

501(c)(3) Groups: Steer Clear of the Legal Minefields

07.05.17 | Linda J. Rosenthal, JD



For directors and staff of many 501(c)(3) organizations, a primary concern and ongoing worry is – as it should be – compliance with all rules and regulations necessary to maintain the valuable federal tax exemption.

Indeed, in earlier posts, we highlighted – collectively and individually – the key ways that a 501(c)(3) can sink a tank exemption. That was – actually – the title of the lead post in this multi-part series: “[5 Ways to Lose Your Tax Exemption.](#)”

Congratulations! You just received the long-awaited determination letter from the Internal Revenue Service...You can accept donations, get grants, and do great things for the world.

But, if you're not careful – there are five foolproof ways to lose this coveted status. You don't need all of them. Just one – any one – of the five will do the trick....

- [Political Activity](#)
- [Too Much Private Benefit/Inurement](#)
- [Too Much Unrelated Business Income](#)
- [Too Much Lobbying Activity](#)
- [Failure to File Form 990s](#)

Each year, it's important to review your operations and activities, and make sure that you're not sinking your tax exemption in any of these ways.

But that's not the end of the story – or your review. While abiding following all of the requirements of the federal tax code is critical, that's not enough. There are other ways to get into trouble with illegal or improper activities, or by sloppiness in not dotting all of the i's and crossing all of the t's.

What Are Additional Legal Minefields?

Any number of online information sites offer checklists and guides to avoiding legal trouble. One such helpful source of advice is the Nonprofit Hub's article: "[Top 4 Things Your Nonprofit Could Be Doing Illegally](#)." Its advice: "Make sure your nonprofit isn't walking into legal trouble you can't afford." Here are a few of their points:

- Don't "borrow" money: that is, don't use 'temporarily or permanently restricted funds' in any unauthorized ways. "It is illegal to 'borrow' money from funds restricted by donors. Don't misspend restricted funds even if you intend to replace the monies. The [Nonprofits Assistance Fund](#) can help keep you in check."
- Don't "share" photos: that is, don't infringe on anyone else's intellectual property rights. Just because an image is online doesn't mean it's available for your use. "If photographers or photo licensing companies find one of their images in your nonprofit web design they could slap you with a big bill for licensing fees. Or a lawsuit." Similarly, don't "borrow" content, logos, slogans, designs and – especially – names that you didn't create or own.
- Don't "spam." "[A] supporter who donates online may not have given you permission to email them unless it's in regard to that particular donation." [Emailing new or prospective contacts without prior consent may be illegal](#).

In our own earlier posts, we've offered several more points, including:

- Don't start fundraising before [complying with all state](#) and local registrations and rules. California, like many other states, about who solicits charitable funds in this state, and how they do it. You may also have to register and follow charitable solicitation rules of other states, even if your only out-of-state reach is via your website's donate button.
- Don't forget about [obligations and rules](#) for all employers, including nonprofits. These include: withholding and paying over employee [payroll taxes](#) as well as observing all labor laws, including wage and hour protections.
- Don't forget to pay other taxes; that is, from state or local bodies. For instance, California [does not have](#) the kind of broad sales-tax exemptions for nonprofits as other states. "A charity that sells items may be required to collect and remit to the state sales tax on goods sold. In California, there is [no general exemption from sales tax for charities](#). Rather, a variety of narrow exemptions apply to certain charitable activities."
- Don't forget to check out rules about fundraising activities like [raffles](#). Even though it may be "just a raffle," there are important restrictions in California. These are helpfully explained on the website of the California Attorney General [here](#), including a raffle checklist [here](#).

Conclusion

For 501(c)(3) organizations, the issue of legal compliance is much more than the rules in the federal tax code and regulations for maintaining federal tax-exempt status.