

## IRS on Governance

*The IRS recently released a staff discussion draft on governance practices for Section 501(c)(3) organizations. They are seeking public comment on the recommendations in the draft and expect to revise it based on the comments they receive from the nonprofit community.*

Nonprofit governance is not normally something one associates with the IRS, but the current climate of congressional investigations and increased public attention on nonprofits has caused the IRS to take a more proactive role. Their theory is that good governance promotes compliance with federal tax law. Given that the IRS is only able to audit a small fraction of information returns filed each year, they have few other options for increasing compliance. While it is labeled as a discussion draft, many in the nonprofit community believe it is only a matter of time before the principles in the discussion draft find their way into formal IRS guidance and extend beyond 501(c)(3) organizations to other tax-exempt organizations.

The IRS's draft of *Good Governance Practices for 501(c)(3) Organizations* offers simple guidance for 501(c)(3) organizations. It does not address many of the governance challenges that some older or more complex organizations face, but some of the suggested practices can be a good starting point for many organizations, particularly those just beginning to examine their own governance practices.

To meet the nine good governance practices identified by the IRS, organizations should:

- 1) Adopt a clearly articulated **mission statement** explaining why the organization exists and what it hopes to accomplish.
- 2) Adopt and regularly review a **code of ethics** for board conduct and a whistleblower policy for employee complaints.
- 3) Adopt policies and procedures to ensure that each director has the information needed to exercise **due diligence** and make informed decisions consistent with a duty of care.
- 4) Adopt a **conflict of interest policy** and regularly disclose conflicts and evaluate the policy so that directors exercise their duty of loyalty.
- 5) Practice **transparency** by making full and accurate information about its mission, activities, and finances publicly available.

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### WELCOME

...to Whiteford, Taylor & Preston's **Nonprofit Organizations Update**. This quarterly service of our Nonprofit Organizations Group provides you with practical information about current laws, regulations, and industry news. If you have any suggestions about topics you'd like to see addressed in future issues, please contact Editor Mary Claire Chesshire at [mchesshire@wtplaw.com](mailto:mchesshire@wtplaw.com). We look forward to hearing from you.

- 6) Adopt **fundraising policies** that require the organization to comply with federal and state fundraising laws, keep fundraising costs reasonable, and only use professional fundraisers who are properly registered with state agencies.
- 7) Practice fiscal responsibility by conducting an annual **financial audit**, having a board approved budget, and giving the full board up-to-date financial statements including the organization's Form 990, auditor's letters and financial and audit committee reports.
- 8) Review **compensation practices** to ensure that the organization pays no more than reasonable compensation for services rendered. Board compensation, other than reimbursement of expenses, is generally discouraged.
- 9) Adopt a written **document retention policy** establishing standards for document integrity, retention, and destruction of paper and electronic records.

The full text of the draft principles is available at [http://www.irs.gov/pub/irs-tege/good\\_governance\\_practices.pdf](http://www.irs.gov/pub/irs-tege/good_governance_practices.pdf). Organizations that have not recently looked at their own governance practices may want to review the draft principles and schedule time at an upcoming board meeting to discuss them.

*Eileen M. Johnson*

## Protecting Volunteers From Liability in Maryland

Under Maryland law, your nonprofit or charitable corporation can shield directors and officers from liability by including in its corporate charter a provision limiting their liability for acts or omissions committed in service to your organization. This immunity, however, does not apply in the cases of fraud, intentional torts, violations of criminal statutes, or regulatory violations (such as intermediate sanctions, trust fund tax liabilities and charitable solicitation registration obligations) that provide for personal liability.

Insurance may cover acts or omissions of your agents, including volunteers, in providing services or performing duties on behalf of your organization or association. Specifically, your agents are not personally liable for damages in any suit if your organization maintains insurance of at least:

- (1) \$200,000 per individual claim and \$500,000 per total claims that arise from the same occurrence; or
- (2) \$750,000 per policy year and \$500,000 in total claims that arise from the same occurrence; and

## Attorney Spotlight

### Mary Claire Chesshire

Ranked in Chambers & Partners in 2006 and listed as one of Maryland's Super Lawyers in 2007, Mary Claire Chesshire is a member of the firm's Employee Benefits practice group and the Nonprofit Organizations practice group. Working with both for profit and nonprofit entities, she advises on tax-qualified retirement plans, governmental pension plans, executive compensation programs, and welfare benefit plans. One of her largest clients is a statewide multiple employer plan with assets of \$30 billion and thousands of participants.

A member of the National Association of Public Pension Attorneys, the Maryland

State Bar Association, and the Baltimore City Bar Association, Mary Claire was named by Baltimore Magazine as one of the "Top Lawyers: The Next Generation." Mary Claire is a member of the Board of Trustees of Villa Julie College and has served as a lecturer for the College's Paralegal program. In addition, Mary Claire has worked as a volunteer trainer for the Maryland Association of Nonprofit Organizations. She earned her J.D. from the University of Baltimore School of Law and received her undergraduate degree from the Johns Hopkins University.

Outside the firm, Mary Claire is a member of the Greater Baltimore Community's Leadership Class of 2007 and is a former Board member of the Baltimore Chapter of the Executive Women's Golf Association.



(3) In either case, if the insurance has a deductible, the deductible may not exceed \$10,000 per occurrence.

When the appropriate level of insurance is in place, a plaintiff may recover damages from your organization only to the extent of the applicable limit of insurance coverage. The amount available for recovery includes any amount for which your organization is responsible as a result of any deductible or co-insurance provisions.

This immunity from personal liability does not apply when the director, officer, employee or volunteer acts with malice or gross negligence. The Maryland courts have defined gross negligence as “an intentional failure to perform a manifest duty in reckless disregard of the consequences as affecting the life or property of another,” or “a thoughtless disregard of the consequences” of one’s conduct.

Volunteers of certain associations and organizations may have limited liability for their acts and omissions even if the organization does not carry insurance. Generally, a volunteer is personally liable only to the extent of any personal insurance carried by the volunteer. However, a volunteer will be held liable beyond the limits of any such insurance for his own acts or omissions if the acts or omissions constitute intentional, reckless, willful or wanton misconduct. A volunteer is also liable for damages beyond the limits of any personal insurance for acts of other agents of the organization if the volunteer knew or should have known of the act or omission and if he or she:

- authorized, approved or actively participated in the act or omission; or
- ratified the act or omission after gaining full knowledge of it.

### Federal Law

Enacted in 1997, the Volunteer Protection Act (VPA) grants immunity from personal, civil liability to volunteers working on behalf of nonprofit organizations and government entities. It was enacted to reduce the fear of unreasonable legal liability that caused a drop-off in volunteerism and to combat the rising costs of liability insurance. The VPA generally provides that no volunteer of a nonprofit organization shall be liable for harm caused by acts or omissions of the volunteer on behalf of the organization.

The VPA preempts state laws that are inconsistent with the VPA. However, if Maryland law provides additional protection to volunteers, Maryland law will preempt the VPA, giving volunteers the greatest possible protection from liability.

In order to qualify for protection under the VPA, a volunteer must have:

- acted within the scope of the volunteer’s responsibilities;



- possessed any requisite state license or authorization for the state in which the harm occurred;
- not engaged in willful or criminal misconduct, gross negligence, reckless misconduct, or conscious, flagrant indifference to the rights of safety of the injured individual; and
- not have caused the harm while operating any vehicle for which the state requires that the operator have a license or carry insurance.

Even if a volunteer does not meet all of the requirements for immunity under the VPA, as long as the volunteer was acting within the scope of his responsibilities to your organization, the volunteer will only be liable for non-economic losses and only to the extent that those losses are directly proportionate to the volunteer’s responsibility for the harm to a claimant. Non-economic losses include physical and emotional pain and suffering, inconvenience, physical impairment, and other non-monetary damages, but would exclude, for instance, hospital bills or lost wages. The VPA also limits a volunteer’s liability for punitive damages to those circumstances when the volunteer is proven by clear and convincing evidence to have acted with willful or criminal misconduct.

### Summary

To insure that individuals are not discouraged from providing service to your charitable organization or association, you should consider implementing protections afforded by Maryland law to limit their potential liability. You should consider including in your corporate charter a provision to limit the potential liability of your officers and directors. You should also consider carrying appropriate insurance to protect your officers, directors, employees and volunteers from liability. In addition, beyond the coverage of any personal insurance they may carry, volunteers have some protections from liability under Maryland and federal law.

*Howard Feldman and Erin O. Millar*

## Board Evaluation of the Chief Executive Officer

Although a compensation committee or the executive committee may be delegated the authority to set the CEO's compensation, the entire board should be involved in the CEO's annual review. A consultant can be helpful in determining what questions to ask and in gathering the responses and facilitating communication between the board and the CEO.

Below are some basic questions designed to be used by a board that has chosen not to work with a consultant. They are by no means the only questions that a board should ask when assessing a particular CEO's performance.

### Questions for the Board to Answer:

- 1) Did the CEO meet the goals that were agreed on between the board and the CEO at the beginning of the year?
- 2) In what ways did the CEO excel this past year?
- 3) In what areas can the CEO improve next year?
- 4) Did the CEO move the organization forward in terms of mission, resources, public attention, and other identified objectives?
- 5) Has the organization made overall progress compared to the prior year?
- 6) If the organization has not progressed as expected, were any factors involved that were beyond the CEO's control?
- 7) How are the relationships between the full board and the CEO and between the executive committee and the CEO?
- 8) Do the board and the CEO balance their responsibilities with the board providing leadership and the CEO providing management?
- 9) Does the board support the CEO?
- 10) Is the CEO's total compensation fair and reasonable when compared to that of other executives in similar organizations, considering such things as mission, geographic area, staff size, budgets, etc.?

### Questions for the CEO to Answer:

- 1) Did you meet your stated goals for the year? If not, why not?
- 2) What were your achievements this year?
- 3) What things did you struggle with this year?
- 4) What lessons did you learn this year?
- 5) How has the organization moved forward this past year?
- 6) How are your relationships with the full board and the executive committee?
- 7) Do you and the board balance your responsibilities with the board providing leadership and you providing the management of the organization?
- 8) Does the board support you?
- 9) How can the board do better in supporting you in the year ahead?
- 10) Is your compensation fair and reasonable?

*Eileen M. Johnson*

## Virginia Sales Tax Law Change Effective July 1, 2007

Virginia has made it easier for Section 501(c)(3) and (c)(4) organizations to qualify for and renew their sales and use tax exemptions. Effective July 1, 2007, the level of gross annual revenue that triggers the requirement for a financial audit to accompany the application has been raised from \$250,000 to \$1 million. Organizations with gross revenues in the previous year between \$750,000 and \$1 million can provide either a financial audit or a financial review performed by an independent CPA. This change was in response to complaints from small nonprofits, particularly rescue squads and fire departments, over the high cost of a CPA audit.



**WhitefordTaylorPreston<sup>LLP</sup>**

Understanding the business of nonprofits

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