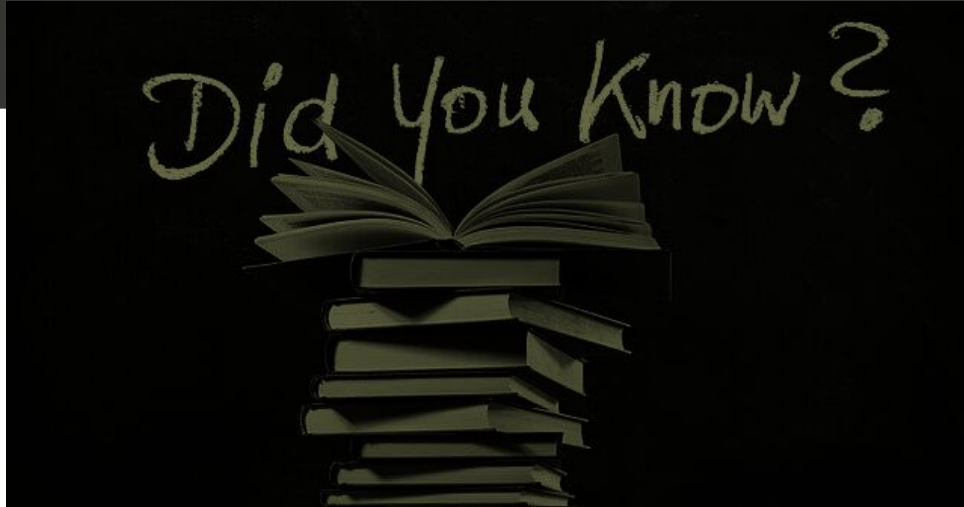


Say What? We're Monitored by How Many Government Agencies?

03.05.15 | Linda J. Rosenthal, JD



Bewildered. Besieged.

That's how folks at many tax-exempt charities feel about the sheer number of mandatory returns, reports, and records they must compile or file on an annual basis. It's a blur of rules and regulations under federal, state and local law.

Just who are all these officials and agencies demanding information and accountability . . . and why is there overlap? These are good – frequently asked – questions; not easily answered in any simple way. But here's our stab at introducing some explanations and links to resources.

First: Why?

Why doesn't the government just butt out?

Philanthropy is private action by one or more people with a sense of purpose and mission. The government recognizes and honors the long tradition of individuals and organizations solving problems, helping others, and enhancing the community well-being.

So why doesn't the government just take care of its own business and leave private philanthropy to private citizens?

Here's why.

It's primarily because the government (federal, state, local) needs money. It imposes taxes, fees, and other costs. Because philanthropic organizations take care of matters that might otherwise have



to be addressed by government, they are given tax breaks – exemptions – to help advance these important private efforts to advance the public good. These tax breaks include exemptions from (corporate) income tax as well as property and sales taxes. There are also the serious tax deductions for people financially support these causes. There are other financial perks as, too, in some cases: for example, reduced postal rates and eligibility for government grants and contracts.

The exemptions and incentives are a special privilege. There is no right to a tax exemption or to a charitable tax deduction. They drain the public coffers.

So the government butts in to ensure that organizations getting these tax breaks meet certain qualifications and are working within accepted norms to advance the public good, and are not secretly siphoning off money to line their own pockets.

But it's more than money.

It's because government also has power to regulate other aspects of our lives. For instance, there's no right to form a corporation. It's a special charter that's granted by the government (in this case, by a particular state). Each state has the power to set the terms and conditions for granting the privilege of operating in the corporate form. Many, though not all, tax-exempt, 501(c)(3) organizations are set up as nonprofit corporations. So they have to file papers, pay fees, and otherwise obey laws that set out minimum standards for how (nonprofit) corporations must operate.

The government also has the power to make sure that money set aside for the public good – for charitable purposes – is used for those purposes. Each state's attorney general is authorized to oversee this process, including establishing rules for charitable solicitations and fundraising, and filing suit on behalf of the public to make sure that these funds are not diverted away to private use or benefit.

The government has “police powers” as well to ensure public safety, health, and welfare. So local governments get involved – for example – in issuing event permits or creating zoning laws allowing charitable organizations to establish facilities.

And, finally, charitable organizations are subject to many of the general laws that affect everyone else, including other employers: labor laws (minimum wage and non-discrimination, for instance).

Second: Why So Many Agencies?

Why do so many agencies butt in?

Here, we go back to basics from your high school civics class. Unlike many other countries, the United States was created under a federal system, with the national government having certain powers, and the remaining powers expressly reserved to the states.

Then, of course, the states have their own multiple levels, including counties and local municipalities. Since there's so much to do – so much to monitor and regulate – each level of government has different agencies and offices to handle distinct functions. There's also a lot of overlap of legal authority. Each level of government has a legitimate interest in regulating charities within its jurisdiction, so there are many legitimate noses poking into your (charitable organization's)



business.

If – in a different, perfect world – an all-knowing, omniscient power were to set up a great system for regulating charities, it wouldn't look anything like what we've got. It would make much more sense and be more streamlined and efficient. It surely would not focus so heavily on a huge federal agency that has as its primary job the raising of revenue. (The Exempt Organizations Division of the IRS, of course, gives away the Treasury's revenue, so the Division has always been relegated to the bottom of the agency pecking order. It still looms large over the philanthropy world, though.)

So we're stuck with what we've got.

In a (California) Nutshell

For California nonprofits, there is a robust non-federal tier of laws and regulations – in addition to the United States legal oversight of tax-exempt organizations.

Other states may have similar, though not identical, regulatory schemes. For reasons *primarily* of budget and logistics, the nation's largest jurisdictions – most particularly, New York – generally have the most comprehensive.

Federal

- *The Internal Revenue Service*

It has the power to recognize, deny, or revoke an organization's tax-exempt status, so it takes the lead in determining whether an applicant meets (and continues to meet) the requirements of the statute, Section 501(c)(3) of the Internal Revenue Code, and rules and regulations that interpret that 132-word law. This is a huge power, expansively applied – for example – to reach into the minutiae of how a charitable corporation is formed and operates. (This, ordinarily, is a power that the state government has – and uses concurrently.)

- *Federal Courts*

When you don't agree with the IRS, you can get a hearing in either the U.S. Tax Court or in a federal district court. This is also the way that a body of (case) law is created that interprets Section 501(c)(3) and other relevant statutes.

State of California

- *Secretary of State:*

If a charitable organization wants to be a corporation, this is the agency that oversees the process of forming and continuing to meet all of the requirements of a valid, authorized nonprofit (Public Benefit) corporation.

- *Franchise Tax Board*

California has a state corporate income tax. If a California charity is set up as a corporation, it must apply for and receive a tax exemption from the state's revenue agency. This is in addition to being approved for an exemption from federal tax. (To some extent, California's tax agency relies on the federal tax exemption application, but it's still necessary to jump through the FTB's hoops and file an



application.)

- *California Attorney General:*

The California Attorney General has the power to supervise charitable assets and funds in the state, including solicitation and fundraising rules, as well as matters of governance that affect whether a charitable organization or trust is managing this money for the public good. It has the power to bring suit against an organization or its directors for mismanagement, diversion, and other misfeasance or nonfeasance.

- *State Board of Equalization:*

Certain organizations may qualify for an exemption from the requirement to collect sales taxes. This is the agency that oversees that process. The BOE also has a dual role with county assessors in determining whether a charitable organization qualifies for a property tax exemption.

- *State Courts*

When you don't agree with state or local agencies, you can get a hearing in state court. Also, charitable organizations and the individuals associated with them can sue or be sued in these courts. This is also the way that a body of (case) law is created that interprets state statutes governing nonprofit corporations and other aspects of operation of charitable organizations.

- *Local Governments*

Local governments including counties and municipalities are creations of state law; accordingly, many statewide laws apply. But there are also numerous county and local agencies and offices that have additional functions and responsibilities that apply to charitable organizations.

Conclusion

We'll have lots of follow-up on various agencies and what they do and why.

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