

Frequently Asked Questions About Nonprofit Organizations

Following widespread coverage of fraud and mismanagement in well-known charities, the public has increased its scrutiny on nonprofit organizations. As a result, it is especially critical that nonprofit board members and staff understand the numerous state and federal laws that govern the day-to-day operations of nonprofits.

This article is a summary of some of the most common requirements, but is by no means a comprehensive overview of every law governing nonprofits. Moreover, laws governing nonprofits and interpretation of these laws by the courts are constantly changing. As a result, while every effort has been made to make these materials as accurate as possible, these materials are not to be used as a substitute for the advice of an attorney. Persons reviewing this guide should not act upon the information without seeking professional legal counsel.

The following are frequently asked questions about the legal obligations of nonprofits in Texas:

1.) How does a nonprofit change its registered agent and address?

When a nonprofit changes its registered agent and address, it must notify the Texas Secretary of State. The consequences for failing to notify the Secretary can be severe: the nonprofit might not receive notice of a lawsuit filed against the nonprofit--resulting in a default judgment being taken against the nonprofit. To make changes to this information, a nonprofit should file notice with the Secretary of State's office. The forms for filing notice are available on the Secretary of State's web site, at www.sos.state.tx.us. The fee for filing the changes is \$15.

2.) Can a nonprofit make a loan to a director?

Absolutely not. Under Texas law, a nonprofit may not make a loan to members, officers, or directors. A director or officer who approves a prohibited loan is personally liable for the total amount of the loan until it is repaid. However, the law does permit loans to employees and officers to finance the officer's principal residence up to 100% of the officer's salary, if the loan is made during the first year of employment, or 50% of the salary if made later. The bylaws must not prohibit such a loan.

3.) Can a board of directors take action without a meeting?

Unless the articles of incorporation allow for written consent that is less than unanimous consent, the board of directors of a Texas nonprofit can take actions without a meeting only if there is unanimous written and signed consent. The written consent must be provided within a certain amount of time and must contain: (a) the specific action taken; (b) the date; and (c) the signatures of each director.

If the articles permit less than unanimous consent to take an action without holding a meeting, the number of directors who approve the action must be at least the same number as the number required by the nonprofit's articles or bylaws to take action at a meeting. Even then, the action is not valid unless the nonconsenting directors and the nonprofit are sent copies of the decision by

certified mail.

4) Can a nonprofit enter into a transaction with a director?

Yes, but directors should not approve a transaction unless it is fair to the organization and does not result in benefits to an insider of the organization that could run afoul of the private inurement rules of the IRS. A nonprofit should have a conflicts of interest policy in place and follow the policy. The policy should require disclosure of material facts, documents that substantiate outside bids, abstention from the vote by any interested board members, and approval by a majority of disinterested directors. Additionally, the policy should require an annual disclosure form that identifies the personal and professional affiliations of each board member. Such policies help to insure that actions taken by a board are in the best interests of the organization.

5.) Must a nonprofit disclose its books and records to the public?

In order to increase accountability and transparency of nonprofit transactions, both state and federal laws require certain records to be available for public inspection. Texas law requires most nonprofits receiving more than \$10,000 in annual contributions from sources outside its membership to keep true and accurate financial records at the nonprofit's registered or principal office for at least three years following the end of the nonprofit's fiscal year. Most nonprofits must also prepare or approve a detailed annual report of financial activity. Members of the public may inspect and copy these documents during normal business hours. Federal law also requires that nonprofits make their IRS tax exemption application, exemption letter, and three most recent annual information returns (Form 990s) available for public inspection. However, contributor information included in IRS reports does not need to be disclosed to the public. Nonprofits do not have to disclose the names of members, except to other members of the organization. Failure to disclose books and records can result in scrutiny from the Attorney General of Texas, fines, and loss of exemption.

6.) Can a nonprofit spend donations however it chooses?

No. A nonprofit can only use funds derived from tax-exempt donations to accomplish the charitable purposes stated in the nonprofit's articles and bylaws. If a donor gives money for a specific purpose, a nonprofit cannot use those funds for a different purpose unless: (a) the nonprofit receives permission from the donor; or (b) the nonprofit files a lawsuit seeking permission from a court and notifies the Texas Attorney General of the suit.

7.) Can a nonprofit engage in political activity?

A 501(c)(3) nonprofit is prohibited from endorsing a candidate for political office or engaging in partisan political activity. A 501(c)(3) nonprofit, however, is allowed to lobby on behalf of particular issues as long as the lobbying does not constitute a substantial part of the nonprofit's activities and expenditures. A nonprofit that wants to participate in legislative activity should consider filing a 501(h) election, which provides a safe harbor for some lobbying activities. For more information, see "Worry Free Lobbying for Nonprofits" from the Alliance for Justice,

www.afj.org.

8.) What should a nonprofit consider when planning a t-shirt sale?

A nonprofit that sells products, such as t-shirts, must obtain a seller's permit and resale certificate from the Texas Comptroller. Moreover, if the sale of products is not substantially related to the charitable purposes of the organization, the IRS may determine that the revenue from the sales is unrelated business income and subject the revenue to income tax. In this case, a nonprofit must file an additional form, 990-T, for unrelated business income.

9.) Can a nonprofit organization hold a raffle?

This is an area where lots of nonprofits violate Texas law. In Texas, only nonprofit organizations that have been incorporated for at least three years can hold a raffle. A qualified nonprofit may hold only two raffles a year. Texas law specifies certain language that raffle tickets must contain. The total value of the prizes purchased for the raffle cannot exceed \$50,000, but there is no limit on the value of donated items. An organization must post a bond for each raffle prize that is not in the nonprofit's possession. The penalty for conducting an unauthorized raffle is a Class A misdemeanor.

10.) What should a board member do if he or she does not agree with a decision of the board?

Board decisions are usually based on majority rule, which assumes there will sometimes be dissenting opinions. If an individual board member strongly disagrees with a motion presented to the board, the member should request that his vote and reasons for disagreement is reflected in the minutes of the meeting. If a board member believes that the nonprofit is acting illegally or unethically, the board member should resign and document in writing the board member's reason for leaving the board. The board member suspecting illegal activity should also contact the Attorney General's Charitable Trusts Section.

For more information on the legal obligations of Texas nonprofits, visit the following website: Texas C-BAR, www.texasbar.org