

Nonprofit Client Alert

Dorothy K. Foster, Esq.
(206) 686-6862
dfoster@fosterlawgroup.com

MAILING ADDRESS

Bainbridge Island:
355 Ericksen Avenue,
Suite 401
Bainbridge Island, WA
98110

Seattle:
999 Third Avenue,
Suite 3800
Seattle, WA 98104

PHONE:
(206) 686-6686

FAX:
(206) 686-6686

E-MAIL:
office@fosterlawgroup.com



www.fosterlawgroup.com

COUNTER-TERRORISM IN THE THIRD SECTOR

September 11, 2001 brought a new consciousness regarding terrorism and, with it, regulations that place the burden on nonprofit organizations to ensure that their resources not finance terrorist activities. There is no safe harbor in these rules: Even with careful due diligence and "expenditure responsibility," a charitable organization that finds itself the inadvertent benefactor of terrorists may be penalized, lose its tax-exempt status and even be subjected to criminal penalties.

Three main legal measures created this environment: Executive Order No. 13224 (September 2001); the USA Patriot Act (October 2001); and a Treasury Department publication, "Anti-Terrorist Financing Guidelines: Best Practices for U.S.-Based Charities" (November 2002, hereafter "Treasury Department Voluntary Best Practices").

Executive Order No. 13224 (an emergency measure that has not been withdrawn) prohibits transactions with persons associated with terrorism. It allows our government to freeze the assets of "identified terrorists" pursuant to a constantly growing list that our government keeps. Support of any nature is prohibited, including otherwise humanitarian assistance.

The USA Patriot Act poses significant fines and potential imprisonment on those who provide "material support or resources" to terrorists. Grantmaking, micro-lending, technical assistance--virtually any kind of assistance--may subject an organization to civil liability. A June 2002 supplement created the crime of "financing terrorism." Fortunately, to reach criminal culpability, the financing must have been willful, intentional and knowing.

Unfortunately, the definition of terrorism is quite broad: "An activity that involves a violent act or an act dangerous to human life, property or infrastructure; and appears to be intended to intimidate or coerce a civilian population; influence the policy of a government by intimidation or coercion; or affect the

conduct of government by mass destruction, assassination, kidnapping, or hostage taking."

The Treasury Department Voluntary Best Practices are guidelines to assist nonprofit organizations to avoid the inadvertent funding of terrorism. Also, the IRS plans a new publication on international grantmaking to provide nonprofits with guidance on appropriate due diligence and financial safeguards. Neither of these sets of guidelines has or will have the force of law, but they provide insight into government policy. The Treasury Department Voluntary Best Practices may be found at: www.ustreas.gov/press/releases/docs/tocc.pdf. We recommend that ALL our charitable clients review these guidelines.

Once you have improved your due diligence, get in the habit of frequently checking the lists of suspected terrorists and terrorist organizations. You may find the Treasury Department's Specially Designated Nationals and Blocked Persons list at: www.treas.gov/offices/enforcement/ofac/sdn/. Also check the Terrorist Exclusion List maintained by the State Department at: www.state.gov/s/ct/rls/fs/2002/15222.htm; the U.N. Security Council List promulgated by United Nations Resolutions 1267 & 1390 at: www.un.org/Docs/sc/committees/1267/pdflist.pdf; and the European Union List promulgated by EU Regulations at: europa.eu.int/eur-lex/pri/en/oj/dat/2002/I_340/I_34020031224en00630064.pdf.

This is a lot of responsibility, and the burden is, indeed, on the grantmaker. Some grantmakers may choose to work through intermediary organizations. Whether or not you choose to make grants directly or indirectly, prudence suggests that all your grants be supported with expenditure responsibility-type grant agreements, with the responsibility for "terrorist due diligence" and liability therefor clearly assigned AWAY from your organization to the extent it is ethical to do so.

NEED A SPEAKER?

Dorothy is a frequent speaker on matters of charitable giving and estate planning for nonprofit organizations. She conducts seminars for the constituents (members, donors, and other stakeholders) free of charge. Call us to inquire into her speaking schedule.

NEWS OF THE FIRM

Dorothy has recently received designation as an attorney of the highest ranking (AV) by the Martindale-Hubbell national legal directory.

Dorothy resurrected her academic past by teaching "International Estate Planning" in the University of Washington Law School's Graduate Tax Program during the 2004-05 academic year.

MONEY MATTERS

As you know, organizations exempt under IRC § 501(c) must report compensation arrangements on the organization's annual tax return—Form 990. Failure to provide complete information may subject the organization to a penalty of up to \$50,000. Furthermore, organizations exempt under 501(c)(3), 501(c)(4) and 501(c)(6) are prohibited from improperly transferring the organization's resources to a private individual or for-profit enterprise ("private inurement") and may lose their exempt status for doing so. In addition, 501(c)(4) organizations, 501(c)(6) organizations, and 501(c)(3) public charities and supporting organizations are subject to penalties under IRC § 4948 for "excess benefits" paid to organizational insiders. All of these rules and regulations seek to address the public policy that an exempt organization's resources be used for exempt purposes and not abusive compensation arrangements.

The IRS has recently implemented a "Compensation Compliance Program" through which it will review the annual tax returns (Form 990) of certain tax-exempt organizations to search for these issues. Furthermore, recent IRS regulations provide guidance to organizations subject to the excess benefit requirements of IRC § 4948 regarding compensation. Although these regulations apply only to organizations subject to § 4948, we advise all tax-exempt organizations to take careful steps to determine what compensation, benefits and reimbursement they make to organizational insiders and to substantiate them adequately.

ORGANIZATIONAL INSIDERS—DISQUALIFIED PERSONS

All compensation and non-monetary benefits given to substantial contributors, trustees, directors, officers, creators, key employees, and related persons and entities must be reported on the Form 990. These individuals and entities are called "disqualified persons" with respect to the organization. All organizations should consider who their "disqualified persons" might be even if the term is not literally applicable to that type of organization.

COMPENSATION VERSUS NONTAXABLE "FRINGE" BENEFITS

Some benefits are, by definition, compensation under the tax laws. Benefits that are compensation that should be reported on the organization's Form 990 and the recipient's Form 1040 include life insurance held by the organization, personal use of an organization car, and travel reimbursement for a spouse. Other benefits are considered "fringe" benefits and need not be reported. Consult with your accountant.

LOANS TO DISQUALIFIED PERSONS

A loan to an officer or director of a Washington nonprofit corporation is a permissible benefit under the Internal Revenue Code, but any loan to such person is specifically prohibited by the Washington Nonprofit Corporation Act (RCW 24.03.140). In charitable trust agreements, we, at Foster Law Group, specifically prohibit loans to the Trustees of Charitable Trusts in the documentation we prepare, as well. We advise a tax-exempt organization to review its policies regarding loans to any disqualified persons and consult us with any questions.

REIMBURSEMENT OF EXPENSES—AN ACCOUNTABLE PLAN

Reimbursement for expenses to a disqualified person must be clearly documented as such, and an organization may make such payments only if the organization maintains an "accountable plan" regarding reimbursement. If a plan is an accountable plan, all monies paid pursuant to the plan are excluded from income and wages. If an organization does not have an accountable plan for reimbursements, they will be considered "automatic excess benefits" without regard to whether the payments are reasonable or the individual's total compensation is reasonable. We advise every tax-exempt organization to adopt an accountable plan for reimbursement of expenses.

We suggest that all tax-exempt organizations, regardless of exempt status, follow these guidelines. Certain organizations, as we have indicated above, must follow them. We would be happy to advise

Nonprofit Governing Structure

Is your governing body suffering from lack of balance? From too much (or too little!) focus on fundraising? From too much focus on programmatic matters? Is there constant conflict between the staff and the board? Has anyone in your organization stopped to consider the rights and responsibilities of board members and how they are reflected in your organization's Bylaws?

For the past several years, we, at Foster Law Group, have generally established nonprofit organizations with three class of directors for the purpose of balancing these interests. We advise on matters concerning the focus of each of these more than one "realms" as they might apply to different programmatic goals. We establish definition, hierarchy and structure to obviate the abhorrence most of us have to serving on nonprofit boards. Our clients tell us they are very well pleased: They are getting work done, they are communicating clearly, they feel "safe."

Does your organizational structure need re-structuring? We can help.