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10 Legal Issues for Nonprofit and Association Leadership in 2024

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As 2024 gets underway, the nonprofit sector will continue to face new challenges in addition to grappling with ongoing challenges that continue to impact the sector. Our interdisciplinary team, serving thousands of nonprofits and associations, has identified 10 topics that may be top of mind as we go further into 2024.

1. Fundraising

Whether a nonprofit is funded by donations from the public, grants from the government or other organizations, or by program service revenue for delivering goods and services to the public, fundraising and fundraising compliance is always top of mind for nonprofit leadership. State charity regulators continue to engage in enforcement efforts to ensure charitable organizations comply with the increasing regulation of charitable solicitation activities. State regulatory efforts extend not only to the organizations themselves but also to professional fundraisers, online charitable solicitation platforms, crowdfunding, and cause-related marketing initiatives by for-profit businesses. In 2023, there were over 45 active investigations brought by state attorneys general.

Organizations that seek donations from the public or solicit grant funds should ensure they remain complaint with the registration and annual filing requirements that apply to their activities. Certain

online charitable solicitation platforms are also using new technology to scan a charitable organization's compliance with state registration and filing requirements, suspending the charity's ability to raise funds through their platform if they are delinquent on their filings, which can materially impact an organization's fundraising efforts. Organizations should also ensure that their engagements with third parties to fundraise on their behalf, or to help plan or conduct fundraising activities or events, comply with any applicable regulatory requirements. Organizations that allow companies to use their name in connection with a cause-related marketing or advertising campaign should also ensure the agreements are structured consistent with applicable laws and any applicable registrations or filings are completed.

2. Unrelated Business Activities

Nonprofits that engage in business activities should continue to be mindful of the rules that apply to unrelated trade or business activities. Although nonprofits are generally exempt from federal income tax on most of their activities, they remain subject to unrelated business tax on income from a trade or business that is regularly carried on and not substantially related to furthering their exempt purposes. There are many exceptions to this rule, but also exceptions to these exceptions. For example, a nonprofit that receives dividend income is generally exempt from tax on that income, regardless of whether it would otherwise be treated as income from an unrelated trade or business. However, if the nonprofit borrows funds to purchase that stock, it may nonetheless have to pay tax on the dividends.

The requirement to calculate unrelated business income tax separately for each unrelated trade or business went into effect for tax years beginning after December 31, 2017. Although the Internal Revenue Service (IRS) regulations, which allow organizations to rely on the first two digits of the North American Industry Classification System (NAICS) codes to determine separate trades or business for this rule, significantly mitigated the potential impact the new requirement might have, nonprofits must still be mindful to track and properly report different unrelated trades or businesses. Depending on the circumstances, a nonprofit may benefit from moving multiple unrelated trade or businesses to a for-profit subsidiary.

Nonprofit leadership should pay attention to how revenue-generating activities are both structured and reported. They may want to work with counsel to consider whether there are alternative structures that may better serve the organization and its goals. At the end of 2023, the IRS also released its Technical Guide on Unrelated Business Income Tax. Although the Guide itself is not law, it provides some helpful insight as to the IRS's examination techniques in this area.

3. Congressional Focus on Nonprofits

US Congress continues to focus on increasing regulation of foreign funding received by nonprofit organizations. Over the last two years, we have seen much more engagement by members of Congress in their input regarding the activities of nonprofits. One area that has received a lot of attention is the work that nonprofits are doing with immigrant populations. Many humanitarian nonprofits have been targeted by members of Congress claiming that groups supporting immigrants are, in fact, engaging in human trafficking. This accusation is made after the nonprofits offer support to immigrants that come across the border illegally, even if these people are looking for emergency asylum support. While this oversight does not always come in the form of legislation, even receiving a letter from members of Congress asking in-depth questions on funding sources and nonprofit activities can cause serious stress and complications. When nonprofits are approached by Congress or feel their work is being implicated by Congressional action, we recommend they engage legal

counsel to carefully negotiate the level of engagement in their response.

Additionally, several bills have been introduced in Congress that would directly impact nonprofits. For example, H.R. 6408 aims to suspend the tax-exempt status of any organization designated as a terrorist-supporting organization. Such designation applies to organizations that have provided material support or resources to a terrorist organization during the three-year period prior to their designation. While this bill is not likely to move through the entire legislative process, it serves as a reminder that nonprofits providing support to residents of certain countries could be subject to greater political scrutiny.

An important consideration for nonprofits is their level of engagement with Congress and local legislative bodies. There are legal differences to keep in mind when a nonprofit engages in advocacy as opposed to lobbying. While most nonprofits can engage in lobbying to a certain extent, a 501(c)(3) public charity has strict limitations on how much legislative lobbying is permitted. A 501(c)(3) private foundation may not engage in any legislative lobbying. A 501(c)(4) organization has different limits and can engage more robustly in lobbying or advocacy. Maintaining a complete understanding of what your particularly nonprofit is allowed to do regarding legislative engagement is vital for its tax-exempt status.

4. Election-Year Considerations

With the upcoming presidential election, nonprofit organizations should be mindful of the rules and restrictions on political campaign activities that apply to tax-exempt organizations. Section 501(c)(3) organizations are prohibited from participating or intervening in any political campaign, and even an insubstantial amount of political campaign activity can lead to the revocation of an organization’s tax-exempt status. These organizations can, however, engage in certain nonpartisan educational activities if structured properly. Section 501(c)(3) organizations should understand the rules that apply to them and take steps to ensure they do not engage in prohibited activities. They should also take steps to help ensure their employees do not use the organization’s resources to engage in prohibited activities.

Certain other Section 501(c) organizations, on the other hand, may engage in some political campaign activities, but they are not entirely without limitations. For example, Section 501(c)(4) organizations can engage in some political campaign activities, but the political campaign activity cannot be the organization’s primary activity because it is not a social welfare activity under Section 501(c)(4). Section 501(c)(6) trade associations, typically funded in whole or in part by membership dues, may engage in political campaign activity. However, it is important to remember that businesses generally are not allowed to deduct expenditures for political campaign activities. Accordingly, if a trade association engages in political campaign activities, its members may be limited in their ability to take a business deduction for the membership dues it pays to the trade association.

Nonprofits that want to engage in political campaign activities are also subject to campaign finance laws. Each state and the federal government have detailed laws and regulations regarding direct contributions to campaigns and politicians. It is vital to fully understand and comply with the rules regarding donation limits, transparency, and reporting requirements, and how to host events or other types of fundraisers. With more states adopting public financing of elections programs, there will be changes to the rules along the way.

5. Employees vs. Independent Contractors

The US Department of Labor (DOL) issued a final rule in January 2024 providing new guidance on how to distinguish between employees and independent contractors under the Fair Labor Standards Act (FLSA). Employees receive the FLSA's minimum wage and overtime protections. Independent contractors, who are in business for themselves, do not. This is a common issue for our nonprofit and association clients, who often seek to grow new programs and capabilities through outside contractors.

The new guidance employs an "economic reality test" to determine whether workers are economically dependent on the employer for work, and thus, are employees. Nonprofits must consider six non-exhaustive factors highlighted by the DOL:

1. The opportunity for profit or loss depending on managerial skill.
2. The investments of capital and time by the worker.
3. The degree of permanence of the relationship.
4. The nature and degree of control over the performance of the work.
5. The extent to which the work performed is an integral part of the nonprofit's operations.
6. The skill and initiative involved.

The new rule is effective on March 11. However, legal challenges may delay its implementation.

6. Artificial Intelligence (AI)

The next year may determine whether the current moment in generative AI (GenAI) will be remembered as its "Napster Era" or its "Spotify Era." A handful of pending lawsuits are challenging a core assumption among GenAI developers; that use of third-party copyrighted works to train GenAI tools is "fair use" under the US Copyright Act. If a court concludes that this assumption is incorrect, developers could be exposed to staggering damages for copyright infringement and be forced to either rebuild their models from the ground up or start paying licensing fees to copyright holders. After much of 2023 was devoted to pretrial motions and resolving secondary claims, courts are likely to start considering plaintiffs' core infringement claims in 2024.

Meanwhile, many organizations are seeking ways to exploit AI before they get left behind. As they do, they must confront key questions such as whether works created by GenAI are protectible under US copyright laws, whether existing contracts need to be updated to reflect AI-related uses and services, whether AI tools could expose employers to liability under fair wage and hour laws, and/or whether certain AI tools may require pre-clearance and safety testing by federal regulators. 2024 may provide clarity on some, but likely not all, of these key regulatory questions.

7. Ransomware Attacks and Privacy

According to Sophos' "The State of Ransomware 2023" report, ransomware affected two-thirds of all organizations in 2023. The effects can be devastating, with data – including sensitive trade secrets and personal data – being encrypted and held ransom for what can be a large payment to obtain a decryption key, which sometimes does not work, and to avoid having these data made public by the threat actor. Nonprofits are not immune from this possibility.

In addition to business disruption for weeks or more, ransomware attacks force organizations to address multiple legal issues in short order. Those that decide to pay the ransom must ensure they avoid the US Department of the Treasury's (USDT) Office of Foreign Asset Control (OFAC)

sanctions restrictions. They also must have an incident response program ready to go, and tested with tabletop exercises, so that when the attack happens, workstreams are clear. From notifying insurance carriers to onboarding incident response forensics companies to engaging crisis communications and data mining firms, there are multiple policies and agreements to review.

There are also contractual notification obligations for business partners and a patchwork of over 50 state data breach notification laws to navigate. For example, notice deadlines for individuals and regulators can be as short as 30 days from the discovery of the incident. Ransomware attacks and other data breaches can also result in liability arising out of state and federal regulatory investigations or class action litigation. They can also trigger indemnity provisions in commercial contracts.

In this environment, having an up-to-date data security program to try to prevent ransomware attacks and other data breaches, and an incident response plan to respond to attacks that do happen, is critical. The landscape is developing quickly. For example, in 2023 alone, the US Securities and Exchange Commission (SEC) adopted a rule requiring registrants to disclose material cybersecurity incidents and to annually disclose material information regarding their cybersecurity risk management, strategy, and governance; the California Privacy Protection Agency (CPPA) initiated a rulemaking on detailed cybersecurity audit regulations; and the Federal Trade Commission (FTC) updated data breach notification requirements for non-bank financial institutions. Nonprofit leaders should be taking steps to ensure their organization's data security program is up to date, mitigate the risk of these types of attacks, and remain current on the evolving legal and regulatory landscape.

8. Website Terms and Conditions

Terms of use for websites and mobile apps are essential for managing an organization's online legal risk. They can protect intellectual property, disclaim warranties, limit liability, and outline dispute resolution methods. However, poorly drafted or outdated terms of use can pose legal threats.

Terms of use enforceability is also under increased scrutiny. This requires close attention, as even the most robust terms of use are of little value if they cannot be enforced against users. To that end, a valid online contract necessitates clear consumer consent, which can be challenging to obtain. Recent court cases have deemed terms of use unenforceable due to minor faults like hyperlink color or screen design where consent is requested. Given these trends, companies should routinely review their digital assets' terms of use to ensure they provide maximum protection, minimize risk, and enhance enforceability.

9. A Changing Real Estate Market

In light of post-COVID times, many organizations are reviewing their real estate positions. Nonprofits and associations that are tenants under office leases should evaluate their landlord's financial stability and strategize to safeguard their interests to protect against the landlord's lender taking control of the building. Implementing a subordination, non-disturbance, and attornment agreement (SNDA) can provide tenants an additional layer of protection, enabling them to maintain their lease even if the lender forecloses on the landlord. Alternatively, the state of the market can lead to discussions about taking additional space or extending the term of the lease to take advantage of the pro-tenant market.

For organizations that are in the role of landlord, managing tenants who are making the aforementioned requests, as well as addressing tenants who want to give back space or simply can no longer pay for part or all of their leased space, requires more resources than previously needed.

Many organizations are retaining professional building managers to assist.

Organizations that own real estate that is collateral for debt must also deal with lenders who are becoming more demanding for information about revenues and operations, if not simply uncooperative. While maintaining a comfortable relationship with the lender is prudent, it is becoming more challenging.

Organizations that own real estate with excess space interested in leasing space to third parties should consider the income tax implications of the third-party lease. While passive income from rental activities is exempt from unrelated business income tax, such income may no longer be considered passive if the organization provides services in conjunction with the rental of property. Services that go beyond typical landlord duties could subject the organization's rental income to unrelated business income tax.

Additionally, if the organization leases excess space in debt-financed property, the rental income could result in unrelated business taxable income even absent the provision of services. Notably, if the organization has income from debt-financed property, it cannot offset the income with losses from other unrelated trade or business activities. This could result in higher unrelated business income tax liability. Moreover, if the leased space was financed with tax-exempt bonds, the organization should be mindful of the restrictions on the property's private business use. The IRS generally allows no more than 5% of the proceeds from tax-exempt bonds to be used for any private business use, and exceeding this limitation may risk the tax-exempt status of the bonds.

10. Antitrust

For trade associations in particular, antitrust litigation and enforcement have perhaps never been more active. The US Department of Justice (DOJ) has filed aggressive "statements of interest" in myriad private and class action antitrust cases to contend that industries' activities through trade associations may violate the antitrust laws. Meanwhile, the DOJ and FTC withdrew decades-old guidance that provided a so-called "safety zone" for information-sharing activities. Trade associations should revisit the antitrust policies and procedures to provide updated guidance to their staff and volunteers, particularly around information-sharing projects and surveys, joint ventures, and other cross-industry collaborations.

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