

Successfully Managing the Costs of Complying with Charitable Registrations

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Watching charities is a necessary government function because, while rare, there's an occasional bad charity, and any number of charities whose activities may deserve occasional scrutiny. The first step in this process is requiring the charities to register with the state's group that monitors charities.

Regulatory Scrutiny Grows

Our purpose is to put this topic in some general perspective, making every effort to be brief with a topic that is inherently complex. There are about forty jurisdictions that may require registration. We look generally at such questions as when registration is required and the costs.

There is soon to be a centralized, electronic place where the charity can register once and this gets sent to myriad jurisdictions. The vehicle is to be launched in upcoming months with some thirteen initial governmental participants. See "Simpler System Will Let Charities Register in Multiple States at Once," Megan O'Neil, Chronicle of Philanthropy, July 25, 2016, and <http://mrfpinc.org>, the Multistate Registration and Filing Portal. This vehicle will entail its own set of costs which are not yet known. It is anticipated that it will make a commendable reduction in the burdens and costs of registration. Yet this vehicle is in its early stages, still not launched, and it remains to be seen how well the site can deal with the disparity of rules among the jurisdictions requiring registration, or the degree to which it will influence greater uniformity within the jurisdictions and whether all jurisdictions will even participate in this approach.

The rules of the various jurisdictions aren't suspended while this centralized approach "gets its legs," and it would be a mistake to postpone registering now because registering in at least some jurisdictions may eventually get easier.

Our principal focus is when the charity should register with the authorities because of a sufficient presence or connection beyond its home state. With such registrations may also come sundry financial reporting and disclosures, and costs of compliance.

Understanding When the Charity Needs to Register

We will presume the charity is already sanctioned as exempt by the IRS and has registered with its home state's regulatory authorities.

An area that may require new registrations is when the charity's exempt work goes multi-state. If your organization helps the homeless and opens a second facility across the border into a second state, the charity would generally consider registering with the authorities when it is operating in a new state, and not be that surprised to pay a small fee for registering.

The area that may surprise many is the issue of registering in a particular governmental jurisdiction because of the charity's activities in raising funds for its exempt purpose. The most common problematic scenario that arises is when the charity begins to think of registering in a state after it has begun to solicit funds in the state.

The most common issue is registering with another state, but we also note that it is possible to run into registration requirements within smaller jurisdictions. A city or county might have its own rules. For example, Los Angeles has rather rigorous requirements.

Our scope doesn't cover any "unrelated" activities of the charity. A charity is generally but not absolutely exempt from income tax. This is true of the federal rules and generally true of the state's income tax rules. A charity may have some "unrelated business income" which becomes subject to income tax without the charity losing its exempt status. What is "related" and "unrelated" are concepts that are very specific to the charity and its exempt purpose(s) found in its governing documents and exemption letter. What is an "unrelated" activity of one charity might be related to the exempt purpose of another charity.

Our focus is on the mainstream exempt activities of the charity and when that may require registration with the regulators beyond the charity's home state.

Registering - How Complex Is Preparation and implementation?

The regulatory environment, including registration issues, needs to be understood up front because the costs involved can even affect decisions concerning the charity's scope and focus.

Part of managing this function is deciding whether the charity's work of registering is done with internal resources, the charity's CPA firm or a non-CPA firm that specializes in registering charities or via the soon-to-be electronic portal whose purpose is to simplify registering in multiple jurisdictions. In some cases, audited financial statements may also be required with registration.

The costs of complying with the registration rules vary significantly with the size and complexity of the organization.

While the term "registration" may sound like it entails little more than disclosure of a name and address, the process of registration is much more involved ...and on-going. Usually, annual registrations or renewals are required.

It will often save money in the long run if the charity's leadership thinks ahead, assigns responsibilities and budgets the costs of compliance. Management might also find a Board member willing to volunteer for this back-office task or fund the cost as a special donation.

Whether the charity does the regulatory registration work in-house or farms it out, management will need these basics for dealing with the task, which is one of detailed, sometimes simple, sometimes complex, disclosures:

Starter documents - Employer identification number, corporate identification number with the state, exemption letter, articles of incorporation or similar documents, including by-laws ;

Recent-past and current people information, such as addresses and compensation of officers, Board members, any commercial fundraisers, registered agents; and

Financial details - the ever-important numbers which may include tax returns, financials, and banking information.

It can be useful to have the Board minutes and important contracts at hand, not to mention prior filings and notes on any prior registration work. Information about related (brother-sister) organizations may be necessary. If your organization happens to be delinquent, you will also need prior years' information.

State-specific information may be needed, such as when the organization first began soliciting funds in the state, and whether there are operations, real estate, or bank accounts in the state.

Questions may arise as to the details of the charity's accounting method for presenting the financial statements and whether there is compliance with particular accounting guidelines.

In general, it is fair to say that most charities are surprised at the level of work and costs involved when they're required to register in another state.

Diversity Within the Regulatory World Adds to the Complexity and Cost

State rules vary widely. For example, a state that requires registration may exempt particular kinds of exempt organizations, or waive registration if the funds raised are below certain dollar levels.

It is quite rare for a state to require a completely separate application for exempt status. California, which seems to be the exception, requires its own separate application for tax-exempt status.

When it comes to these concepts, each jurisdiction is basically free to adopt its own rules, but it is also true that most jurisdictions will piggy-back the rules of others. It is common for a state to accept an out-of-state charity's filings with the IRS. The state or other jurisdiction may add its own one-to-two page report to the charity's federal filings.

Registration will generally get the charity into the regulator's database of registered charities which can even be a plus when a potential donor is working to better understand the charity.

With registration, there usually comes varying degrees of financial disclosures and reporting. Most commonly, the disclosures look to or add somewhat to the annual reporting to the IRS, Form 990.

Most, but not all, states look for the charity to register with them if they're soliciting funds within the state. There are exceptions. The most common statistic as one reads on this topic is that some eighty percent of the states (approximately if not exactly forty) require registration when a charity solicits funds within their borders.

The vocabulary that brings the regulators to the forefront entails "soliciting" in the state and/or "doing business" in the state.

An IRS site summarizes the latter saying, "Doing business' in a jurisdiction may include any of the following: (1) soliciting contributions or grants by mail or otherwise from individuals, businesses, or other charitable organizations; (b) conducting programs; (c) having employees within that jurisdiction; (d) maintaining a checking account; or (e) owning or renting property there." <https://www.irs.gov/charities-non-profits/charitable-organizations/charitable-solicitation-periodic-state-reporting>.

It is generally best to check with the regulators if the charity isn't sure whether it is soliciting funds or "doing business" in the state.

The rule is the rules in one state will vary from the rules in another state, although it is also fair to say the states often work together to minimize the charity's problems in dealing with multiple regulators.

The regulators are not the charity's enemies yet their work and demands entail some cost and time. It is more satisfying to spend the charity's funds on its exempt purpose...or to occasionally take a big donor to dinner, but it is necessary to allocate time and funds to meeting the regulators' requirements. The regulators expect an attitude of compliance from the charity, and an up-front attitude of compliance will generally save the charity's resources in the long run.

The charity will find that planning ahead for such costs will usually minimize them. Planning ahead keeps the topic of dealing with the regulators in the category of a small big deal rather than what may be a significant problem.

We noted that there is some collaborative effort among the states to enable the charity to file a unified registration statement. In the near term, there is to be a centralized vehicle such that a single registration can be multiplied electronically among participating jurisdictions.

But the charity may also find it more expedient to start the registration process with each state's website.

Web Site Fundraising – Simple But Are There Hidden Costs?

There is a complexity that arises from simply putting on the charity's web site a "donate here" button. The issue is whether that button, in and of itself, triggers a registration requirement in a state because one of that state's residents might send a donation.

There are what are termed the "Charleston principles" whose purpose is to find reasonable regulatory principles and whose scope includes internet donations arising from the charity's web site.

The Charleston principles are briefly summarized as follows: The charity should register in the state where it is domiciled and regularly solicits funds. It should register in states where it is targeting contributors, and where it is having some success in a recurring or substantial way by its website solicitations. Also looked at here are non-internet efforts; i.e., looking to whether the state's rules require registration because of mail or phone solicitations.

These principles are not adopted in many states and are only cited as general guidelines in some states.

The general context is that before the charity even solicits funds in a state, it may be required to register looking to the guidelines of that state.

If the charity registers after it began soliciting, it may find the regulatory form asks when solicitations began. There may be late fees if the charity registers after it began solicitations.

Are you soliciting in all the states because of that "donate here" button? Theoretically, potentially, you are subject to registration because a state might conclude you are soliciting in the state when their residents read your site.

The issues here often raise questions, if not heated debate.

The practicalities are that this is a difficult and evolving area.

It may not seem practical to expect that a small charity will necessarily register in every possible regulatory jurisdiction when there is a remote contingency of getting a donation from a distant state, but the rules being read by the regulator in that distant state may not reflect sympathy to the charity's plight. As we noted, the state's rules may also exempt registration prior to donations reaching certain levels.

Part of the problem here is that there are some charities whose fundraising history is such that they do eventually get shut down by the regulators.

Regulators have some legitimate concerns of abuses via the internet.

The regulatory rules facing your particular charity are going to be unique to your circumstances - the nature of the charity, its particular fundraising and charitable activities, etc. It is management's responsibility to understand those activities and relate them to the regulatory world that provides oversight of charities on behalf of the general public.

Preserving the Charity's Resources While Satisfying the Regulators

It is the job of the charity's management and Board to understand the regulatory environment and chart a course that keeps the costs of compliance at a reasonable, if not always minimal, level, and safeguard's the charity's assets from unnecessary penalties.

It puts the charity's assets at risk to disregard or minimize the regulatory environment, including the requirements about registering and filing periodic reports with the regulators.

It is much easier to preserve the charity's resources if issues of registration are foreseen and planned as early as possible, preferably from the charity's inception. One of the topics at the first meeting of the Board should be to purpose to understand and comply with the regulatory environment, including the reporting and filing requirements that apply to the particular circumstances of the charity.

The new electronic portal will hopefully succeed in its goal of simplification. Not to be pessimistic, we note there are issues here of sovereigns getting together to cooperate. And while the analogy does seem a stretch, the original thirteen colonies grew into the United States, but there were disagreements and struggles, even a civil war. We hope for the best but wait to see what the original thirteen "states" participating in the electronic portal will grow into.

Connections

Consider discussing with upper management a policy as to when the charity registers with out-of-state regulators.

Consider whether the regulatory registration function is best handled with internal or outside resources. If the function is handled externally, after identifying the service provider, set procedures for reporting.

If the regulatory registration function is handled internally, identify a person responsible for monitoring registration with the regulators. Such person should be educated in the issues and keep up with regulatory developments. The person should assemble the information typically

required in the registration process and arrange for ongoing, updated data. Such person should organize the files and correspondence on the topic, and be kept informed when the charity's nexus with a particular state increases due to increased fundraising efforts or other factors. This person may need to organize a time table of due dates, necessary actions, etc. This person should periodically report to management.

Coordinate with accounting the financial information needed to comply with regulatory filings and consider whether registering with regulators needs to be added to the budget process.

Please feel free to contact us at Rojas & Associates , CPAs, rojascpa.com, for any help we can provide.