

Lay the Groundwork for Leadership Succession

With so many pressing governance and funding issues, succession planning is not always high on the agenda of not-for-profit boards — that is, unless there's a looming vacancy in the executive director post.

But even when you don't anticipate an opening, it's important for your board to plan. Based on the odds alone, boards are likely to be faced with the need to tap a new leader because turnover is high in the executive director ranks. According to national and local surveys, the average tenure is about three years.

Also, ascertain whether an ad hoc transition committee or a permanent committee will lead the search.

Another consideration is whether you'll need assistance from an executive search firm or board consultant. If so, do you already have a relationship with someone who can help you?

Even if the performance of the current executive has been exemplary, a not-for-profit may be growing in new directions and need different skills. For instance, you might want someone who brings stronger managerial skills or

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Selecting a new leader is one of the most critical decisions boards are asked to make and it's too important to fail to plan for.

Being prepared

Boards should always be ready to launch an organized executive search. Prepare by determining in advance which board members are qualified and willing to screen

better conveys your organization's mission. Staff members, funders, clients and others who interact with your not-for-profit can offer valuable insights about your leadership needs.

Creating an emergency plan

Another solid practice is to have an emergency plan that allows your

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Does your Not-For-Profit Earn Unrelated Income?

Profitable activities may trigger unrelated business income tax

Tax-exempt organizations must be operated primarily for their stated exempt purpose, but the IRS allows them to carry on certain unrelated business activities without jeopardizing their exempt status. If these ventures are not related to a nonprofit's core mission, however, the organization may have to pay unrelated business income tax (UBIT) on the net income.

Even organizations exempt from filing Form 990, such as churches, could still be subject to UBIT if an income-generating activity is deemed to be unrelated to their purpose.

Some not-for-profits have opted to simply steer clear of activities that might be considered unrelated out of appearance concerns or fear they might endanger their exempt status. Others have taken the stance that because they may incur tax liability, it's best to avoid having unrelated business income altogether.

But when carried out properly, unrelated activities pose little risk for not-for-profits. Even if UBIT is owed — and often it isn't because taxes are paid only on the net income after expenses — your organization still has the potential

to retain substantial income for your effort.

Rather than routinely avoiding ventures that might incur income tax, raise your awareness of the rules in this area so you can effectively comply if you conduct an income-generating activity.



Take the “unrelated” test

According to the IRS, an activity is unrelated and potentially subject to tax if it's:

- A trade or business,
- Regularly carried on, and
- Not “substantially related” to an organization's exempt purpose.

A trade or business is defined as selling goods or performing services to produce income. It's considered to be regularly carried on if it's frequent, continuous and pursued in a manner comparable to the commercial activities of a nonexempt organization.

To determine if an activity is substantially related, the IRS looks at whether there is a clear relationship between the activity and the organization's ability to achieve its exempt purpose.

Understand unrelated activities, exclusions

Many types of income-producing activities may be unrelated, depending on the circumstances. For example, income derived from the rental or sale of most debt-financed property, rental income from parking lots, and regular revenue from advertising are usually considered unrelated income.

Sponsorships aren't included in advertising because they are treated as contributions rather than income. The IRS has loosened the rules on sponsorships to allow qualitative or comparative descriptions if they are part of that organization's slogan or corporate message — for instance, “the region's best.”

In addition to the general rules for unrelated activities, there are numerous activities and situations that are excluded from UBIT, including:

- Activities substantially performed by uncompensated volunteers,
- Most passive income, such as royalties, dividends and interest,
- The sale of donated merchandise (for example, goods given to a thrift shop),
- Real property rental income (unless it's debt-financed),

- Income from bingo in states where it isn't carried on by for-profits,
- Income from the rental or exchange of mailing lists with other exempt organizations or with for-profits, as long as no other services are provided,
- Income from trade shows and conventions,
- Activities carried on primarily for the convenience or benefit of members, students, patients or employees (such as a school cafeteria), and
- Qualified sponsorship payments.

Organizations with annual gross income of less than \$1,000 from unrelated business activities are excluded from UBIT.

Follow the tax rules

As is the case with most tax matters, the rules pertaining to unrelated business income contain numerous exceptions and stipulations. For instance, if you expect to owe \$500 or more in UBIT, your organization must make quarterly estimated tax payments.

Unrelated activities, whether excluded from UBIT or not, may consume too many resources. When this occurs, the IRS may see the unrelated business activities as your organization's primary focus

and revoke your exempt status.

In complex financial situations such as these, you should seek professional advice before starting a for-profit venture or filing Form 990-T, the income tax return for exempt organizations.

Assess your objectives

It's not inherently bad for



your not-for-profit to conduct unrelated business activities. You can develop a much-needed income source, which can further your mission.

But, as with any business matter, your decision to engage in profit-making should be carefully evaluated in the context of your organization's needs and goals. ■

Being Green May Yield a Tax Break

A little-noticed provision of the American Jobs Creation Act of 2004 offers exempt organizations an opportunity to generate tax-free income for being a good steward of the environment.

The law specifically excludes from unrelated business income tax any gain or loss resulting from the remediation of brownfield properties and their subsequent sale or exchange by not-for-profits.

Several requirements are associated with the tax break, including:

The acquisition date and brownfield status. You must acquire the property before 2010 and it must be a qualifying brownfield — that is, one that has been certified as possibly having hazardous substances, pollutants or contaminants.

Remediation expenses. Your not-for-profit must spend a certain amount on remediation: the greater of \$550,000 or 12% of the property's fair market value at the time you acquired it.

Lack of involvement. You can't have caused the property's environmental damage or have ties to anyone who could be held liable.

This provision could pave the way for not-for-profits that are receptive to new income-producing activities and that have the resources to carry them out to do a good deed for the environment. ■



A New Frontier in Fund Raising

Online auctions can extend your donor base and more

In the never-ending search for new fund-raising avenues and tools, many not-for-profits are finding that online auctions allow them to expand both their reach and their revenues.

The benefits

Online auctions enable organizations to broaden the universe of potential bidders beyond those who are able to attend live events. This tends to drive up bid prices on items and increase exposure for sponsors.

Not-for-profits that have a geographically dispersed donor base are especially good candidates for online auctions. One charity that has a successful track record of hosting online auctions is St. Jude Children's Research Hospital in Memphis, Tenn. The organization, which has hosted online auctions for about four years, draws support from across the country.

Hand-in-hand with live auctions

Not-for-profits that have taken auctions online typically use one of two approaches. The first involves substituting an online auction for a live event. Organizations say that virtual auctions enable them to significantly reduce the time and

costs involved in planning a traditional auction.

Another approach is to use a cybarauction as a precursor to a live one. The online portion allows supporters to place early bids, which are then used to establish the opening price for live bidding. Online participants can also place advance maximum bids that are conveyed by proxy during the live auction.

The auction platform

Many not-for-profits that have run online auctions have used cMarket (www.cmarket.com), which offers an Internet-based auction platform for charitable fund raising.

Here's how it works: Your organization creates a home page for an auction that features your full catalog. You link to the auction site from your regular home page. Integrated into the auction page is the capability to e-mail your entire database, provide links to sponsoring companies and process payments.

In lieu of upfront fees, cMarket charges a percentage of the auction proceeds. The amount is based on a sliding scale, capped at 9%.

According to cMarket, customers have been able to lower their costs and raise more money by taking auctions at least partially online. Some not-for-profits that have used online auctions as a lead-in to a live event report having

raised 50% to 75% of their fund-raising goals before the live auctions started.

Still another way for your organization to raise funds is to sell items directly on eBay. The company collaborates with MissionFish, a not-for-profit organization, to offer eBay Giving Works.

The program, designed specifically for not-for-profits, allows you to raise funds in two ways:

1. Direct selling. The charity lists items for sale, collects the proceeds from buyers and provides a tax receipt; and

2. Community selling. Anyone can sell items on eBay and donate all or part of final sale prices to not-for-profits. MissionFish collects the donations and distributes them to not-for-profits, and issues tax receipts for the organizations.

In addition, MissionFish supports not-for-profits by hosting the listing tool for charity items on eBay and offering free marketing tools that allow not-for-profits to promote their eBay activities.

The perfect audience

As not-for-profits seek to expand their geographic reach and increase the number of contributors, they're finding that cyberspace offers the perfect audience: one that is ever-present, virtually limitless and at ease with online transactions. ■

Giving Businesses Reasons to Give

Like many not-for-profits, your organization would probably like to strengthen relationships with existing business supporters and forge new ones. Although increasing corporate commitment is similar in many ways to seeking support from individual donors, a critical difference is that companies typically need emotional and strategic reasons to give.

Here's how you can make your appeal successful on both counts:

Draw parallels. Because businesses look for opportunities that are a natural fit, target those that share your organization's goals, values and service areas. For instance, the toy company Hasbro Inc. focuses its philanthropy on children's causes. A company may also be receptive if key executives have personal interests or first-hand experiences relating to your organization's mission.

Seek out corporate forums to showcase your mission. Many companies invite not-for-profits to participate in informational fairs held at work sites. This often leads to pledges of monetary or volunteer support from employees. Some companies even match a percentage of their workers' charitable contributions.

Don't just ask, sell. Corporate givers frequently cite a not-for-profit's ability to express a clear, compelling mission as a decisive factor in making donations. Businesses also want to align themselves with organizations that have good fundamentals. Among the things they want to know: Is an organization self-sustaining? What kind of outcomes does it achieve?

How much is actually spent on programs?

Underscore the benefits. Although companies are savvy about the PR value of their giving, it's still important to explain how their donations will help your organization

and what benefits they'll receive.

Finally, emphasize that contributions are investments and the work that is done in the community is the return on the investments. These two concepts always resonate with corporate givers. ■

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board to respond quickly to unplanned leadership transitions so that operations aren't negatively affected. An emergency plan defines the executive's key responsibilities and proposes how the organization will temporarily reassign his or her duties.

This process might highlight the need for current staff members to undergo additional training if they'll take over certain tasks. Or, if the board has already determined that existing staff lack the time or expertise to assume new responsibilities, an experienced interim director can be brought in to maintain operations until your organization finds a permanent replacement.

Selecting a new leader

The regular succession plan expands on emergency backup procedures by outlining your organization's leadership needs in the context of its long-term strategy. For instance, if the five-year plan involves expanding your geographic reach or forming alliances, you would probably want a leader with experience in these areas.

By integrating strategic goals into the succession plan and into the executive director's job description and annual performance evaluation, the focus remains on the specific actions that both current and future executives must perform to further the strategic plan.

Identifying possible successors

Not-for-profit groups don't always have the depth of in-house talent that their for-profit counterparts do, making the need for ongoing succession planning even more important.

To identify possible successors, start by considering whether you have capable candidates within your organization, perhaps an associate director or program director. As you identify potential leaders, determine if they need additional development experiences and help them find ways to attain them. You might increase their involvement in strategy discussions, for example, or have them lead initiatives that increase their visibility and build their interpersonal skills. Grooming existing staff for leadership positions also helps to motivate and retain them.

Although there are benefits to hiring internally, sometimes you need a fresh start. Executive directors are often recruited from outside organizations. Through networking and industry events, board members can keep tabs on talented individuals at other organizations whom they can approach when an opening arises.

Making the transition

By laying the groundwork for succession well in advance of the need, boards can effortlessly guide their organizations through these periods of opportunity and challenge. ■

Mississippi leads country in generosity

Mississippi, the country's poorest state, is also the most generous — for the eighth consecutive year — according to the Catalogue for Philanthropy's *2004 Generosity Index*.

Following Mississippi are other Southern states: Arkansas, Oklahoma, Louisiana and Alabama, in that order. At the bottom of the giving list are Wisconsin, New Jersey, Rhode Island, Massachusetts and New Hampshire, which ranked last. (New York is in the middle of the pack, coming in at #26.) The survey results are based on the difference between residents' average adjusted income and itemized charitable donations as reported on 2002 federal tax returns.

The Catalogue for Philanthropy, which publishes a directory of not-for-profit organizations, created the index in 1997. To view the 2004 survey, visit the organization's website at www.catalogueforphilanthropy.org.

Take precautions for Check 21

You may need to adopt safeguards to protect your not-for-profit against negative repercussions from the Check Clearing for the 21st Century Act. The new federal law, known as Check 21, allows financial institutions to exchange checks electronically, using high-quality reproductions of original checks.

The new system is expected to reduce the "float" — the one-to-five-day period when a check is written and funds are withdrawn from the check writer's account. Many organizations and consumers have become accustomed to relying on the float to stretch their funds, often writing a check a few days before a deposit is scheduled to be made to their accounts. And though checks will clear faster, banks aren't required to reduce the "hold" time they place on deposits.

With the passage of Check 21 last October, the effects of reduced float time have been gradual because many banks don't have the technology to process electronic check images. Nonetheless, the law is expected to cause more bounced checks.

In light of the recent law, you may want to ensure your account has overdraft protection, initiate or increase a credit line, and ask your bank what it will return as evidence of cleared checks. And, of course, don't rely on float time.

IRS revises application for 501(c)(3) exemption

The IRS has revised the application form for organizations seeking tax-exempt status. The new Form 1023, *Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code*, streamlines the application process and minimizes contact with the IRS. It also requires more upfront information, which the IRS says will help it become aware of potential problems earlier in the application process.

"We have identified the use and abuse of charities as one of our four servicewide enforcement priorities," said IRS Commissioner Mark W. Everson. "This new form will give us valuable information about those who might abuse the tax-exempt system and erode public confidence in charities. At the same time, this change will help smooth the application process and minimize the burden on new groups."

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For more information on any issues within these articles, please contact the Partners in our Not-For-Profit department:

Beatrix G. McKane
(631) 752-7400 x-350
BMcKane@hrrllp.com

Gordon M. Siess
(631) 752-7400 x-315
GSiess@hrrllp.com

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NFPAdviser@hrrllp.com.