

"Nonprofit Traps and Pitfalls"

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Many of us lawyers are involved with nonprofits. Some of us assist clients in incorporating and providing legal advice to nonprofits, and others of us serve on nonprofit boards.

Nonprofit law is surprisingly complex. Lawyers not only have to deal with the nonprofit corporation code but also with state and federal tax laws. As may be seen below, many other laws rear their head as well, including workers' compensation, FOIA – and criminal laws!

This article deals with some of the more common issues lawyers typically face as nonprofit board members – and while providing pro bono advice to the multitude of friends and acquaintances who badger us for nonprofit advice at lunch and social functions.

Consider the following. Our nonprofit has had a great year – so much so that we've put one of our volunteers on a part-time payroll, giving us four employees. Our annual fundraiser is coming up and our wealthy members have donated a bunch of pricy goods and services (week stay at a house in Key West!) for our annual raffle. To spice up the night, we are planning a faux casino night with play money. No pricy gifts will be cashed in so we're fine. We've already sold 80 tickets to the event at \$100 a pop. We are not selling beer/wine/liquor by the drink so we're not worried about any pesky DOR permits. For the first time, the city made a contribution to our charity so we've invited the Mayor. About the only thing that has gone wrong is that some harpy showed up at the office last week and demanded to see our books and records! We're positive she was a front for the real estate developer we have been embarrassing, so we showed her the door. Now she's filed a FOIA which we obviously discarded. Surely no legal issue will get in the way of our noble cause, right?

It's a trap! Running a nonprofit has its fair share of legal traps and pitfalls. Read on to learn how to avoid some of the biggest ones.

Nonprofits are required to have Workers Compensation Coverage?!

Our nonprofit is small, a couple of full time employees, 2-3 paid part time employees and a few unpaid volunteers. Surely, nonprofits are exempt from workers' comp coverage, aren't they? And if they are not, surely we don't have enough employees to trigger coverage, do we?

Your nonprofit may very well be required to have workers compensation coverage. You probably already know that Workers' Compensation is a system that requires most employers to either purchase insurance or be self-insured in order to provide benefits to employees injured at work.[1] Benefits available to the injured employee include the prompt payment of medical bills, lost wages, and awards for permanent disability and/or disfigurement.[2] Employers receive benefits in return; for example, they are typically immune from lawsuits brought by injured workers and claims usually proceed swiftly.

Originally nonprofits, as "charitable organizations," were exempt from Workers' Compensation. In 1948, the case of *Caughman v. Y.M.C.A.*[3] construed the legislative intent behind the Workers' Compensation Act to exempt charitable organizations from coverage. The court felt that because a charitable institution has long been immune from tort liability under the doctrine of charitable immunity, it follows that the institution is also exempt from the necessity for Workmen's Compensation coverage.

However, in 1981 the Supreme Court abolished the doctrine of charitable immunity in its entirety in *Fritzer v. Young Men's Christian Association*.^[4] It follows that charitable institutions are no longer exempt from the Workers' Compensation Act. The Workers' Compensation Commission agrees, taking the position that charitable institutions are now covered under the Act.

According to the South Carolina Code, "[e]very employer and employee, except as stated in [chapter 1 of title 42], shall be presumed to have accepted the provisions of this title . . . and shall be bound thereby."^[5] The Act goes on to say that the "term 'employment' includes... all private employments in which four or more employees are regularly employed in the same business or establishment."^[6] In summary, the "general rule of thumb is [that] employers who regularly have four or more part-time or full-time employees must be insured."^[7]

Despite these broad definitions, certain employers are expressly exempted. One such exempted employer is one "who has regularly employed in service less than four employees in the same business within the State or who had a total annual payroll during the previous calendar year of less than three thousand dollars regardless of the number of persons employed during that period."^[8]

Nonprofits are often under the mistaken assumption they are exempt from worker's comp. Many others simply never think about it. Bad things can happen to nonprofits which are required to have worker's comp coverage – and don't.

Many small nonprofits run afoul of the Act when they gradually expand. For example, the nonprofit with three employees offers a full or part time paid job to a hard working volunteer without realizing it has triggered the requirement to purchase workers comp coverage. To avoid liability under the Workers' Compensation Act, nonprofits

should pay careful attention to how many paid employees they have and how many hours they are working.

Nonprofits can be Subject to FOIA?!

The City gave over our nonprofit a few bucks last year and our office is in a building owned by the university. We've been making some waves opposing a large proposed real estate development and now the developer has filed a FOIA. Do we have to respond?!

If your nonprofit is a "public body," then yes! Nonprofits that qualify as a "public body" are subject to the Freedom of Information Act (FOIA). Congress created FOIA to ensure that "public business is performed in an open and public manner ... [making] it possible for citizens, or their representatives, to learn and report fully the activities of their public officials at a minimum cost or delay to the persons seeking access to public documents or meetings."^[9] The act guarantees every citizen the right to attend government meetings at all levels, and obtain documents and records kept by state and local jurisdictions.^[10] As seen below, the Act can also apply to private nonprofits.

Nonprofits subject to the Act must comply with a variety of statutory requirements. These include:

- 1) Making available for public inspection and copying certain documents, including minutes of meetings, during regular office hours without any written request;^[11]
- 2) making available for inspection and copying upon written request any "public record;"^[12]
- 3) holding meetings which are open to the public;^[13]
- 4) providing written notice of all public meetings not later than 24 hours before the meeting;^[14] and
- 5) notifying persons or organizations, local news media or such other news media as may request notification of the times, places, and agenda of all public meetings.^[15]

Definition of "Public Body"

If your nonprofit is a "public body" then you have to respond to those pesky FOIA requests. The definition of "public body" is quite broad. Naturally it includes any department of the state, any state board, commission or agency as well as any political subdivision of the state, including counties, municipalities and school districts.^[16] The act goes on however, to explicitly include "any organization, *corporation*, or agency supported in whole or in part by public funds or expending public funds, including committees, subcommittees, advisory committees, and the like of any such body by whatever name known...".^[17]

Weston v. Carolina Research and Development Foundation^[18] held that Carolina Research and Development Foundation, a private organization organized under the South Carolina Nonprofit Act, was a public body for FOIA purposes.. The *Greenville News* and the Associated Press filed FOIA requests for a variety of financial records, alleging the Foundation was a public body because it received or expended public funds.

The Foundation argued that it was a private corporation organized under the South Carolina Nonprofit Corporation Act and that the FOIA does not apply to private corporations, even if they receive or expend public funds. The court disposed of that argument stating “the unambiguous language of the FOIA mandates that the receipt of support in whole or in part from public funds brings a corporation within the definition of a public body. The common law concept of public versus private corporations is inconsistent with the FOIA’s definition of public body and this cannot be superimposed on the FOIA.”

What Kind and How Much “Public Support” is Required?

While FOIA does not define the term “support,” “the South Carolina Supreme Court has constructed ‘support’ to mean ‘to maintain or aid and assist’ in the maintenance... or to ‘uphold or sustain.’ What kind of support, or how much, is needed to bring an entity under FOIA is likewise not found in the FOIA.”^[19]

The Office of the South Carolina Attorney General has opined that an informal, unincorporated, group of individuals called the Charleston Harbor Estuary Citizen’s committee which had no bank account, received no direct monetary support and expended no funds received the requisite “public support” to be subject to the FOIA. The Committee did receive in-kind support from the South Carolina Sea Grant Consortium in the form of services from one employee and meeting space. Federal funds from EPA/NOAA were also used by the Sea Grant Consortium to pay for postage, printing, as well as transportation and accommodations for speakers at Committee meetings. The Office of Attorney General felt that “[t]hese expenditures of grant (i.e., public) funds on behalf of the Committee, while not expended by the Committee itself, do aid in the support of the committee.” Thus, it is clear that accepting even a small amount of public funding can make a nonprofit subject to FOIA. But what about doing business with the government?

Sale of Goods or Services as “Support”

The Supreme Court in *Weston* noted that:

This decision does not mean that the FOIA would apply to business enterprises that receive payment from public bodies in return for supplying specific goods or services on an arms length basis. In that situation, there is an exchange of money for identifiable goods or services and access to the public body’s records would show how the money was spent.

Also, in *Disabato v. South Carolina Association of School Administrators*, the Supreme Court of South Carolina recently reiterated that, with respect to private entities, FOIA only applies if those entities received public funds “*en masse*,” and “would not apply to a private entity that receives public funds for a specific purpose” such as “to operate a child care center or healthcare clinic.”^[20]

If a Nonprofit Receives Public Support How Much of FOIA Does it Have to Comply With?

As stated above, a nonprofit which receives even minimal public support may be subject to FOIA. Does this mean it has to make available for public inspection and copying *all* of its documents? Provide written notice of *all* meetings at least 24 hours in advance? According to Jay Bender^[21], long time attorney for the South Carolina Press Association, if a private nonprofit is a public body because it is supported in whole or part by public funds, it is a public body for all purposes under FOIA, and is required to hold public meetings and allow opportunities to inspect and copy records.

And does the FOIA requirement ever burn off? If a nonprofit receives minimal public support in 2012 for one year only, is it still subject to FOIA in 2014? According to Bender, whether one-time support from public funds creates a permanent status as a “public body” would likely depend on the use of the funds. If the funds provided land or a building that continued to be used, the public body status would continue. On the other hand, a one-time grant to conduct a conference might allow the status to revert to private after a period of time.

Nonprofits Can't Hold Casino Nights? Or Raffles?!

Our nonprofit is getting ready to hold its annual fundraiser. We've convinced all of our members to donate goods and services for a raffle. And we are gonna have a faux casino night with play money which can be handed in by the winners for gifts on nominal value. Surely there ain't nothing wrong with this? Is there?

Casino nights are a no go! Raffles are still risky territory, but change is in the midst. South Carolina traditionally had two legal forms of gambling: bingo and the state-run lottery. Virtually all other forms of gaming or gambling were either specifically banned by specific criminal statutes or were considered an unlawful lottery and were thus prohibited in this state.

As detailed below, assuming voter approval, Act 11 of 2013 will authorize certain nonprofit raffles for charitable purposes. The provisions of this Act will become effective thirty days after ratification of a constitutional amendment which will go before the voters in the November 2014 General Election.

Illegal Lottery

The South Carolina Supreme Court has held that there are three elements involved in conducting an illegal lottery: 1) the offering of a prize, 2) by a method involving chance and 3) for consideration paid by the participants for the opportunity to win the prize.[22]

Consideration refers to monies paid in order to be able to participate. The money does not have to be paid for specific participation in an illegal game. If money is paid to attend an event that includes gaming by way of a cover charge, donation to a charity, admission fee, ticket or similar method, the consideration element would be met.[23]

Casino Night

All three elements of illegal gaming are present in casino nights. If game winners are awarded prizes, whether cash, a donated item, play money to be used in an auction at the end of the night, or some similar setup, the first element, the offering of a prize, is met.

Indeed, the Attorney General has ruled in a number of opinions that even a casino night where no prizes were awarded would likely be illegal under section 16-19-40, which prohibits people from playing games involving cards or dice, regardless of whether a prize is given.[24] Most recently, the Attorney General opined that the following fact pattern likely constituted an illegal lottery:

The event is presented as a “celebrity casino night,” a party with music and a casino theme. Each guest purchases a ticket for admission to the event. Prices are \$65 for one ticket, \$110 for two, \$165 for three, or \$200 for four. Each guest receives \$25,000.00 in play money, 2 drink tickets, and hor d'oeuvres. The games consist of Blackjack, Poker,

Roulette and Craps. No cash is involved in gaming, and no prizes are awarded for winning. Proceeds from ticket sales for the event will go to the Aiken County First Steps program.

Raffles

Raffles generally meet all three elements of an illegal lottery, as enumerated in *Darlington Theatres v. Coker*.^[25] This is true even if the money paid to participate in the raffle is deemed a donation.^[26]

In 2013 the General Assembly made two significant changes to the laws regarding nonprofit lotteries. First, as discussed below, it amended section 61-2-180 which purported to allow nonprofits to conduct raffles. It also passed enabling legislation and a constitutional amendment to authorize nonprofit raffles. The Amendment goes before the voters in the November 2014 General Election.

1. Section 61-2-180

S.C. Code Section 61-2-180 purported to condone the use of raffles by nonprofits by previously stating: “Notwithstanding any other provision of law, a person or organization licensed by the department [of revenue] under this title may hold and advertise special events like bingo, raffles and other similar activities intended to raise money for charitable purposes.”^[27] The Office of the Attorney General has stated that this statute would likely be deemed unconstitutional if litigated.^[28]

In any event Act 5 of 2013 significantly changed the wording of section 61-2-180. The Act deleted the “Notwithstanding any other provision of law” provision as well as the reference to raffles. The Act also explicitly notes that section 61-2-180 is not an exception to section 12-21-2710.

2. The new Nonprofit Raffles for Charitable Purposes Act of 2013

In 2013 the General Assembly passed 2013 Act No. 11, the Nonprofit Raffles for Charitable Purposes Act. The provisions of the Act become effective thirty days after ratification of an amendment to Section 7, Art. XVII of the Constitution. The General Assembly also passed 2013 Act 102, a Joint Resolution proposing the Constitutional Amendment. The matter goes before the voters in the November 2014 General Election.

If passed by the voters, the new law will allow qualified nonprofits to conduct certain raffles. A qualified nonprofit is one that is (1) recognized by both the SC DOR and the IRS as exempt from federal and state taxation or is a class, department or organization of an educational institution; (2) is organized and operated for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals; and (3) is registered (or exempt from registration) with the Secretary of State.^[29]

The Act authorizes two types of raffles, “fifty-fifty” raffles and all others.

A fifty-fifty raffle is one where tickets are only sold to members or guests of a nonprofit organization and not to the general public and the total value of proceeds collected is not more than \$950 and total value of the prizes is not more than \$500. An organization conducting such raffles is exempt from registration but may not operate more than one raffle every seven calendar days (but is not restricted to four raffles a year as are the other raffles).^[30]

For other (non fifty-fifty) raffles, a nonprofit may conduct up to four raffles a year,[31] with individual prizes not to exceed a maximum FMV of \$40,000 and a total FMV of \$250,000.[32] No less than 90% of the net receipts of a raffle must be used for charitable purposes.[33]

Recognizing the numerous abuses of charitable bingo (where the charity frequently receives only a very small percentage of the bingo proceeds and the remainder goes to for-profit bingo promoters) the Act goes to great lengths to prevent diversion of raffle proceeds to for-profit raffle promoters. The Act provides that a raffle may be conducted by a nonprofit only through its directors, “bona fide” employees, and unpaid volunteers.[34] The Act specifically prohibits a nonprofit from conducting raffles through any agent or third party.[35] Indeed, “A nonprofit organization shall not enter into a contract with any person to have that person operate raffles on behalf of the nonprofit.”[36]

Nonprofits have to disclose financial information to anyone who walks in the door?!

Your nonprofit has become a pain in the keister to powerful – and maybe not so powerful – people. They don’t appreciate your letters to the editor, website, Op-Eds, and general rabble-raising. One day, Jane Slob shows up with an attitude at your nonprofit door and demands to see (and copy) not only your tax returns but also your list of donors. You don’t receive public funds so you know you are not subject to FOIA. Can’t you just show her the door? Or do you have to comply?!

Nonprofits do have to provide Jane *some* information. As detailed below, regulations implementing IRC section 6104 require a nonprofit to produce its exemption application and its three most recently filed annual information returns to anyone who asks.

IRS regulations implementing IRC section 6104 generally require tax-exempt organizations to make certain tax documents available for public inspection and to provide copies to requesting parties.[37] The law affects organizations exempt from federal income tax under section 501(a) and described in section 501(c) (except for certain private foundations) and section 501(d).[38] Organizations which are required to comply with the section 6104 include public charities, schools, labor organizations, business leagues, fraternities, veteran organizations and social clubs. Organizations that are not required to file annual information returns, such as churches, do not have to comply with section 6104 requests.

Documents that must be made available

The nonprofit must produce its exemption application and its three most recently filed annual information returns.[39] An exemption application includes the Form 1023 (for organizations recognized exempt under § 501(c)), or the letter submitted under the paragraphs for which no form is prescribed, together with supporting documents and any letter or document issued by the IRS concerning the application.[40]

The information returns are the Form 990, *Return of Organization Exempt from Income Tax*, Form 990-EZ, *Short Form Return of Organization Exempt From Income Tax*, Form 990-PF, *Return of Private Foundation*, and the Form 1065, *U.S. Partnership Return of Income*.^[41] The regulations do not require an exempt organization to disclose the Form 990-T, *Exempt Organization Business Income Tax Return*, Form 990 Schedule B nor the Schedule K-1 of the Form 1065.^[42]

Documents that are not required to be made available

The regulations specifically exclude the name and address of any contributor to the organization from the definition of disclosable documents (Schedule B).[43] However, due to a subsequent statutory change, that exclusion does not apply to political organizations described in section 527. Certain tax-exempt political organizations are required to report the name and the address, and the occupation and employer (if an individual), of any person that contributes in the aggregate \$200 or more in a calendar year on the Schedule A of Form 8872.[44] Tax-exempt political organizations may also be required to file Form 990, including Schedule B. Political organizations are required to make both of these forms available to the public, including the contributor information.[45]

How to respond to an inspection or copy request

An organization that falls under section 6104 must provide a copy of the tax documents in response to a *written* or *in-person* request by an individual at the principal office of the organization, and if such organization regularly maintains one or more regional or district offices having three or more employees, at each such regional or district office.[46] If the request for copies is made in person, the request usually must be honored on the day of the request; if the request is written, then the organization usually has thirty days to respond. (A request that is faxed, e-mailed or sent by private courier is considered a written request.)[47]

The law permits an organization to charge reasonable copying costs and the actual cost of postage before providing the copies. Currently, that amount is \$1.00 for the first page and \$0.15 for each subsequent page. But, the organization must provide timely notice of the approximate cost and acceptable form of payment, which must include cash and money order (in the case of an in-person request) and certified check, money order, and personal check or credit card, in the case of a written request.[48]

A tax-exempt organization does not have to comply with individual requests for copies if it makes the documents *widely available* as described in the regulations. This can be done by posting the documents in a readily accessible World Wide Web site, either its own or on a database of exempt organization documents maintained by another organization, provided the documents are posted in a format that meets the criteria set forth in the regulations. However, there is no exception (similar to the *widely available* exception) from the requirement to make documents available for public inspection.[49]

What are the penalties for failure to comply, and who must pay them?

If you are a “responsible person” of a tax-exempt organization who fails to provide the documents as required then you may on the hook for a penalty of \$20 per day for as long as the failure continues.[50] There is a maximum penalty of \$10,000 for each failure to provide a copy of an annual information return.[51] There is no maximum penalty for the failure to provide a copy of an exemption application.[52] Willful violations of subsection (d) of section 6104 are subject to a fine of \$5000 for each application![53]

If your valid document inspection request is refused, you should write to IRS Examination Division, 1100 Commerce Street, ATTN: SE:T:EO:E, Dallas, TX 75242. Your letter should provide the name and address of the organization that refuses to allow public inspection or provide copies of its return, and request that the return be made available for public inspection.[54] The Tax Exempt/Government Entities Division of the IRS will contact the organization and

arrange a time during which the return may be inspected. If the organization fails to provide the return at the agreed upon time, statutory penalties will be assessed.[55]

Nonprofits have to get liquor licenses?!

Your nonprofit is putting on its annual fundraiser. You won't sell liquor or beer/wine by the drink but people will have to buy tickets or pay a fee at the door. (It is a fundraiser, silly!) Surely the nonprofit doesn't have to fill out any paperwork or get an ABL license when it doesn't sell drinks or beer/wine, correct? Alas, that's generally not the case.

Nonprofit organizations must comply with a variety of alcoholic beverage laws when holding events such as fundraisers, where beer, wine, and/or liquor will be available. The Department of Revenue has the authority under various codes sections to issue temporary licenses or permits with respect to the possession, sale, and consumption of alcoholic liquors, beer, and wine at events conducted by nonprofit organizations. Below is a discussion of pertinent code sections and their applicability to nonprofit organization events.

A few code sections allow the possession and consumption of alcoholic liquors, beer, and wine, but do not permit the sale of these beverages. As a result, when determining which permit, if any, a nonprofit organization must obtain, it is important to know whether the alcoholic liquor, beer, or wine at the event will be sold.[56] The definition of "sold" is expansive. Under the alcoholic beverage laws, alcoholic liquor, beer, or wine is "sold" if there is (1) a per drink charge; (2) a charge for admission to enter an event where these beverages are provided; (3) if a donation is accepted with respect to an event where these beverages are provided; (4) if consideration is accepted or required in connection with a meal which includes these beverages; or (5) if any consideration is accepted or required in connection with an event where these beverages are provided.[57]

Private Functions

1. Possession and Consumption at a Private Function

If a nonprofit organization leases a separate and private area of an establishment for a function, alcoholic liquors may be possessed and consumed in the leased areas "whether or not the establishment includes premises which are licensed pursuant to S.C. Code Ann. §§ 61-6-1600 or 61-6-1610." [58]

The terms of the lease agreement must be reduced to writing where a holder of a sale and consumption license leases separate and private areas of the establishment to specific individuals for a function.[59] A copy of the written lease must be kept by the licensee on the licensed premises.[60] The host of the private function, or the designated agent of the host "must purchase[61] and deliver to the leased area any alcoholic beverages to be possessed and consumed" at the function.[62] Additionally, the host or agent must constantly remain in possession of the alcoholic beverages until the function has concluded, at which time the alcoholic beverages must be removed from the leased area and transported to a legal storage location.[63]

2. Temporary Permit

The Department of Revenue is authorized by statute to issue a temporary license for a *single* occasion to a nonprofit organization for a period not in excess of twenty-four hours.[64] The temporary license enables the nonprofit organization to purchase alcoholic liquors from licensed retail dealers and sell them by the drink for possession and

consumption at the specific event.[65] Liquor should be sold only to members and bona fide guests.[66]

Beer and Wine

A nonprofit organization is not required to obtain a permit when it holds an event in an unlicensed premise and provides beer and wine at the event free of charge or other consideration.[67] (As stated above, the definition of “consideration” or “sale” is expansive, and picks up virtually every fundraiser.)

A nonprofit organization must obtain a temporary permit to sell beer, wine and liquor at an event.[68] The Department of Revenue is authorized to issue temporary permits to possess, sell, and consume beer and wine pursuant to S.C. Code Ann. §§ 61-4-550, 61-6-500, and 61-6-2000.[69]

In order to obtain a temporary permit to possess, sell, and consume beer, wine and liquor, the nonprofit organization must submit an application packet to the Department of Revenue at least fifteen days prior to the event.[70]

A nonprofit organization may apply for a temporary permit that covers multiple types of beverages using one application packet (Example: temporary permit to sell beer, wine, and liquor).

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A printable version of this article, including endnotes, can be found here.