

Legal and Tax Issues Quiz for Managers and Directors of
North Carolina Nonprofit Organizations
Suggested Answers (rev. 4/08)

(Note: These suggested answers are provided for educational purposes only and do not constitute legal or tax advice, and may not be relied on as such. For guidance with respect to a particular organization, you should contact your professional advisors as appropriate.)

1. **False.** Any organization that solicits at least \$25,000 annually in North Carolina must apply to the Charitable Solicitation Section of the NC Secretary of State for a license. In addition, licensed nonprofits must make a required disclosure on fundraising materials and confirmations to donors.

2. (a) is incorrect. Section 501(c)(3) charities are exempt from the federal unemployment tax (FUTA). **(b) is correct.** A North Carolina nonprofit with four or more employees each working at any time during a week for a total of 20 or more weeks in a calendar year is subject to state unemployment compensation coverage.

3. (a) is incorrect. North Carolina nonprofits pay sales tax on purchases and are required to collect sales tax on sales in the same manner as for-profit entities. There is an exception for sales made in connection with annual fundraising events where the products sold are received by the buyer within 60 days. (b) is incorrect. With certain exceptions, the sales tax provisions apply to 501(c)(3) nonprofits in the same manner as for-profit entities. (c) is incorrect. Nonprofits pay sales tax at the point of purchase in the same manner as other entities. A nonprofit may apply for refund of sales tax paid on most purchases by semi-annually filing Department of Revenue form E-585. **(d) is correct.**

4. **True.** Nonprofits do not issue publicly traded securities and are therefore not directly covered by the provisions of the Sarbanes-Oxley Act. Individuals within the nonprofit organization, however, are nevertheless subject to the “whistleblower” and document retention provisions of the Act. It is therefore in the best interest of the nonprofit to adopt policies that conform to the requirements of the Act. Moreover, expansion of Sarbanes-Oxley coverage to nonprofits is likely if nonprofit leaders do not voluntarily take it upon themselves to adopt such practices of good corporate governance.

5. **False.** In situations where collection from the nonprofit entity is unsuccessful, federal and state authorities may reach beyond the nonprofit organization and collect these taxes from the personal assets of “responsible persons”. The Trust Fund Recovery Penalty may be imposed on all persons (including volunteers) determined to have been responsible for collecting, accounting for, and remitting payment of these taxes, and who acted willfully in not doing so.

6. True. Beginning in 2008, organizations not required to file Form 990 because their gross receipts are less than \$25,000 are required to annually file Form 990-N “E-postcard,” which provides basic information about the nonprofit and the nature of its

activities that qualify it for continuing tax exemption. This threshold will be raised to \$50,000 for tax years beginning in 2010. Therefore, nonprofits with less than \$50,000 in annual gross receipts need only file the simple online Form 990-N (instead of Form 990-EZ or 990) in 2010 and thereafter.

7. **False.** Section 501(c)(3) publicly supported charities (as opposed to private foundations) may engage in lobbying activities that are not substantial. Intervention in any type of political campaign activity, however, is strictly prohibited and will jeopardize tax-exempt status. Since the determination of whether lobbying activities are “substantial” for a particular organization is subjective, an organization that regularly engages in lobbying activity should consider an election under Section 501(h) of the Internal Revenue Code. This provision makes the determination of substantial lobbying a mathematical test by defining annual percentage limits, based on total exempt purpose expenditures, which an organization can spend on direct and grassroots lobbying activities without jeopardizing its tax-exempt status.

8. **False.** Real estate owned by a nonprofit is exempt from real estate tax only to the extent it is used in carrying out qualifying charitable purposes. For example, if a nonprofit owns land for the future construction of a program center, the land will remain taxable real estate until the center is operating.

9. **False.** Nonprofit employers must follow the same rules as for-profits in determining whether an individual can be classified as an independent contractor. The determination of whether an individual is an employee or independent contractor is made based on the facts and circumstances of each situation. The most important determining factor of employee status is the amount of control the organization has a right to exercise over the individual. An employer has the right to control the *means* in which work is performed. This is in contrast to the *result* only in the case of an independent contractor.

10. (c) is incorrect. Payments of interest on funds borrowed from a non-corporate lender that total \$600 or more for the year are reported to the recipient on IRS Form 1099-INT. **(d) is correct.** Payments to independent contractors described in (a) along with payments for legal services described in (b) totaling \$600 or more for the year must be reported regardless of whether the recipient law firm is incorporated.

11. (a) is true. This describes a “quid pro quo” donation (i.e. the nonprofit provides something in return as an incentive to give). (b) is true. It is the donor’s responsibility to request written confirmation of the contribution, except where the “quid pro quo” rules come into play. As a practical matter, however, it is good stewardship for the nonprofit to send a donor the information required to substantiate the donor’s tax deduction. This information may be incorporated into a thank you letter. **(c) is not true.** IRS permits confirmations of contributions to be sent electronically.

12. **True.** In addition, any work time not meeting this difficult legal threshold to qualify as volunteer work will be included in the determination of the weekly 40 hour base for the payment of overtime wages. Because of these risks, it is generally advisable for

nonprofits to adopt a policy prohibiting an employee from volunteering unless the position satisfies one of the overtime exemptions under the Fair Labor Standards Act, relative to salaried positions.

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