



# Firm Foundation: When a Library Needs One

Terry M. Knowles

Assistant Director

AG – Charitable Trusts Unit



# Financial Support for the Library

- Towns and cities in New Hampshire are required to “annually raise and appropriate a sum of money *sufficient* to provide and maintain adequate library service therein or to supplement funds otherwise provided.” RSA 202-A:4 (Emphasis added)
- The term “sufficient”, however, is not defined in the Statutes.

# Eye of the Beholder

- While the amount of money raised through taxation may seem legally sufficient to the voters to adequately support the public library, it is often not seen as adequate or sufficient by the Library Trustees, Library Director, and staff .
- More funding can lead to better programs, better resources, and a growing and vibrant library but obtaining additional tax revenue may not be a realistic goal.
- Are there other options? **Yes!**

# We Libraries

- Many donors want to support their public libraries but will not make a donation to the town or city for fear it will not be used correctly.
- The creation of a Friends group or Library Foundation can help solve this problem.
- But when Library Trustees make the decision to create a nonprofit organization, what form should it take?

# Friends vs. Foundation

- Friends groups and Foundations are both 501(c)(3) nonprofit charitable organizations, but they serve very different purposes
- The Friends raise money for today's needs – books, supplies, technology, etc.
- Foundations raise money to insure tomorrow's needs are met through income generated by endowment funds.

# First Questions

- What is the purpose of the nonprofit – short term or long term library needs?
- Since foundations are more complicated to govern and manage, can the Library Trustees identify potential board members with the time, dedication, and expertise to serve on the foundation board?
- If the new entity is successful, how will the Library Trustees explain the role of the nonprofit to Selectpeople and taxpayers who want to tap into its funding to lower taxes?

# Beginning the Discussion

- What is the mission of the organization?
  - Be specific
  - Be brief
  - Keep in mind the “elevator speech”
- Volunteers
  - Identify individuals with an interest in the library and the potential to be an effective board member
  - Agree on method of recruitment

# 501(c)(3)

- Section 501(c)(3) of the Internal Revenue Code describes the purposes for which nonprofit, charitable status will be granted.
- There are two types of 501(c)(3) organizations:
  - **Public charities** (Friends groups)
  - **Private Foundations** (Foundations)

# Public Charities

- Must meet the IRS “public support” test:
  - **At least 1/3 of annual revenue must come from outside the organization: gifts, bequests, donations, grants, etc.**
- Friends of the Library groups are generally classified as public charities

# Private Foundations

- At least 1/3 of annual revenue is “self generated” from endowment funds and investments.
- New library foundations are generally granted public charity status initially and may be reclassified as private foundations by the IRS at a later date

# Differences in Administration

- Public charities may receive and retain as much money as the board deems to be prudent or necessary and will not incur federal taxes or penalties as a result
- Private foundations are bound by the “5% rule” and must distribute at least 5% of the fair market of the foundation each year.
- Private foundations may be subject to a 2% excise tax on their investments

# Creating a Foundation

- **Foundations are nonprofit organizations not subject to the right-to-know law BUT**
- **If the Library Trustees also serve as the board of the nonprofit, the entity may be subject to the right-to-know law:**

**RSA 91-A:1-a VI (e)** Any corporation that has as its sole member the state of New Hampshire, any county, town, municipal corporation, school district, school administrative unit, village district, or other political subdivision, and that is determined by the Internal Revenue Service to be a tax exempt organization pursuant to section 501(c)(3) of the Internal Revenue Code.

# Creating a Foundation

- **In deciding whether to authorize the formation of a foundation there are several points to consider:**
  - **Is this the right type of organization for our library?**
  - **Who should be chosen as incorporators?**  
**Remember, the incorporators elect the first board.**
  - **Is there a potential to adversely affect the amount appropriated to the library if the foundation is successful?**
  - **How will requests from the library for funding be handled especially if the foundation disagrees with the Library Trustees' priorities?**

# Creating a Foundation

- 1. Draft the mission statement. Example:
  - ***To increase and improve educational and cultural activities in the Town of X through the continued support, growth, and development of the resources, services, and facilities of the X public library. Such support to be in addition to that derived through the normal budgetary process.***

# Creating a Foundation

- 2. Determine governing structure:
  - **Corporation**
  - **Unincorporated Association**
  - **Trust**

# Governing Structure

- Unincorporated Association:
  - Constitution
  - Bylaws
- Corporation:
  - Incorporate with the Secretary of State (must have five incorporators)
  - [www.sos.nh.gov/](http://www.sos.nh.gov/)
  - Bylaws

# BYLAW BASICS

What you need to consider in  
drafting bylaws

# What are bylaws?

- Bylaws are considered a legal document second in importance only to the organization's Articles of Incorporation or Constitution
- Bylaws dictates how the organization is governed.
- Failure by a board to follow the stipulations outlined in the bylaws can have severe consequences that may result in litigation

# Standard bylaw provisions including N.H. specific requirements

- Name (**make sure you renew your charter with the Secretary of State in 2015**)
- Mission or Purpose
- Board of Directors
  - **REMEMBER, RSA 292:6-a: all nonprofit corporations to have a board of directors composed of at least **five independent directors not related by blood or marriage.** This law is designed to promote diversity on boards and to prevent conflicts of interest.**

# Standard bylaw provisions (cont)

- Board role and size (**at least five**)
- Terms (**important to discuss whether or not there should be term limits**)
- Meetings (**when and where including annual meeting**)
- Means of participation in meetings (**Skype? Speaker phone? Virtual meetings?**)
- Notice of Meetings (**snail mail only? Or can notice be given electronically?**)

# Standard bylaw provisions (cont)

- Election of board members – how and when? Do board members serve until their successors are appointed or elected?
- Quorum? What number of directors/members constitutes a quorum?
- Duties of Officers
  - President
  - Vice-President
  - Secretary
  - Treasurer

# Standard bylaw provisions (cont)

- Vacancies – what is the procedure for filling a vacant officer or director position? And by whom?
- Resignation, termination, or absence – consider whether or not to have the ability to remove officers and/or directors for cause. What are the reasons? How is removal accomplished? Due process considerations.

# Standard bylaw provisions (cont)

- Special meetings – called by whom and for what purpose?
- Committee structure – are there standing committees (audit, nomination, executive)? How are members to the committees selected and by whom?
- Process for amending bylaws must be included

# Other Provisions

- Whistleblower Policy
- Document maintenance and destruction policy
- Specific powers that directors can only exercise upon supermajority votes of the directors – purchase or sale of real estate, hiring and firing decisions, etc.
- Qualifications of board members – are background checks required?

# Membership organizations: N.H.

- If the entity is a membership organization, the law dictates certain requirements:
- RSA 292:6-b **Articles of Agreement for membership organizations must contain:**
- **II-a. The provisions for establishing *criteria and procedures* for membership and participation in the corporation.**

# Membership organizations (continued)

- **Members shall have no voting rights, except as specifically provided in the articles or **bylaws**.**
- **The articles or **bylaws** may fix the term of membership.**

# Membership organizations (continued)

- **IV. Notwithstanding any provision of the articles or **bylaws** to the contrary, each individual board member and each member of a voluntary corporation entitled to vote shall be entitled to no more than one vote.**

# Why is this important?

- If membership criteria and voting rights are not clearly defined in the **bylaws** it can lead to confusion.
- More importantly, if there is a group of disgruntled members who discover membership criteria is vague they may have the ability to take over the organization by recruiting new voting members.

# Conflict of Interest requirement

- RSA 7:19-a requires nonprofit organizations to adopt a conflict of interest policy and to affirm the policy on an annual basis.

# Conflict of Interest bylaw provisions

- RSA 7:19-a I (c) “the following shall not be considered as pecuniary benefit transactions:
  - (2) A benefit provided to a director, officer, or trustee or member of the immediate family thereof if:
    - (A) The benefits are provided or paid as part of programs, benefits, or payments to members of the general public; and
    - (B) The charitable trust has adopted written eligibility criteria for such benefit **in accordance with its bylaws** or applicable laws; and
    - (C) The director, trustee, or family member meets all of the eligibility criteria for receiving such benefit;

# Conflict of Interest bylaw provisions

- II. A pecuniary benefit transaction shall be prohibited unless it is in the best interest of the charitable trust and unless all of the following conditions are met:
  - (b) The transaction receives affirmative votes from at least a 2/3 majority of all the disinterested members of the governing board of the charitable trust, which majority shall also equal or exceed any quorum requirement **specified in the bylaws of the charitable trust**

# Robert's Rules of Order

- *“We have said it before and we will say it again: Most organizations should avoid Robert's Rule of Order like the plague. There is nothing wrong with Robert's Rules of Order when adopted by the right organization for the right reasons. The right organization is a parliamentary or legislative body, not your typical nonprofit charity.”*
    - Jack Siegel A Desktop Guide for Nonprofit Directors, Officers, and Advisers, Avoiding Trouble while Doing Good
- Used with permission from Jack Siegel***

# Should we adopt Robert's Rules in our bylaws?

- There is no law mandating that nonprofits must make decisions using Robert's Rules but organizations often make the decision to use the Rules.
- If you decide to adopt Robert's Rules of Order it is important to understand what that means – perhaps appoint a Parliamentarian

# Tips

- Make sure the **bylaws** are tightly worded and not open to conflicting interpretations
- Review the **bylaws** on a periodic basis and eliminate or amend any outdated or obsolete provisions
- Make sure all new board members receive a copy of the **bylaws** and encourage the members to read them.

# Tax Issues

- 3. Apply for tax exempt status from the IRS on form 1023:
  - <http://www.irs.gov/pub/irs-pdf/f1023.pdf>
- Apply for employer identification number (EIN) on IRS form SS#4:
  - <http://www.irs.gov/businesses/small/article/0,,id=102767,00.html>
  - **An EIN may be obtained on-line**

# Obtaining Tax Exempt Status from the IRS

- Complete the IRS form 1023 (application for tax exempt status) and the IRS form SS#4 (application for tax identification number)
- Register with the Attorney General, Charitable Trusts Unit
  - <http://www.doj.nh.gov/charitable-trusts/documents/nhct-1-application.pdf>

# IRS Form 1023

- Essential information necessary to complete the form:
  - **For the Internal Revenue Service (the IRS) to recognize an organization's exemption, the organization must be organized as a trust, a corporation, or an association.**
  - **Does the organization have an exempt purpose?**

# IRS Form 1023

- **Part I: Identification of Applicant questions**
- **Part II: Organizational Structure**
- **Part III: Required provisions in your organizational documents**
- **Part IV: Narrative description of your activities**
- **Part V: Compensation and Other Financial Arrangements With Your Officers, Directors, Trustees, Employees and Independent Contractors**

# IRS form 1023

- **Part VI: Your Members and Other Individuals and Organizations That Receive Benefits From You**
- **Part VII: Your History**
- **Part VIII: Your Specific Activities**
- **Part IX: Financial Data including three-year budget**
- **Part X: Public Charity Status**

# IRS Form 1023

- **Part XI: User Fee Information**
  - **If your average annual gross receipts have exceeded or will exceed \$10,000 annually over a 4-year period, you must submit payment of \$750.**
  - **If your gross receipts have not exceeded or will not exceed \$10,000 annually over a 4-year period, the required user fee payment is \$300.**

# IRS Form 1023 attachments

- Schedules A – H may or may not be required depending upon the structure and purpose of the organization and whether it will have members.
- Decide if you want to have members and, if yes, what authority members will have over the organizations' decision making process.

# **Types of Gifts: Endowment Funds – Blessing or Bane?**

# Are endowment funds a blessing?

- Alice Smith was a faithful patron of the ABC Public Library for her entire life. When she died she bequeathed her entire estate, \$1,000,000, to the ABC Library Foundation for the establishment of an endowment fund with the income to be used for beautification of the library building.
- The funds were received and invested by the ABC Library Foundation.
- During the next budget cycle the Library Trustees asked the taxpayers for money to replace the old windows in the Library. The taxpayers said “no”.
- What happened?

# Endowment as Bane

- The concept of an “endowment” is often misunderstood and when a large sum of restricted money is received, taxpayers may not understand the funds must be used as directed by the donor.
- Hostility can result when Selectboards or taxpayers see \$1,000,000 sitting on the books of the Library Foundation while at the same time they are being asked to pay higher taxes.
- “*Why can't we just use the \$1,000,000?*”

# Endowment as a Blessing

- Any Board of Library Trustees contemplating the establishment of a foundation with the goal of creating a large endowment fund, should make sure taxpayers and Selectboards understand the law of endowments and donor intent.
- *This is not the taxpayers' money.*

# General Concepts: Administering Donated Money and Property

- Important terms and concepts:
  - What is an endowment fund?
  - What does “temporarily restricted” mean?
  - How about “unrestricted” gifts?
  - Can additional restrictions be placed on an unrestricted gift?
  - What does “fiduciary” mean?

# What is meant by the term “Endowment”?

- *Permanently restricted:*  
A donor-imposed restriction that stipulates that resources be maintained permanently but permits the organization to use or expend part or all of the income (or other economic benefits) derived from the donated assets.

# Example

- I give the sum of \$100,000 to X Public Library Foundation, the income to be used to purchase computer equipment.”
  - **The principal amount must be held in tact, only the income may be expended and then only for the purchase of computer equipment.**

# What does “temporarily restricted” mean?

- A donor-imposed restriction that permits the organization to use or expend the donated assets in their entirety as specified by a certain event in time or by actions of the organization.
  - Example: “I give to the X Public Library Foundation the sum of \$100,000 to be used in building an addition onto the library.”

# Unrestricted Gifts

- May be expended in their entirety according to the language of the donation.
  - “I hereby give to the X Public Library Foundation the sum of \$5,000 for its general purposes.”

# Can unrestricted gifts become restricted?

- **Library Trustees and Boards of Directors of nonprofit organizations will sometimes want to gather together the unrestricted gifts received by the entity to create an “endowment fund” to provide for future needs.**
- **It is important to note the donee organization cannot place additional restrictions on a gift; successors in these positions are not bound by the actions of their predecessors and may remove the restriction.**

# Board Members are “fiduciaries”

- Duty of Loyalty
- Duty of Care
- Duty to Manage
- Duty of Obedience

# Duty of Loyalty

- **Board members must act in the best interest of the trusts held in their custody rather than in furtherance of personal interests or of the interests of third parties.**
- **Unless the trust instrument specifies otherwise, no entity has the authority to override the Board's decision making power in the administration of these funds except the Attorney General and the courts but only under certain circumstances.**

# Duty of Care

- ***Pay Attention!***
- **Duty to take reasonable steps to monitor the management and investment of the endowment funds;**
- **Duty to be satisfied that any decisions made are in the Foundation's best interests.**
- **The duty of care means to act carefully when acting as a nonprofit board member.**

# Duty to Manage/Duty of Obedience

**Board members have the duty to manage and administer the endowment funds in accordance with donor intent, to establish an investment policy, to exercise due diligence, and to act within the scope of authority as stated in the Statutes.**

## RSA 292-B Uniform Prudent Management of Institutional Funds Act

- Applies to the management, investment, and expenditure of endowment funds held by nonprofit organizations.
- Does not apply to funds held in the custody of the Library Trustees.
- Contains a standard of care for fiduciaries to follow in selecting a spending policy.

# Finally,

- Keep in mind that while the board members of the Friends group or Foundation support their library, they will not necessarily agree with all funding requests made by the Library Trustees.
- Open and honest communication between the Library Trustees and the nonprofit board will ultimately benefit the libraries we all love!

# Contacting the Attorney General

## General

**Department of the Attorney General  
Charitable Trusts Unit**

**33 Capitol Street**

**Concord, NH 03301-6397**

**Phone: 603-271-3591**

**Fax: 603-223-6221**

**E-mail: [terry.knowles@doj.nh.gov](mailto:terry.knowles@doj.nh.gov)  
[lisa.english@doj.nh.gov](mailto:lisa.english@doj.nh.gov)**

