October 24, 2012

Day Pitney Nonprofit News - Fall/Winter 2012

When Can Employees Provide Unpaid Volunteer Services? By Daniel L. Schwartz and Jaclyn K. Leung All employers, including nonprofit organizations, need to know when their employees can and cannot provide unpaid volunteer services to the organization. If an employer mistakenly accepts or receives "volunteer" services under the wrong circumstances, it could risk liability for a variety of claims arising under wage, tax, unemployment compensation and workers' compensation laws. Under the Fair Labor Standards Act (FLSA), individuals who provide services without any expectation of compensation are "volunteers." In enforcing the FLSA, the United States Department of Labor (DOL) considers several factors to determine whether an individual is an employee or a volunteer. Such factors include but are not limited to whether (1) the designation of "volunteer" status is done unilaterally by the employer to avoid minimum wage or overtime requirements; (2) the volunteer time is for a civic, charitable or humanitarian purpose without any promise, expectation or receipt of compensation by the employee; and (3) the act of volunteering is truly voluntary, without any direct or implied coercion from the employer. The DOL has provided some guidance as to when an employee of a nonprofit organization may volunteer at the same organization where he or she is employed. Specifically, the DOL has taken the position that employees may not volunteer to provide services for the nonprofit organization that are "the same as, similar, or related to" their regular job duties. As a general example, a school custodian may not volunteer to empty the trash cans after a basketball game, but he or she may volunteer to coach the team. The DOL also has stated nonprofit organizations cannot request or direct employees to perform volunteer work during the employee's normal working hours, even if the requested volunteer duties are not the same as or similar to the employee's regular job duties. In addition, nonprofit organizations must exercise caution with respect to the type of perks or rewards given to volunteers for their services. While volunteers may be provided with nominal and occasional perks and rewards for their services (such as snacks or certificates), actual payments in the form of stipends and/or products of meaningful monetary value may be interpreted by the DOL as compensation for services, which may cause a putative volunteer to be classified as an employee. Determining when an employee may provide volunteer services is a fact-specific inquiry, and if in doubt, employers should consult legal counsel. **Issuance of Form 8940-- Request for Miscellaneous Determination** By Jennifer M. Pagnillo The IRS recently issued Form 8940, Request for Miscellaneous Determination, in response to the concern expressed by practitioners that there was no published or uniform way in which a tax-exempt organization could make certain requests of the IRS or take various actions. Now, tax-exempt organizations have a mechanism to obtain advance IRS approval of particular activities, request determinations (other than the organization's initial determination of tax-exempt status) and request exemption from the Form 990 annual filing requirements. Out of the nine uses for Form 8940, six relate specifically to private foundations. Accordingly, this form will be of particular interest to private foundation managers as well as to public charities that experience difficulty in meeting the public support test. Form 8940 may specifically be used for the advance approval of:

- Private foundation "set-asides" (to treat funds set aside for a specific project as a qualifying distribution in the year of the set-aside rather than in the year the funds are actually paid)
- Private foundation voter registration activities
- Private foundation scholarship procedures
- The determination that a potential contribution from a particular donor constitutes an "unusual grant" (and thus is excluded from certain public support calculations)

In addition, Form 8940 may be used to request a change in (or initial determination of) the Type of a Section 509(a)(3) supporting organization (an organization that qualifies as a public charity because of its support of a particular type of tax-

exempt organization). Finally, Form 8940 may be used to request a reclassification of foundation status, including a voluntary request from a public charity for private foundation status or to request the termination of private foundation status. The instructions for Form 8940 set forth both the required supporting documentation and the required user fee to be submitted in connection with each request submitted on the form. The form and instructions are available at www.irs.gov. December 31 Deadline for Avoiding 20 Percent Additional Tax on Employees By David P. Doyle In 2004, Section 409A was added to the Internal Revenue Code. Section 409A is designed to rigidly regulate nonqualified deferred compensation arrangements. In order to encourage compliance with Section 409A, Congress provided for a 20 percent excise tax (as well as other penalties) to be imposed on any individual who is the beneficiary of a noncompliant deferred compensation arrangement. In other words, if Section 409A is violated, the affected employee (and not the employer) is penalized. Since the legislation was originally enacted in 2004, regulatory and other guidance has been issued in several installments. By now, most employer-employee arrangements that fall under the Section 409A umbrella have been amended at least one time to comply with the myriad of Section 409A rules. Before the end of 2012, however, all employers should review their employer-employee arrangements one more time for a very specific provision that could cause those arrangements to be noncompliant. In 2010, the Internal Revenue Service (IRS) issued a correction program for Section 409A-related plans. In the correction program, the IRS stated that a very common provision in severance plans and employment agreements may cause those arrangements to fail to comply with Section 409A. Specifically, the IRS has stated that if a contractual payment is conditioned on the employee or former employee first executing a release of claims in favor of the employer, and if the time period during which the employee is allowed to consider and revoke the release spans two tax years, then the employee or former employee effectively has the ability to impermissibly defer receipt of the payment from one tax year to the next. In the correction program, the IRS provided that such impermissible provisions can be corrected or clarified without incurring a penalty, but the correction needs to be effected prior to the end of 2012. Typical arrangements under which a release is required in order to obtain a payment include:

- Offer letters that provide for severance payments
- Employment agreements
- Severance agreements
- Severance plans
- Certain bonus plans
- Change in control agreements

The "correction" that needs to be implemented is relatively simple (by ensuring the employee does not have the ability to determine the year in which the payment will be made), but it needs to be completed and documented very soon. All employers should review their employee arrangements now, and employees also should ensure their agreements are compliant with the Section 409A release rules. **Responsibilities of Trustees and Directors** By Warren J.Casey Many individuals asked to join a board of trustees or board of directors of a nonprofit organization are prominent members of the community whose experience, community relationships and, often, financial support are sought by that organization. These individuals are generally honored to have been chosen and, at times, even view this position as somewhat "honorary" and not involving any significant commitment of time or heavy lifting in terms of responsibilities. However, trustees or directors of any nonprofit institution are, in fact, under applicable law, "fiduciaries" of that organization, with fiduciary responsibilities to be satisfied by each individual trustee or director, not unlike the fiduciary duties of directors of publicly held corporations. Trustees and directors of nonprofit organizations need to be aware they have three basic fiduciary duties that must be satisfied in their role and capacity as trustees or directors: the duty of care, the duty of loyalty and the duty of good faith. **Duty of Care** The duty of care requires each trustee or director to obtain and consider all significant and available information related to the matter being considered by the board and to take adequate time to review that information in connection with a board decision on a matter. The same holds true for each member of a committee of a board that is considering a particular matter or making a particular decision. In short, trustees and directors must act on an informed basis, be diligent in obtaining and reviewing relevant information, act in good faith, and act in the best interests of the organization and all of its constituents. Trustees and directors can rely on a variety of sources in informing themselves, including information provided by the organization's management or by outside financial advisers or legal counsel. Such reliance, however, cannot be "blind." In order to meet his or her fiduciary duty, each trustee or director must at all times remain actively involved and

actively participate in the consideration of the matter to be acted on and retain the authority and willingness to say "no" if the circumstances require. **Duty of Loyalty** The duty of loyalty requires that each trustee or director place the interest of the organization and its constituents above any personal interest. If a trustee or director has a personal interest in any transaction or other matter involving the nonprofit organization, the organization and its board, as well as the individual trustee or director, need to adhere to and satisfy clear conflict-of-interest policies and guidelines, which generally involve both full disclosure and action by independent decision-makers so the integrity of the particular transaction or decision, and of the organization, are fully protected. **Duty of Good Faith** No court, either in the private company sector or with respect to nonprofit organizations, has precisely defined what constitutes a violation of a fiduciary duty to act in "good faith" by a trustee or director. It is clear, however, that a trustee or director could be found to have ignored his or her duty to act in good faith if the trustee or director consciously and intentionally disregards his or her responsibilities in the face of a known duty or consciously fails to monitor or oversee the particular matter subject to decision-making or oversight of the trustee or director - adopting a "we don't care about the risk" attitude by reason of a failure to exercise proper oversight. In observing each of these fiduciary duties, trustees and directors, first and foremost, need to ensure proper processes are followed by the board and by the particular nonprofit organization. Meetings need to be held and attended; significant or important decisions need to be fully vetted, considered and approved; finances and financial matters need to be vigorously overseen and tested; and information concerning all matters needs to be free-flowing and made available to trustees or directors. Being a trustee or director is *never* simply an honorary role. **"Green" Leases** By Colleen R.Donovan If your organization is considering moving or retrofitting its existing offices, why not "go green"? As the environmental impact of buildings becomes more apparent, a new field called "green building" is gaining momentum. Building a green or sustainable building or retrofitting existing space is basically the practice of creating and using healthier and more resource-efficient models of construction, renovation, operation and maintenance. Green buildings are designed to reduce the overall impact on human health and the environment by protecting human health (lower levels of volatile organic compounds are used, more natural light is included) and to allow for the efficient use of energy, water and other resources. Other intangible benefits of green or sustainable buildings are greater employee satisfaction, increased productivity and reduced sick days. Additional benefits in moving to or converting existing space into green space may be lower operating expenses, less potable water use, improved indoor environmental quality and potential tax credits. For these reasons, organizations should consider going green. Whether you are building your own building, renting space from a landlord in a yet-to-be-built office or negotiating with your landlord to retrofit existing space, consider incorporating some or all of the following into your space: reflective roofs, green roofs, geothermal wells, wind and solar power, interior bio walls, radiant floor heating, sunshades, and the use of recycled materials. While green buildings often have increased construction costs, these costs can be recouped through operation and maintenance savings incurred over the life of the building. While the intricacies of actually drafting and negotiating a "green lease" may be the subject of another article, keep the idea in mind when you are considering new space or retrofitting existing space. **Hot Topic: Regulating the Compensation of Nonprofit Boards and Executives** By Jill A. Collins Recently, several states have enacted or proposed laws prohibiting, limiting or otherwise regulating the compensation of nonprofit board members and nonprofit executives. In some cases, this is in reaction to provocative reports of high pay for board members and top executives at high-profile nonprofits. In other cases, it's part of states' efforts to cut costs. Federally, compensation at nonprofits is limited by the reasonableness standard, with excessive compensation resulting in a violation of the prohibition on private inurement. In addition, compensation paid to disqualified persons of private foundations results in an excise tax unless the compensation is for personal services necessary to the private foundation. Reasonableness is a question of fact, and in recent years the Internal Revenue Service (IRS) has encouraged charities to focus on their process for setting compensation as a means to ensure reasonable results. Although it is not a legal requirement, the IRS suggests charities determine the compensation for executives, key employees and other highly compensated persons after a review and approval by independent people of comparability data and contemporaneous substantiation of the deliberation and decision. On the state side, there has been an increase in regulatory activity. New York's Gov. Andrew Cuomo issued an executive order in May limiting compensation supported by state funds to $199,000. The proposed regulations implementing the executive order -- scheduled to go into effect in January 2013 - are complex and not well-tied to the federal standards already in place. Any charities in New York receiving funds from state agencies should carefully evaluate their compensation structure in light of these impending changes. In New Jersey, starting in July 2010, those charities providing services under state contracts from the departments of Human Services and Children and Families have been limited in the use of contract funds. These new limitations include a $141,000 cap on salaries funded by state grants. In Massachusetts, which does not currently impose any limits on the compensation paid by a charity to its board of directors or executives, several pieces of

legislation were introduced in 2011 to limit or prohibit compensation of board members. This flurry of activity was the result of an investigation launched by the Office of the Attorney General into executive and director compensation at Massachusetts' four major charitable health insurers. The legislation remains in committee, and its champions, such as Sen. Mark Montigny and Attorney General Martha Coakley, remain committed to addressing the issue. In light of the regulatory efforts in these states as well as in others outside the Day Pitney LLP footprint, all nonprofits are encouraged to review their state's rules and their internal processes for making compensation decisions for executives and board members. **Notice 2012-52 -- Deductibility of Contributions to Wholly Owned LLCs** By Jennifer M. Pagnillo IRS Notice 2012-52 resolves the uncertainty that formerly existed regarding the deductibility of contributions to limited liability companies of which a public charity is the sole member. The notice makes clear that a contribution to a limited liability company wholly owned and controlled by a public charity is treated as a charitable contribution to a branch or division of the member charity. Even though a single-member limited liability company is generally considered a "disregarded entity" for tax purposes and thus it makes sense that a contribution to such an entity would be treated as having been made to the member charity, this notice provides welcome confirmation of that analysis. Accordingly, a public charity may now rely on this notice to accept contributions of particular assets (such as real estate) through a limited liability company in order to insulate itself and its other assets from any liability that could be associated with outright ownership of the asset. The notice goes on to provide that the member charity will be responsible for the disclosure and substantiation requirements in connection with the contribution to its wholly owned limited liability company. As the "donee" of such a contribution, the member charity is required to issue the contemporaneous acknowledgment (required for contributions in excess of $250) and to disclose whether any goods or services were provided in exchange for the contribution. The notice is effective for contributions made after July 31 but may be relied on for earlier tax years if the period of limitation on refund or credit has not yet expired. **Approaching Deadline for Transitional Relief for Small Organizations Whose Tax-Exempt Status Was Automatically Revoked** By Jill A. Collins December 31 is the deadline to apply for transitional relief for those small organizations that lost their tax-exempt status in the first round of automatic revocations. Small organizations (organizations with annual gross receipts of not more than $50,000) are eligible for transitional relief if their tax-exempt status was revoked automatically for failing to file an annual electronic notice (Form 990-N e-Postcard). Beginning in 2007, organizations with gross receipts in excess of $25,000 (increased to $50,000 in 2010) are required to file an annual Form 990-N e-Postcard, a new requirement that many organizations failed to recognize. Transitional relief allows these small organizations to have their tax-exempt status reinstated retroactively to the date of automatic revocation. In order to qualify, an organization must meet the following criteria:

- The organization was not required to file annual information returns (such as Form 990 or Form 990-EZ) for taxable years beginning before 2007.
- The organization was eligible to file a Form 990N e-Postcard in each of its taxable years beginning in 2007, 2008 and 2009. This typically applies to organizations with gross receipts normally not more than $25,000 in each year but excludes private foundations and most supporting organizations.
- On or before December 31, the organization submits to the IRS a completed application for reinstatement. Applications are made using Form 1023 (for 501(c)(3) organizations) or Form 1024 (for most other organizations seeking exemption under 501(a)).

For more information, see the Automatic Revocation of Exemption List and Notice 2011-43, both available at www.irs.gov. Organizations subject to automatic revocation that do not qualify for transitional relief should review Notice 2011-44 for information on applying for reinstatement. **NJ Extends and Expands Permit Extension Act** By Thomas J. Malman and Christopher James Quinn On September 19, Gov. Chris Christie signed Bill A1338 to amend the Permit Extension Act of 2008 (the PEA). The process of obtaining land development approvals and permits can be difficult, time-consuming and expensive. Because of this, these approvals typically afford a protection period to allow a developer time to secure financing and complete a project without the fear of changes to governmental regulations or repeated application processes. Unfortunately, as a result of the national recession, in recent years projects have taken longer to complete, because of financing and marketability issues. Thus, the New Jersey Legislature initially enacted the PEA in 2008 "to prevent the wholesale abandonment of approved projects and activities due to the present unfavorable economic conditions, by tolling the term of these approvals for a period of time, thereby preventing a waste of public and private resources." *N.J.S.A. 40:55D-136.2(m).* The PEA extended the life span of certain governmental approvals to December 31, 2014, to provide additional time to build a project. However, given the duration of the current economic downturn, the Legislature identified in

A1338 the need to further extend and expand the PEA, as follows. First, the expiration of the PEA's tolling period is extended from December 31, 2012, to December 31, 2014. This means that a qualifying permit or approval covered under the PEA may now be valid up to June 30, 2015. Second, the scope of the PEA is retroactively expanded to include properties that were previously excluded from PEA protection. The PEA does not extend the life of all government permits and approvals. To qualify for an extension, a permit must meet the act's definition of an approval and fall outside its list of exceptions. The broadest exception excludes any permit or approval involving land located in an Environmentally Sensitive Area. This term initially included any land within the Highlands and Pinelands that was not designated as a growth center. A1338 redefines and narrows the Environmentally Sensitive Area exception to afford PEA protection to more properties, including the following lands:

- The Highlands planning area, provided the land is (i) not located in State Planning Areas 4B or 5; (ii) not a critical environmental site; and (iii) not located in a town that has adopted a Highlands master plan element, Highlands land use ordinance or an environmental resource inventory as of May 1.
- Villages and towns designated in the Pinelands Commission's comprehensive management plan, provided the land is (i) not located in State Planning Areas 4B or 5 and (ii) not a critical environmental site.

Finally, A1338 applies the new, narrower exception retroactively. This can significantly impact development by breathing life into several dormant projects in the Highlands and Pinelands. The full text of the act is available at http://www.njleg.state.nj.us/2012/Bills/AL12/48_.PDF.