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CASE MANAGEMENT SOCIETY OF AMERICA
BOARD OF DIRECTORS MEETING
LITTE ROCK, ARKANSAS
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TEN COMMON TAX AND LEGAL MISTAKES ASSOCIATIONS AND THEIR CHAPTERS MAKE [AND WHY THEY MATTER]

10. Failure to file annual reports.

9. Failure to observe tax filing basics.

8. Failure to observe lobbying and political activity requirements.

7. Failure to follow royalty (passive income) rules.

6. Failure to distinguish independent contractors from employees.

5. Failure to follow corporate sponsorship rules.

4. Failure to secure intellectual property rights.

3. Failure to read the D&O and other insurance policies.

2. Failure to read, know and understand contracts.

1. Failure to understand and follow Bylaws, Articles of Incorporation and applicable state not-for-profit corporation laws.

10. Failure to file annual reports.

The typical association, or chapter, is a not-for-profit corporation under the Not-for-Profit Corporation Act of a particular state where it is incorporated and/or doing business. The annual report, a form with information to be filled in, is sent out by and returned to the Secretary of State where the association is incorporated or doing business. If the association is incorporated in one state and now headquartered in another state, it may have to file with both states (where incorporated as a "domestic corporation" and where located as a "foreign corporation doing business in …." While requirements vary from state to state, typically the filing requires listing the officers and directors, name and address of the registered agent for service of process in the state, and the purpose of the organization. If you fail to file, the Secretary of State will usually send a follow-up notice, and then if you still fail to file will involuntarily dissolve the corporation for failing to file the annual report. This has major repercussions, including loss of the corporate "legal person" as the entity that can sue and be sued, leaving individual officers and directors personally liable for actions and debts of the now dissolved corporation. Always to check and see the annual report is filed, and if you have any doubts, check with the Secretary of State's office where you are located and/or doing business. A corporation may be reinstated but it takes time and money to do so, and boards of directors do not like such oversights.

9. Failure to observe tax filing basics.

Associations are typically exempt from paying federal income taxes under IR §501(c)(3) [Charitable, Scientific, Educational, Religious] or IRC §501(c)(6) [Trade Associations]. In order to obtain an exemption, the not-for-profit corporation must apply for exempt status by filing IRS Form 1023 or 1024 respectively. The IRS requires the forms to be submitted with copies of the articles of incorporation and bylaws including a statement of exempt purposes under federal tax law, initial budget information and possibly other information to satisfy the IRS that the association should be exempt from taxation. Chapters are sometimes listed under their exempt national association's group exemption, and thus avoid filing individually.

Thereafter, the association is expected to file IRS Form 990 if the organization's income meets minimum requirements of $25,000, and IRS Form 990T if the association's non-exempt income exceeds $1,000 in a year. These are the basic filing requirements. Not all association income is exempt from taxation if it is derived in part from non-exempt activities. The most common such example is advertising income. If an association fails to file its 990 and 990T returns, the association is subject to heavy fines and loss of exempt status.

Associations may also be liable for some state taxes including property taxes. Check your own state's law.

8. Failure to observe lobbying and political activity requirements.

Section 501(c)(3) organizations are very limited on lobbying and political activities. A § 501(c)(3) organization cannot engage in any federal or state candidate campaigns without risking the loss of its tax exemption. Section 501(c)(6) organizations are less restricted in this regard, and frequently establish political action committees (subject to separate federal and state laws). If an exempt organization engages in lobbying, the amount spent on lobbying activities, including a calculation for staff time and overhead, as a percentage of dues receipts (not all income), and is taxable at the highest corporate rate if paid by the association. The association has the option of informing its members – in advance which requires an estimate of what the association will spend on lobbying in the following year -- that a percentage of their dues, based on the cost of the lobbying expense compared to the dues income of the organization, is not deductible because of the lobbying. The association may also have to register as a lobbying organization under applicable federal or state laws, and file annual reports with the state attorney general where incorporated or doing business. Failure to report the lobbying expenses or to register can result in substantial penalties.

7. Failure to follow royalty (passive income) rules.

Associations often enter into contracts to promote the services of third parties such as insurance companies, credit card companies, airlines, car rental companies, etc., to their members and receive a fee or commission, and will often rent or sell their member mailing list for a fee. The association can avoid taxation on such income through carefully drafted contracts which treat the income as a royalty (passive income) and if the association does not provide services, typically promotional or administrative, to the third party. Associations and third parties should carefully structure such arrangements and draft appropriate contracts if the association is to avoid taxation on the income derived from such activities.

Associations may sell books and publications related to its exempt purposes, and the income on such publications should not be taxable income. The key is that the publications, videos, tapes, seminars, etc., are related to the association's exempt purposes, whereas advertising, insurance, affinity credit cards, freight services, and other such activities are not related to the association's exempt purposes even though the income derived is used for the association' s exempt purposes..

6. Failure to distinguish independent contractors from employees.

The IRS, U.S. Department of Labor and states' Departments of Labor have rules and tests for distinguishing between employees and independent contractors. This is particularly important if an association or its chapters have staff. An association may think it does not have employees, only independent contractors performing services, but the IRS or Departments of Labor may disagree, using their respective tests to distinguish between employees and independent contractors. This may lead to independent contractors performing as staff being characterized as employees, and the association finding itself liable for income tax withholding and overtime, plus penalties, interest and other consequences. The association's board of directors, lawyers and accountants, and staff, should all be familiar with the IRS rules and tests for distinguishing between employees and independent contractors in order to avoid unexpected tax liabilities and other obligations, and the test used in the state where your association or chapter is located. Associations also have to send IRS Form 1099 to independent contractors who provide services to the association and earn more than $600 in a calendar year, with appropriate notice to the IRS.

5. Failure to follow corporate sponsorship rules.

Sponsorship income has become a much bigger factor in recent years for associations. The IRS recently promulgated final rules governing sponsorships, and association staff, board members, and their lawyers and accountants should be familiar with the rules. The key to keeping sponsorship income from being taxable is to limit the promotional aspects of the recognition of the sponsor at the association's meetings, in the association's publications or on the association's Website. When the sponsorship listing goes beyond the sponsor's name and activities and gets into promotion of the sponsor, a subsequent IRS audit may declare that the sponsorship had lapsed into advertising which generated taxable income rather than exempt nontaxable sponsorship income. This has become even more problematic with the advent of association websites linking to member, nonmember and third party vendor websites.

4. Failure to secure intellectual property rights.

Associations deal in intellectual property on a frequent basis, but frequently do not recognize the implications. Among the basics: Every association newsletter, conference brochure, educational course, book or other publication should bear a copyright notice which states at a minimum, "Copyright - name of the organization - year." More important or permanent publications should be filed with the U. S. Copyright Office in order to receive the protection of the Copyright Act's provisions. Association websites should also have a copyright notice, as well as other directions regarding what use may be made of materials on the website. The association should also be careful to restrict the use of materials on its website that are copyrighted by third parties.

Associations can get into trouble using copyrighted materials by third parties without permission in the association's publications or Website. You not only have to protect your own intellectual property, but you must be careful, especially in these days of easy electronic transfer of data, to avoid using the copyrighted materials of third parties. This would include the use of copyrighted music at association events without an appropriate license, a topic in itself.

3. Failure to read the D&O and other insurance policies.

An association should carry liability insurance protecting its officers, directors, members and staff from personal liability (D&O policies), and general commercial liability protecting its headquarters and property, use of automobiles, and protection at events; and other more specialized coverage if the need arises, such as liquor liability (host) insurance. If an association's bylaws provide for indemnifying volunteers performing services for the association, they may reasonably anticipate the association's "deep pockets" will not be limited to its reserves, but the indemnification is backed up with real protection from insurance.

Chapters of an international or national organization may be protected by the insurance of the international or national association. Check with the staff of the national organization. But recognize the potential exposure if you do not have insurance for something as simple as the use of automobiles, a slip and fall in your office or at an event.

2. Failure to read, know and understand contracts.

It is all too common for associations not to carefully read and understand contracts, and sometimes to even know that they have made a contract, particularly in the meeting planning area. Contracts may be oral or written. A written contract is better because it depends less on the memory and availability of two or more witnesses. But oral contracts may be valid and upheld so be careful about such agreements. Insurance policies are contracts. Agreements to conduct a function such as a meeting or a function at a restaurant or hotel are contracts. Agreements to publish newsletters and to pay for them are contracts. Associations deal in contracts all the time, but all too frequently they are not carefully read and understood, especially the "fine print" or "boilerplate," until a dispute has arisen. Contracts can be amended at any time if both parties agree. Know what you are signing! This is typically not an area in which to skimp on legal fees.

1. Failure to understand and follow Bylaws, Articles of Incorporation and applicable state not-for-profit corporation acts.

The association is a corporation, therefore subject to its state's Not-For-Profit Corporation Act. It is also subject to its articles of incorporation, its bylaws and policies adopted by the board of directors, in that order. The Articles of Incorporation are a contract between the association and the state where it is incorporated. These are frequently boilerplate but the most essential part is the statement of purposes which tell the world what the association is organized to do. An association's activities should come within the stated purposes of its Articles of Incorporation. The bylaws are essentially a contract between the association and its members. These are usually more detailed than the articles of incorporation, and state how the association will be governed, officers and directors elected or appointed, and provide other rules for managing the association. The bylaws should not conflict the Articles of Incorporation; neither should conflict with the Not-for-Profit Corporation Act of the state where the association is incorporated. Acts in violation of the bylaws, articles, or statute may be challenged by the members and found void. Actions taken outside the exempt purposes permitted under the Articles of Incorporation may also be challenged, and the association may lose its exemption. One of the requirements of s state's not-for-profit corporation act is filing of the annual report, and failure to do so may lead to involuntary dissolution. The state statute also provides guidance in those areas where the Articles of Incorporation or bylaws may be silent.

TWO HOT TOPICS

Hot Topic #1: Electronic Voting – The District of Columbia, Illinois and Virginia now expressly provide in their Not-For-Profit Corporation Acts for electronic voting. Association can use electronic voting in place of mail votes or even fax votes. Associations located in states that do not have electronic voting in their Not-For-Profit Corporation Acts should get good advice before assuming that electronic voting is permitted in such a state. Some associations may take the position that so long as it is not prohibited it is permitted, but get good advice on that point. Where it is expressly permitted by statute, associations should consider amending their bylaws to explicitly provide for electronic voting as an option, but need not make electronic voting the only method of voting.

Hot Topic #2: Liquor Liability – Any discussion of liquor liability should be a sobering reminder of the potential liability of an association for actions or omissions at its events. If the association sponsors an event at which alcohol is provided, it should take risk management steps to reduce its potential legal exposure for accidents somehow related to the alcohol service. The association should avoid being in the alcohol service business. Have a licensed caterer, a restaurant or hotel do the actual serving of the alcohol. Restrict or eliminate hospitality suites sponsored by the association, and police them carefully if the association does sponsor such an event. Limit the amount of alcohol served by using drink tickets, having fewer bars, requiring bartenders to use "standard pours," and shorten the hours of the event at which liquor is being served. In the meeting contract, allocate responsibilities and potential liabilities, require bartenders and others involved to have liquor training, and expressly require they shut off any person who appears intoxicated or underage. Consider proving cab service or other transportation to any attendee who seems impaired when leaving the event. Be proactive! It is simply too easy for someone to leave an association event, drive away and be involved in an accident. In such cases, the association should anticipate being sued. Also, consider host liability insurance for the event if it is not part of your regular insurance.

Terrence Hutton is an officer and partner of Howe & Hutton, Ltd., Chicago, IL. Howe & Hutton, Ltd. concentrates its practice in the representation of not-for-profit organizations, principally trade associations and professional societies, their foundations and other related entities. The firm also concentrates its practice in the hospitality industry as an outgrowth of its association and professional society practice, representing meeting planners, hotels and other hospitality industry vendors.

Mr. Hutton graduated from the University of Notre Dame with a BBA in 1961; served with the U.S. Navy aboard a Pacific fleet destroyer and the Naval Advisory Group in Vietnam from 1962 to 1966; and was with the National Bank of Detroit and RCA Computer Systems Division before law school. He graduated with honors from Northwestern Law School in 1972 where he was a member of the Law Review and Order of the Coif before joining a large Chicago from 1972 to 1985 where he concentrated in litigation and federal trade regulation initially, leading him to his present concentration in trade associations and other not-for-profit organizations. In 1985 he and Jonathan T. Howe founded Howe & Hutton, Ltd., to concentrate in the representation of trade associations, professional societies and the hospitality industry. He is a member of the Association Forum of Chicagoland which Howe & Hutton, Ltd. serves as general counsel, and the American Society of Association Executives, and various bar associations.