Nonprofit Observer

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Protect your exempt status in Election 2020

Nonprofits that are tax-exempt as 501(c)(3) organizations, including charities and churches, are barred from participating or intervening in any political campaign for or against a candidate for public office. Organizations that violate the prohibition risk losing their tax-exempt status. They also could find themselves on the hook for an excise tax. Here's what you need to know to keep your nonprofit on the right side of the political activities law.

What are the rules?

According to the IRS, an organization intervenes in a political campaign if it:

- Makes or solicits contributions to or for candidates or political organizations,
- Endorses a candidate or rates candidates,
- Distributes partisan campaign literature or written statements,
- Has its representatives speak out about a candidate, or
- Uses its resources to influence an election.

Your nonprofit can, however, conduct *nonpartisan* activities that educate the public and help them participate in the election process.

What's OK, what isn't?

Some politics-related activities or expenses may be permissible depending on the facts and circumstances. For example:

Voter education. Voter education activities, such as publishing voter education guides, don't constitute prohibited activity if conducted in a nonpartisan manner. That means your organization and the people conducting the activities should avoid mentioning candidates or political parties in communications about the activity. Such communications include publicity, posters, registration materials and handouts.

Voter registration. Activities intended to encourage participation in the electoral process also aren't considered prohibited activity if conducted in a nonpartisan manner. Your nonprofit should do no more than urge people to register and vote or describe the hours and places of registration and voting. You must offer any related services, such as voter registration forms or transportation to the polls, to all, regardless of political persuasion.

Voting records. You may publish voting records to report the activity of a legislative body but not to comment on an election campaign. Voting records can represent political campaign intervention if they identify any incumbent as a candidate or compare an incumbent's positions with those of other candidates.

Issue advocacy. You can continue to advocate issues during a campaign if your activities don't constitute campaign intervention. For example, you risk intervening in a political campaign if your message

invites the recipient to compare a candidate's position on an issue with your organization's views.

The message needn't directly urge a vote for or against a candidate or even mention the candidate by name to violate the ban. You can improperly imply the specific candidate simply by using labels such as "conservative," "liberal," "pro-life" or "pro-choice."

Your nonprofit can conduct nonpartisan activities that educate the public and help them participate in the election process.

Candidate appearances. If you invite a candidate to speak in the role of a candidate, you must give all qualified candidates an equal opportunity to speak. For example, if one candidate speaks at your annual meeting and another at a sparsely attended committee meeting, you haven't provided equal opportunities. In addition, you must make clear that you neither support nor oppose an invitee's candidacy.

A candidate also can appear in another role (for example, discussing a topic other than an election). You must clearly indicate the capacity in which the candidate will appear in any announcements, maintain a nonpartisan atmosphere at the event and ensure that no campaign activity (including fundraising) occurs. And your representatives can't mention the campaign or candidacy.

Candidate forums. One way around the risks of candidate appearances is to hold a forum with all of the candidates invited to appear together to answer questions. You must see that every candidate is treated fairly and impartially. It's best if the questions are prepared and presented by an independent nonpartisan panel and the discussion covers a wide range of issues. The moderator and the forum's sponsors also should refrain from commenting on the questions, answers and candidates.

Caution your leaders

Your organization's representatives are, of course, free to make partisan comments as individual citizens speaking in a nonofficial capacity. But they need to make clear that their comments are personal and don't represent the views of your nonprofit. If they don't, they could put it at risk.

"SUBSTANTIAL" LOBBYING ISN'T ALLOWED EITHER

Just like campaigning, lobbying could result in the forfeit of your nonprofit's 501(c)(3) status. Lobbying includes contacting — or urging the public to contact — members or employees of a legislature to propose, support or oppose legislation. Advocating the adoption or rejection of legislation qualifies, as well.

The IRS looks for lobbying it considers "substantial." Two tests are available to determine this. The subjective substantial part test considers all pertinent facts and circumstances, including employee and volunteer time and money spent. Alternatively, nonchurch organizations can elect the expenditure test. Lobbying won't jeopardize your tax-exempt status *if* the related expenses don't normally exceed a certain threshold. The threshold generally is based on the size of the organization but can't exceed $1 million.

Under the expenditure test, an organization that engages in excessive lobbying activity over a four-year period could lose its exempt status. Under both tests, nonchurch organizations will be liable for excise taxes when lobbying limits are exceeded.

Collective impact initiatives rely on harmony

Collective impact, an approach that's growing among nonprofits, is more than just collaboration. Its originators describe the phrase as the commitment of a group of important players from different sectors to a common agenda for solving a specific social problem. That includes the nonprofits themselves, government, businesses and constituent communities.

In the *Stanford Social Innovation Review* article that introduced the concept, the authors explicitly contrasted collective impact with collaboration. Unlike most collaborations, they explained, collective impact initiatives involve a centralized infrastructure, dedicated staff and structured process.

Create the right environment

An example of the approach: In 2016, the Hampton Roads Community Foundation in Southeast Virginia initiated a regionwide process to improve the results in early care and education programs. It tapped almost 100 stakeholders in planning a program designed to unite previously disparate programs and participants to achieve greater impact. The Minus 9 to 5 initiative has been able to align actions across five cities in Virginia in only two years.

Adherents of collective impact typically cite five prerequisites that together produce the alignment necessary for successful initiatives:

First, a common agenda is paramount. All participants in the initiative must have a shared vision for change, based on a common understanding of the problem and their goals. While everyone doesn't need to agree on every facet of the problem, differences among the participants' definitions of the problem — and their goals — must be resolved to preempt splintered efforts.

Second, participants agree on how success will be measured and reported. If they don't, conformity on a common agenda will have little value. Each of the participants must take the same approach to data collection and metrics to ensure the continued alignment of efforts, foster accountability and facilitate the kind of information sharing that can make it easier to meet goals.

Third, activities strengthen the project as a whole. Collective impact depends on stakeholders working together in an overarching plan. But that doesn't mean they all must do the same thing. Rather, each participant should be encouraged to pursue the activities at which it excels, in a way that both supports and coordinates with its fellow participants' activities.

Fourth, continuous communication is required. Perhaps *the* biggest challenge to collective impact is the need for trust among stakeholders. Trust generally develops over time and across interactions; the most effective initiatives meet regularly. As months and years progress, stakeholders who work

together to share information and solve problems can recognize and appreciate their individual roles *and* their common motivation.

Last, a "backbone" entity takes the lead. As mentioned above, collective impact requires a separate organization with its own infrastructure, which will provide the "backbone" for the project. The backbone entity needs its own dedicated staff to plan, manage and support the initiative. Think about it: Will any of the participants alone have the extra resources needed to handle all the logistical and administrative details?

> *Perhaps the biggest challenge to collective impact is the need for trust among stakeholders.*

Evaluate outcomes holistically

These days, evaluation frequently focuses on a project's outcomes. For example, how many graduates of an adult literacy program can now read at a sixth-grade level? Collective impact programs, however, generally are too complicated and unpredictable for such an approach to provide an accurate measure of progress and success.

Instead, you need to look at a collective impact initiative holistically and consider all parts of the "puzzle." To best assess progress in bringing about desired change, consider — among other things — the effectiveness of the initiative's changemaking process, including its structure and operations. You'll also need to review ways influencers of the targeted issues are changing and the degree of progress toward the ultimate goals.

Consider, too, the initiative's stage. For example, an early-stage evaluation might focus more on structure and operations, while a later-stage assessment looks at progress made toward the goals.

The parts equal the whole

As nonprofits increasingly take on thorny problems that call for large-scale social change (for example, global warming, economic development or better education), more and more entities are turning to the collective impact approach. Organizations that join in on such an initiative must give each component of the project the attention it warrants to meet collective goals.

South Dakota v. Wayfair, Inc.

What this sales tax case means for nonprofits

A landmark ruling by the U.S. Supreme Court in 2018 dramatically expanded the ability of states to impose sales tax collection obligations on out-of-state organizations that sell goods and services within their boundaries. Since then, state legislatures and municipalities have scrambled to pass laws targeting organizations that lack a physical presence in their jurisdictions.

Some of these laws could ensnare nonprofits that make taxable sales to those states — even if similar sales aren't taxable in their home states. Ticket sales, online auctions, cloud-based transactions (for example, webinars, telemedicine and app sales) all might fall within another state's definition of taxable sales, as well as more obvious sales such as those of CDs and hard-copy publications.

The current landscape

The Supreme Court case (*South Dakota v. Wayfair, Inc.*) involved a South Dakota law that requires out-of-state retailers that made at least 200 sales, or sales totaling at least $100,000, in the state to collect and remit a 4.5% sales tax. Under previous law, if you, for example, sold T-shirts via your website to out-of-state supporters, you needn't have worried about sales tax obligations. The court upheld the tax, though.

According to the National Conference of State Legislatures, as of October 1, 42 states and the District of Columbia have required sales tax collection by out-of-state (or "remote") sellers. The laws generally cover sales of tangible goods but also might include sales of digital products such as e-books.

Certain states offer limited or broad exemptions to qualifying nonprofits, but others don't. (Nonprofits generally are exempt from sales taxes when making out-of-state purchases.) Yet many organizations have yet to take measures to ensure compliance in those states.

Some nonprofits may look at the typical trigger of 200 sales or $100,000 in sales, focus on the $100,000 figure and think they don't have to worry. But 200 $1 sales would trigger obligations. Others might not even consider sales taxes because they know they have no obligations in their home states. However, affected organizations that don't collect sales taxes from purchasers could end up on the hook — not only for the taxes but also for fines, penalties and interest.

The most significant impact for nonprofits so far may be in the publishing area. States want to tax subscription revenues for professional journals and newsletters, together with related advert-ing income, based on the addresses where the materials are mailed.

Your next steps

Your organization can't afford to ignore the implications of the *Wayfair* decision. If you haven't already, it's time to take these steps:

1. Determine your exposure to sales taxes outside your home state. Which of your goods and services are sold to out-of-state buyers? Which jurisdictions are they sold to? Do they have economic nexus laws or regulations?

2. Determine which goods and services sold are taxable out of state. You'll need to examine the applicable laws for each jurisdiction where you sell to identify which goods and services are considered taxable. Items that are taxable in one state may not be in another. You also must determine if you qualify for exemptions in any of the implicated jurisdictions.

3. Compare your sales activity in each jurisdiction with the respective threshold. Jurisdictions can use different threshold tests. For example, a state could measure sales based on gross sales receipts, the number of transactions, or a combination of the two tests.

4. Register as required. You must register as a vendor in those jurisdictions where your sales activity triggers tax responsibilities. Most require such registration as a prerequisite to obtaining a sales tax account.

5. Establish policies and procedures to ensure compliance. You likely will need to develop or adjust several policies and procedures. For

example, nonprofits with out-of-state sales must have processes for capturing the information necessary to determine which jurisdictions sales must be allocated to and for charging the correct sales tax on invoices to different areas. Tracking sales can become complicated for nonprofits when they're dealing with items like gala tickets and membership dues that have both sales and donation components.

You may need to create sales tax liability accounts and modify your tax accrual processes. Document retention policies should be developed to retain the supporting documentation. And you will want to institute procedures to make timely compliance filings in all relevant jurisdictions.

Act now

The *Wayfair* ruling means new layers of complex and varied compliance requirements for nonprofits that sell outside of their home states. Your CPA can help you set up the processes and procedures now to meet your sales tax obligations going forward.

Writing donation acknowledgment letters

Sending thank-yous to your donors doesn't just make sense in terms of building and maintaining relationships. The IRS mandates that taxpayers substantiate single contributions of $250 or more with contemporaneous written acknowledgments. Here's what you should include in those acknowledgments.

The essentials

A written contribution acknowledgment should contain:

- The name of your organization,
- The amount of the contribution,
- The date of the contribution,
- A description (but not the value) of noncash contributions,
- When appropriate, a statement that no goods or services were provided by your nonprofit,
- When appropriate, a description and good-faith estimate of the value of any goods or services provided in exchange for the contribution, and
- When appropriate, a statement that any goods or services provided consisted entirely of intangible religious benefits.

Some state tax authorities also require a tax-exempt status statement with your organization's Employer Identification Number.

The IRS leaves it up to nonprofits to decide on the appropriate medium for donation acknowledgments. For example, it could be a letter, postcard, email or text.

Timing matters

According to the IRS, acknowledgments are "contemporaneous" when donors receive them by the earlier of 1) the date they actually file their income tax returns for the year of the contribution or 2) the due date of the return. But, from a strategic perspective, you're best off sending acknowledgments out as close to the receipt of the donation as possible.

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