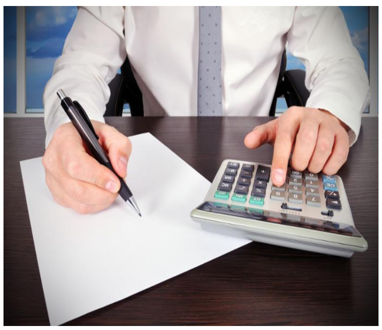
New Overtime Rules Affect Nonprofits

PLUS: Changes in Filing Fee for 1023-EZ, Ask Annie and Uyen, and Upcoming Seminars

Community Development Project
July 2016 eNewsletter



New Rule on Overtime Exemptions May Affect Nonprofits

On May 18, 2016, the Department of Labor released new updates to the Fair Labor Standards Act (FLSA) overtime exemption regulations, changing the salary threshold required for a white collar salaried employee to be exempt from federal minimum wage and overtime protections. Under these new rules, nonprofit employers may either be required to pay overtime to certain employees that would have been exempt under the old rules, or raise employees' salary to take advantage of the exemption.

The new rules go into effect on December 1, 2016.

What is the FLSA?

The FLSA establishes minimum wage, overtime pay, recordkeeping, and youth employment standards affecting employees in the private sector and in Federal, State, and local governments. The Wage and Hour Division of the U.S. Department of Labor (DOL) administers and enforces the FLSA with respect to private employment, and State and local government employment.

Does the FLSA Apply to My Employees?

There are two main ways that a nonprofit employee may be subject to the minimum wage and overtime requirements of the FLSA: (1) the employer is a *covered enterprise*; or (2) the worker is *individually covered*. A *covered enterprise* is one that engages in ordinary commercial activities (e.g., running a gift shop) that result in $500,000 or more in business or sales per year. Income from contributions, membership fees, and donations used to further charitable activities are not counted toward the $500,000 threshold. There are also certain types of

In This Issue...

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Free Training on Revenue Generating Models for Nonprofits

Please join us for a **free training on social enterprise and revenue generating activities for** nonprofits which are always covered under the FLSA, regardless of annual business or sales, including hospitals, schools, and institutions providing care to older adults and people with disabilities who reside on the premises. Even if a nonprofit employer is not a covered enterprise, an *employee* may be covered if he or she engages in interstate commerce - for example, making out-of-state phone calls or ordering goods from an out-of-state supplier.

There are various categories of employees who are exempt from the FLSA due to their specific method of payment (salaried versus hourly), job duties, and, important for the new rule, *salary*. An "exemption" means that the overtime law does not apply to a particular classification of employees. A comprehensive list of all requirements for each exemption can be found here: https://www.dol.gov/whd/overtime/fs17a_overview.pdf.

What Are the New FLSA Regulations**?**

The new regulations update the *salary* required for the executive, administrative, and professional ("white collar") exemption. The job duties and method of payment components of overtime eligibility will remain the same. Specifically, the new regulations double the minimum salary threshold for the white collar exemptions from $23,660 annually ($455 per week) to $47,476 annually ($913 per week). Further, beginning on January 1, 2020, the salary threshold will automatically update every three years and will be tied to the 40th percentile of weekly earnings of full-time salaried workers in the region of the country with the lowest wages.

In addition, the new regulations increase the minimum salary threshold for the FLSA's "highly compensated" exemption from $100,000 to $134,004 per year. This new salary threshold also will increase every three years and will be tied to the 40th percentile of earnings of full-time salaried workers nationally. DOL estimates that this threshold will increase to $147,524 during the first automatic update in 2020.

What About California Laws?

Although the federal threshold for exempt status has been $23,660 annually, California has very distinct wage and hour laws - in California the threshold level for exempt status is set as twice the state's minimum wage. Therefore, with the current minimum wage in California being $10 per hour, in California the minimum salary for exempt status is currently $41,600 a year and as of January 1, 2017, when the minimum wage increases to $10.50 per hour, the minimum salary for exempt employees will be $43,680 per year. In California the differential between the current ($41,600) and new ($47,476) exempt thresholds is not as large. For example, if a nonprofit employee covered by the FLSA in California currently makes $45,000 per year, beginning December 1, 2016, she will need to make at least $47,476 in order to be classified as an exempt employee under the new federal threshold. Note that the California wage and hour laws apply to all nonprofit employees - there is no requirement of enterprise coverage or engaging in interstate commerce. For more information on how the new FLSA regulations impact California, please visit: http://calnonprofits.org/publications/article-archive/495-new-overtime-rules-for-nonprofits-what-s-different-about-california.

If the FLSA Applies to My Employees, What Changes Do I Need to Make?

nonprofits on Wednesday, August 31, 2016, from 8:30 AM to 10:30 AM, sponsored by Boston Private. Social enterprise generally describes some form of commercial activity in support of a socially beneficial purpose.

A nonprofit may consider engaging in a social enterprise as it explores additional ways to generate income and become self-sustaining while staying true to its mission. There are a number of legal and tax options for structuring social enterprise activities. In this seminar, Cecily Jackson-Zapata of Sustainable Law Group, P.C. will provide you with an overview of the social enterprise landscape, an understanding of various legal models which can be used to conduct social enterprise activities, and next steps to consider in carrying out your social enterprise. For more information, visit our website.

Nonprofit Incorporation Seminar

Join us on **September 27, 2016 from 5:30 PM to 8:00 PM** for an affordable seminar for new nonprofits, cosponsored by Public Counsel and the Center for Nonprofit Management. Startups and new nonprofits

For workers who work more than 40 hours in a week and no longer qualify for an exemption from overtime due to their salary level, nonprofit organizations - like all business organizations - have multiple options on how to respond to the rule. The organization may:

1) Increase the salary of an employee who meets the duties test associated with the exemption to at least the new salary level to retain his or her exempt status;

2) Pay an overtime premium of one and a half times the employee's regular rate of pay for any overtime hours worked - this approach works for employees who usually work 40 hours or fewer, but have seasonal or occasional spikes that require overtime for which employers can plan and budget the extra pay during those periods;

3) Evaluate and realign employee workload - employers can limit the need of employees to work overtime by ensuring that workloads are distributed to minimize overtime and that staffing levels are appropriate for the workload.

The circumstances of each affected employee will likely determine how employers respond to these new regulations. For example, employers may be more likely to give raises to employees who regularly work overtime and earn slightly below the new standard salary level, in order to maintain their overtime-exempt status so that the employer does not have to pay the overtime premium. For employees who rarely or almost never work overtime hours, employers may simply choose to pay the overtime premium whenever necessary.

Employers should review their current FLSA employment classifications to determine whether the classifications are compliant with the new regulations. Nonprofits also should review their wage and hour policies and time keeping policies to ensure compliance with the new regulations. For more information on the new overtime rules, check out the following resources:

https://www.dol.gov/whd/overtime/final2016/
https://www.dol.gov/sites/default/files/overtime-nonprofit.pdf
https://www.dol.gov/whd/overtime/final2016/nonprofit-guidance.pdf
https://www.venable.com/what-every-nonprofit-should-know-about-the-new-federal-rules-likely-to-cause-a-significant-increase-in-your-non-exempt-workforce-and-overtime-pay-05-19-2016/

If you want to update your employment classifications or have questions regarding how the new regulations impact your organization, Public Counsel may be able to assist you if you qualify for our services. Please call 213-385-2977, ext. 200 to leave a message on our intake line.

face a number of planning, financial, and legal challenges from the outset.

This introductory course will cover both legal and programmatic fundamentals, including best practices for designing successful programs, recruiting an effective board, developing a sustainable fundraising plan, forming a California nonprofit corporation and applying for tax exemption, and complying with ongoing tax and legal requirements.

Seminar attendees are eligible to participate in a FREE "Ask A Lawyer" Nonprofit Formation Clinic (date TBA at the seminar), where they will be able to meet one-on-one with an attorney to discuss specific questions relating to forming a nonprofit and obtaining tax exemption. Advance registration is required. For more information and to register for the seminar, please visit our website.

CDP eNewsletter Archive

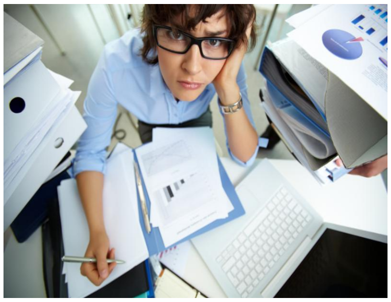
Have you recently joined our mailing list and feel like you've been missing out on great information? If so, we have good news! Previous issues of the CDP eNewsletter are available on our website.

Legal Services for Nonprofits

The Community Development Project builds strong foundations for healthy, vibrant and economically stable communities by providing comprehensive legal and capacity building services to organizations serving people with lower-incomes in the Los Angeles area. CDP provides assistance on a wide range of matters to community organizations, including:

Contract & Lease Negotiation

Does your nonprofit need to



Filing Fee for Form 1023-EZ Lowered to $275 - But Think Twice Before Submitting!

Effective July 1, 2016, the IRS lowered the price of the Form 1023-EZ tax exempt application from $400 to $275. The Form 1023-EZ offers small charities a streamlined application for tax exempt status. Charities with $50,000 or less in annual gross receipts qualify to use the Form 1023-EZ, unless an exception applies.

However, at only three pages and with little information required, Form 1023-EZ applicants risk losing their tax exempt status if they do not appropriately prepare to comply with the many state and federal requirements. The IRS designed Form 1023-EZ to alleviate a backlog of applications for tax exempt status by small charities. In fact, IRS audits show around twenty percent of charities that receive approval through Form 1023-EZ would not survive basic scrutiny of organizational documents. As a result, charities risk losing tax exempt status after operations begin if they fail to properly plan for compliance before submitting a Form 1023-EZ application. New charities should not respond to the new price by simply filing a new Form 1023-EZ application. Instead, before applying for tax exempt status, nonprofit founders should recruit a committed and independent board of directors; carefully draft articles of incorporation, bylaws, and a conflict of interest policy; think carefully about the organization's planned activities; and develop a realistic budget.

For an overview of how to launch and sustain a new nonprofit organization, please attend our low cost seminar on September 27, 2016 from 5:30-8 pm. More information is available here.

Dear Annie and Uyen: Raising Money For A Nonprofit Through Sales or Other Businesses

The Public Counsel Community Development Project newsletter is launching a new feature - "Ask Annie and Uyen." In each newsletter, staff attorneys Annie and Uyen will answer a different question from our readership regarding laws related to nonprofit, tax-exempt organizations. If you have a question which you would like to be addressed in the newsletter, please send an email to Dear Annie and Uyen at

terminate or renegotiate contractual or lease obligations? Do you know whether your nonprofit is legally permitted to sublet unused space?

Employment Advice

Is your nonprofit exploring reduction of employee benefits, salaries or hours? Do you know the criteria to use when downsizing staff? Are you attempting to reclassify employees as independent contractors? Are you aware of the legal implications of all of these actions?

Corporate Governance

Is your board aware of its duties during a period of financial difficulty? Do your board members know how to conduct financial and programmatic oversight? Has your organization adopted a conflict of interest policy? Are your directors aware of the situations where they could incur personal liability for the acts of the corporation, and do you have appropriate controls and procedures in place to protect them?

Debt Reorganization & Cash Flow

Does your nonprofit need to renegotiate debt repayment terms? Do you know what agreement terms you should pay special attention to if applying for or increasing a line of credit? Have any of your key vendors filed for bankruptcy?

Fundraising & Social Enterprise

Is your nonprofit considering alternative fundraising methods (e.g., loans from directors, starting a for-profit business, joint-ventures, etc.)? Do you know how to structure these activities to protect your tax-exempt status? Are you aware of the legal ramifications of using restricted or endowment funds to pay ongoing expenses?

Mergers & Strategic Alliances

Is your nonprofit considering a merger or consolidation to save or expand programs? Do you know the difference between a formal merger and other types of askcdp@publiccounsel.org

Dear Annie and Uyen,

Our nonprofit is exploring alternative ways to increase revenue, such as selling baked goods or holding a car wash. What do we need to consider when analyzing whether to get involved in ventures such as these?

Yours,

Baker Bob and Car Washing Connie

Dear Bob and Connie,

Nonprofit corporations should carefully consider at least three issues before raising funds by engaging in a trade or business (i.e., selling goods or performing services):

First, the nonprofit should make sure that the activity is *consistent with its articles of incorporation.* The articles of incorporation typically include a statement of the organization's purpose. If the purpose in the articles is not sufficiently broad to cover the new business activity, the nonprofit should not engage in the trade or business unless and until it files an amendment to its articles. You can download a form of certificate of amendment here.

Second, the nonprofit needs to consider whether the business activity *will generate taxable income*. Income from a nonprofit's business activities will be exempt from federal and California income tax if the activities are "substantially related" to the nonprofit's purpose. For example, if an organization that provides job training to former foster youth operates a bakery where the foster youth can learn how to make and sell baked goods, that activity would contribute importantly to the nonprofit's purpose and so the income from the sale of the baked goods would most likely not be taxable. But if a hospital or museum operated the same bakery, the business would be unrelated to the charitable purpose; and therefore, it would have to pay taxes on income from the sale of baked goods. In addition to UBIT, a nonprofit may also have to pay sales tax and obtain a seller's permit if it raises revenue through selling tangible personal property. For more information on a nonprofit's obligation to pay sales tax, consult Board of Equalization Publication 18.

Even if a nonprofit's business activities are not substantially related to the nonprofit's exempt purpose, the income might not be taxable if the nonprofit engages in business activities on only an occasional basis (e.g., once or twice a year). The law also provides for certain other specific exemptions. For example, business or trade income will not be taxable if unpaid volunteers perform the work or if the nonprofit sells merchandise or goods that the nonprofit originally received as gifts or donations. For additional information, see IRS Publication 598 on "Tax on Unrelated Business Income of Exempt Organizations."

Finally, a nonprofit should ensure that the unrelated trade or business activities *do not jeopardize its tax exempt status*. A nonprofit may also lose its tax exempt status if it distributes profits from the business to its directors or employees. Further, if an unrelated business activity becomes a substantial activity of the organization such that the organization is no longer operated primarily for an exempt purpose, the nonprofit may lose its tax exempt status. This may happen if a nonprofit's

strategic alliances?

Organizational Documents

Did you know that the Articles of Incorporation and Bylaws determine the legal scope of your organization's activities? Has the economy forced your nonprofit to consider changing its activities or operations? Do you know the procedure for amending your nonprofit's organizational documents and notifying the proper government agencies?

Lobbying & Advocacy

Is your nonprofit advocating for certain government budget allocations or ballot measures on behalf of its constituents or key programs? If so, do you know how much lobbying your nonprofit can engage in and what registration and reporting rules apply?

If your organization needs legal assistance, please call (213) 385-2977, ext. 200 or email cdp@publiccounsel.org unrelated business activities require substantial staff time and/or require additional paid staff, or if these activities produce too substantial a portion of the nonprofit's total income. If unrelated business activities cause an organization to lose its tax exempt status, it will have to pay taxes on all of its income, donors will no longer be able to deduct the amount of their donations from their personal taxable income, and the organization will lose eligibility for certain grants. In short, losing tax exempt status could have a disastrous effect on overall fundraising efforts.

For more information on revenue generating activities for nonprofits, **please come to our free seminar on Wednesday, August 31, from 8:30-10:30 A.M. Click here for more details.**

Very Truly Yours,
Annie and Uyen

Public Counsel is the nation's largest pro-bono law firm with six offices across Los Angeles.

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