Venable Model Nonprofit Governance Policies

Fall 2008 – Updated to Reflect the New Form 990

After months of deliberation and public comment, guided by the principles of "transparency, compliance, and burden minimization," the Internal Revenue Service ("IRS") has released a dramatically redesigned Form 990. Although the 2008 Form 990 allows tax-exempt organizations to better describe their activities and contributions to the community, it also requires significantly more disclosure than it ever has before.

In many respects, the most far-reaching changes to the Form 990 appear in Part VI of the Core Form, *Governance, Management, and Disclosure*. Section A of Part VI requires an organization to describe aspects of its internal governance: the composition of its board, the delegation of certain management responsibilities, and the rights of its members. Section B of Part VI asks, in almost checklist fashion, whether or not an organization has certain written policies in place. Specifically, the IRS is inquiring whether a tax-exempt entity has a conflict of interest policy, a whistleblower protection policy, a document retention and destruction policy, a policy for setting the compensation of key employees, and a policy to govern joint ventures with taxable entities. Part VI also asks whether or not the board of directors has reviewed the Form 990 before it is filed.

It should be noted that, while applicable nonprofit corporation laws in various states are continually being revised, often with the imposition of new obligations and restrictions, we are not aware of any state or federal statute that broadly requires nonprofit corporations to implement all of the above policies or actions. Nonetheless, it has become increasingly clear that adopting and implementing these policies is an accepted "best practice" within the nonprofit community. As such, even without affirmative statutory requirements, having such policies in place may soon be part of the prevailing common law standard of care for nonprofit organization governance. Further, given the close attention paid to organizations' Forms 990 by the IRS, watchdog groups, and others, an indication that such governance policies have not been implemented may increase the risk of public complaints and/or IRS examination.

We have drafted this set of model policies with a few basic objectives in mind. First and foremost, we want your organization to be prepared when it files its next Form 990. These forms are designed to help you gather the information you need to describe your organization with accuracy and confidence. By adopting the policies by the end of your taxable year—as early as December 31 for many organizations—you will be positioned to answer "yes" to several key questions in Part VI.

Second, we recognize that there is no one best approach to any of these policies. Rather than adopting these model documents word for word, treat them as blueprints and craft a set of policies that fits the size and scope of your particular organization. We often provide you with more than one version of the same policy to help you with this task. Note particularly that, given the vast differences among statutes and regulations in the states, it is impossible for us to provide an effective "model" document retention policy. As such, we provide only a very brief statement regarding records retention responsibilities that will suffice for an organization to check "yes" in response to the applicable Form 990 question. We do not provide a model schedule or detailed policy in this regard. Note also that some of the attached policies may refer to an executive committee or an audit committee. We recognize that many nonprofit organizations may not have such committees, and the policies provided would need to be revised accordingly in such situations.

Finally, we hope that these documents lay the groundwork for year-round practices that strengthen and protect your organization well beyond the scope of annual reporting requirements. Simply adopting these policies as you find them may satisfy the narrow goal of being able to check the "yes" box on the IRS Form 990, but that alone affords little security in the long run. In fact, failure to enforce a written policy may cause your organization to be worse off than had it never adopted the policy at all. Use this period of adjustment to the new Form 990 to your advantage. Implement new policies to encourage candor and transparency, and revisit old policies that may prevent your organization from putting its best face forward. Good governance need not be overly burdensome or complicated, but it does take some thought.

As always, please let us at Venable know how we may be of assistance.

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Joint Venture Policy

Tax-exempt organizations and taxable entities frequently team up to take advantage of available business opportunities. These interactions are increasingly common, but joint ventures with taxable entities may raise some concerns. A tax-exempt organization that operates substantially outside its express tax-exempt purposes risks a revocation of its tax-exempt status. Even if unrelated activities are carefully limited, revenue generated from a joint venture may still constitute unrelated business income subject to federal income tax (this tax is often referred to as "UBIT").

Because 501(c)(3) organizations are subject to different and more restrictive standards than 501(c)(4) and 501(c)(6) organizations with regard to the types of activities such organizations may engage in, these concerns may also extend to a joint venture between a public charity and a different type of tax-exempt entity. Simply put, every joint venture should be governed by a written agreement, reviewed by counsel, and designed to protect your tax-exempt status.

The new Form 990 asks your organization to take an additional step in preparation for such joint ventures. Line 16a of Part VI asks whether or not your organization has invested in, contributed assets to, or otherwise participated in a joint venture or similar arrangement with one or more taxable entities within the past taxable year. A "yes" response prompts your organization to answer Line 16b: "has the organization adopted a written policy or procedure requiring the organization to evaluate its participation in joint venture arrangements . . . and taken steps to safeguard the organization's exempt status with respect to such arrangements?"

The instructions define a "joint venture or similar arrangement" as "any joint ownership or contractual arrangement through which there is an agreement to jointly undertake a specific business enterprise, investment, or exempt-purpose activity." In essence, Line 16 asks whether an organization has adopted a set of basic principles to follow in the negotiation of any joint venture with a taxable entity or entity with tax exempt status under a different section of the Internal Revenue Code. The model document that follows is a brief statement of such principles.

ABC NONPROFIT
Joint Venture Policy

In compliance with Internal Revenue Service guidelines for approval and management of any joint venture entered into by ABC Nonprofit, Inc. ("ABC"), the Board of Directors adopts the following guidelines.

Activities Subject to this Policy

For the purposes of this policy, the term "Joint Venture" is defined as any arrangement, including contractual or more formal arrangements undertaken through a limited liability company, partnership, or other entity, though which ABC and another entity jointly undertake any activity or business venture, or otherwise agree to joint ownership of any asset. A Joint Venture may include both taxable and tax-exempt activities.

Approval and Management of Joint Activities

Before making any decision to participate in a Joint Venture, ABC will ensure that the Joint Venture furthers ABC's exempt purposes and will negotiate at arm's length contractual and other terms of participation that safeguard ABC's exemption from federal income tax. Such terms shall be in writing in the operating agreement of the Joint Venture and shall include the following minimum requirements:

- With respect to any whole joint venture (that is, a joint venture in which ABC contributes substantially *all* of its assets to the enterprise), ABC's control over the Joint Venture through fifty-one percent (51%) or more of the voting rights and/or veto power;
- With respect to any ancillary joint venture (that is, a joint venture to which a portion of ABC's resources are contributed), ABC would, at a minimum, maintain sole control over the tax-exempt aspects of the Joint Venture and would have voting and ownership interests in the Joint Venture that are consistent with ABC's capital contributions;
- A requirement that any subsequent contract with ABC's partner in the Joint Venture be negotiated at arm's length and for fair market value;
- A requirement that the Joint Venture give priority to ABC's tax-exempt purposes over maximization of profit for the participants of the Joint Venture; and
- A prohibition on activities that would jeopardize ABC's tax-exempt status.

Where there is any question as to whether a particular Joint Venture may pose a risk to ABC's tax-exempt status, a decision to enter into such Joint Venture will be made only in consultation with legal and/or tax counsel.