee before approving transaction such as compensation paid by similarly situation organizations for functionally comparable positions or independent compensation surveys compiled by independent firms;[30] and
3. **Concurrent documentation** of the basis of the determination, including information such as the terms of transaction, board members present and those who voted, the comparability data relied on and actions taken with respect to individuals with a conflict of interest.[31]

Advocacy

Nonprofit advocacy is often a critical component to addressing the root of the problems that spurred the creation of many nonprofits. It is also an often-avoided activity as nonprofit advocacy rules are admittedly complex and often misunderstood. Discussions about the role of nonprofit advocacy can furthermore become quite contentious, especially during election years. For example, nonprofit advocacy has been subject to much criticism and concern in the aftermath of last year's Supreme Court ruling on *Citizens United v. Federal Election Commission*[32] and the subsequent proliferation of 501(c)(4), 501(c)(5), and 501(c)(6) organizational funding in support of candidates for

[27] Treas. Reg. 53.4958-3.
[28] Treas. Reg. 53-4958-4(a)(1).
[29] Treas. Reg. 53.4958-6(c)(1).
[30] Treas. Reg. 53.4958-6(c)(2).
[31] Treas. Reg. 53.4958-6(c)(3).
[32] 130 S. Ct. 876 (2010).

public office (taking full advantage of the allowance of "anonymous" donors[33]), and this attention will only amplify as the nation approaches the 2012 U.S. Presidential election.

The importance of nonprofit advocacy has intensified in conjunction with recent federal and state public policy developments. In August of this year, President Obama signed into law the Budget Control Act of 2011 (S. 365), which calls for a federal-deficit reduction of more than $2 trillion. $1.5 trillion of such cuts are to be identified by a 12-person bipartisan committee, also known as the super committee, and subsequently voted on by Congress. Nonprofits, like everything else, may be at risk[34] and accordingly, many are calling on nonprofits to lobby against federal funding cuts to the sector.

Nonprofits are also being called on at state and local levels to address growing concerns about eroding tax-exemption privileges. A 2010 report, State Budget Crises: Ripping the Safety Net Held by Nonprofits, noted that states were struggling with a $460 billion cumulative state budget gap for 2009-2012.[35] Consequently, the sector has seen increased pushback from state and local governments in the form of assessing new fees, imposing new taxes, urging payments in lieu of taxes (PILOTs), and withholding payments from nonprofits.[36] Thus, it seems more important than ever that boards of public charities are knowledgeable about the legal rules regarding nonprofit advocacy.

Lobbying

A common misconception is that public charities cannot attempt to influence legislation[37] (i.e., lobby). To the contrary, a public charity may engage in lobbying so long as such activity represents an "insubstantial" amount of its total activities.[38] Despite this limitation, a public charity may be able to devote a generous amount of resources to lobbying without running afoul of the law. A public charity's lobbying activities will be measured according to the substantial part test unless the organization elects to use the expenditure test also known as the 501(h) election:

- The **substantial part test** is based on all facts and circumstances (including time and expenditures devoted to the activity) and does not provide a threshold expenditure amount or percentage for defining what is considered "substantial." This test is often criticized for a lack of clear guidance. Excessive lobbying in any given year under this test may result in loss of tax-exempt status and/or the

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[33] An organization that files a Form 990 or 990-EZ, except for a section 527 political organization, is not required to make a Form 990 Schedule B ("Schedule of Contributors") available for public inspection.
[34] The White House Blog, "All About the So-Called 'Super Committee'" (Aug. 4, 2011).
[35] National Council of Nonprofits, *Special Report, State Budget Crises: Ripping the Safety Net Held by Nonprofits* (Mar. 16, 2010).
[36] National Council of Nonprofits, *Special Edition for Nonprofit Leaders, State and Local Budget Crises Threaten Nonprofits: Policymakers Propose New Taxes, Fees, and PILOTs* (Jan. 24, 2011).
[37] Legislation includes action by Congress, any state legislature, any local council, or similar governing body, with respect to acts, bills, resolutions, or similar items (such as legislative confirmation of appointive office), or by the public in referendum, ballot initiative, constitutional amendment, or similar procedure (source: http://www.irs.gov).
[38] IRC Section 501(c)(3).

imposition of a five percent tax of the lobbying expenditures against the organization managers approving such expenditures.

- The **expenditure test (or 501(h) election)** will be used if the organization files a Form 5768. This test measures lobbying based solely on expenditures and provides for nontaxable direct and grassroots lobbying expenditure limits.[39] This expenditure test not only provides more certainty on applicable lobbying limits but also allows for organizations to take advantage of low-cost or no-cost means of lobbying such as Internet communications or volunteer-run activities. Lobbying expenditures beyond the permissible amount in any given year results in an excise tax equal to 25 percent of the excess. Excessive lobbying over a four-year period may result in loss of tax-exempt status.

By definition, certain activities are not considered lobbying. These activities include attempting to influence (1) an administrative agency regarding its regulations or rulings; (2) executive branch decisions; and (3) legislators on non-legislative matters (e.g., to conduct an investigative hearing); and engaging in litigation. The exceptions to lobbying are[40]:

- Nonpartisan analysis, study or research;
- Examinations of broad social, economic and similar problems;
- Technical advice or assistance to governmental body upon written request; and
- Self-defense communications.

Electioneering

A 501(c)(3) organization is absolutely prohibited from directly or indirectly participating in, or intervening in, any political campaign on behalf of, or in opposition to, any candidate for elective public office.[41] This generally means that the organization cannot contribute to a political campaign fund (cash or in-kind); make a public statement of position on behalf of the organization in favor of, or in opposition to, any candidate for public office (e.g., endorsement); or allow one candidate to use the organization's resources without giving equal opportunity to other candidates. The IRS may revoke an organization's tax-exempt status or impose an excise tax on the political expenditures[42] for violating this rule.

The IRS uses a facts and circumstances approach to determine whether activities are impermissible political campaign activities, looking to factors such as content, timing, and the method of distribution. There are however many election-related activities that are permissible forms of advocacy because they are deemed to promote or facilitate democracy for the benefit of the public rather than intervene for or against any candidate. This includes activities such as voter education (e.g., candidate questionnaires and voter guides), voter registration, candidate education, and issue advocacy.

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[39] IRC Section 4911.
[40] Treas. Reg. 56.4911-2(c)(1).
[41] *See* IRC Section 501(c)(3).
[42] IRC Section 4955.

Although organizations cannot engage in partisan activities, individuals associated with an organization can do so under their First Amendment rights so long as they do not represent the organization and are acting in their individual capacities. This is a common area of confusion and boards should take steps to educate the organization on:

- Using visible disclaimers;
- Not allowing support or opposition of candidates at an organization-sponsored event;
- Not publicizing an individual's election choices;
- Not allowing organizational assets or facilities to be used for an individual's electoral work (e.g., organizational email account, staff time); and
- Documenting policies and educating the appropriate individuals of such policies.

Boards of organizations engaging in nonprofit advocacy work are encouraged to seek appropriate counsel or advice on such lobbying and election-related activities given the highly technical nature of these inquiries. Additionally, lobbying and political campaign activity is regulated by a multitude of federal, state, and local agencies and laws and organizations are encouraged to seek appropriate experts.

Affiliated Organizations

Due to the limitations regarding lobbying and electioneering, 501(c)(3) organizations sometimes set up non-501(c)(3) affiliate organizations, such as a 501(c)(4) social welfare organization, to carry out nonprofit advocacy work. Although it is not uncommon for some overlap of individuals or shared resources between the organizations, they are separate entities and should be treated as such. Boards contemplating affiliate structures should be aware of key principles regarding appropriate procedures and practices:

- If there are overlapping directors, having independent board members is generally considered advantageous in demonstrating and maintaining separation of the entities;
- If the affiliated organizations share resources such as staff or facilities, each organization is responsible for its share of the expenses. An organization should also consider whether to document such arrangements in a cost-sharing agreement;
- 501(c)(3) assets are subject to stricter rules and such assets cannot be used to fund or support activities of the affiliate that would not be permitted if conducted within the 501(c)(3) itself (e.g., electioneering). 501(c)(4) assets on the other hand are subject to fewer limitations and such assets can be granted to a 501(c)(3) organization without any consideration in return;
- Both organizations should provide clearly communicated information to regulators, donors and the public about the separate activities of each organization (e.g., clearly separated websites); and
- Both organizations should provide accurate and clear solicitation materials (e.g., donations to a non-501(c)(3) organization are not tax-deductible).

Miscellaneous

In sum, there is no shortage of legal issues that may appear in today's boardroom. While this article addresses only some of the important emerging legal issues, a couple other trends worth mentioning (but are not addressed in full in this article) include:

Executive Transitions
A troubling finding of the recent study *Daring to Lead 2011: A National Study of Nonprofit Executive Leadership* was that many boards continue to be unprepared for an executive turnover and many organizations have yet to adopt best practices for executive succession even though the anticipated rate of executive transitions remains high. Only 17% of the surveyed organizations had a documented succession plan and only 33% of surveyed executives felt confident the organization will hire the right successor.[43] Boards are responsible for the oversight and management of an organization, including planning for and supervising executive transitions. The loss of a valuable executive director combined with a poorly carried out executive transition can cause great damage to an organization including loss of major donors and funders, loss of goodwill, and waste of charitable assets. A board that is not having this discussion on a regular basis is ignoring a key responsibility.

Collaborations
Prior to the economic downturn, nonprofits had been increasingly pursuing collaboration opportunities to capture economies of scale, maintain sustainability despite limited resources, or avoid the duplication of services. This trend continues to gain traction in today's nonprofit landscape. Collaborations, in its broadest understanding, can come in many forms such as cross-trained staff, shared services, joint ventures, or mergers, both within the sector and across sectors. They can create opportunities for many benefits, including strategic alliances, improved productivity, cost savings, and income generation. But collaborations can also open doors to problems such as misaligned agendas, revocation of exemption, violations of the prohibition against private benefit, other tax law penalties, conflicts of interests among organizations, a disgruntled faction or membership, hostile takeovers, turf battles and public backlash or criticism – all of which boards should consider and appropriately address before entering into such arrangements.

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[43] CompassPoint Nonprofit Services and the Meyer Foundation, *Daring to Lead 2011: A National Study of Nonprofit Executive Leadership.*