

---

## CORPORATE AND TAX AFFAIRS OF A LODGE

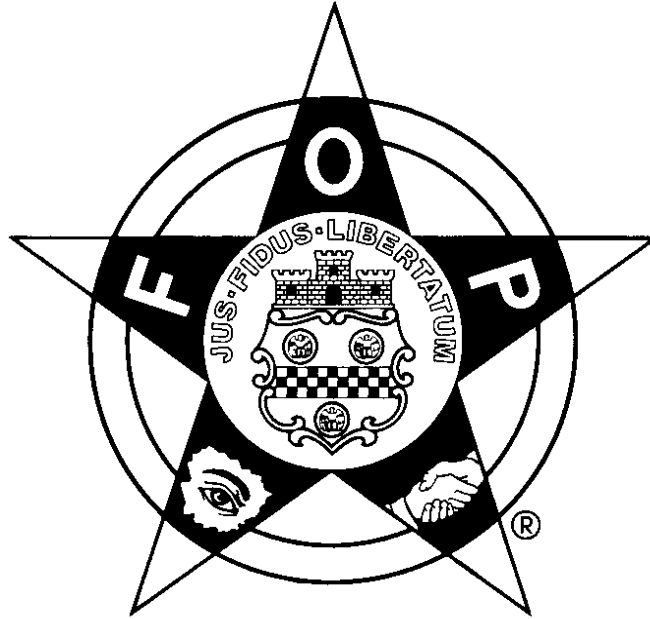
---



# GRAND LODGE FRATERNAL ORDER OF POLICE

National Headquarters  
701 Marriott Drive  
Nashville, TN 37214  
(800) 451-2711  
[www.fop.net](http://www.fop.net)





CHUCK CANTERBURY, NATIONAL PRESIDENT  
DAVID HILLER, NATIONAL VICE PRESIDENT  
PATRICK YOES, NATIONAL SECRETARY  
THOMAS PENOZA, NATIONAL TREASURER  
FRANK GALE, NATIONAL SECOND VICE PRESIDENT  
TIM DOWNS, SERGEANT AT ARMS  
MIKE BURNETT, NATIONAL TRUSTEE CHAIRMAN

© 1988  
1993 Reprinted  
1997 Revised  
1999 Revised  
2003 Revised  
REVISION COMING IN 2008  
Robert Krone, CPA, Frank L. Sasseti & Co.  
Thomas Penza, FOP National Treasurer

GRAND LODGE FRATERNAL ORDER OF POLICE  
All Rights Reserved

REPRODUCTION IN WHOLE OR IN PART  
WITHOUT PERMISSION IS PROHIBITED

## TABLE OF CONTENTS

I. INTRODUCTION .....	1
II. CORPORATION STATUS .....	2
What Is a Corporation? .....	2
How Is a Nonprofit Corporation Structured? .....	2-3
Why Should a Local Lodge Incorporate? .....	3
What Are the Disadvantages of the Corporate Form? .....	3-4
III. TAX STATUS .....	4
What Is a Nonprofit Corporation? .....	4
How Does a Local Lodge Obtain Federal Tax Exempt Status? .....	4-6
What Filings Are Required for Payments Made to Employees? .....	6
Does Qualifying for Federal Tax Exempt Status Mean a Local Lodge Will Not Have to Pay Any Federal Income Taxes? .....	6-7
What Special Tax Returns Are Required for Payments Made to Independent Contractors? .....	7-8
What State and Local Government Filings Are Required? .....	8
What Is an Employer Identification Number? .....	8
Does Each Lodge Need Its Own Employer Identification Number? .....	8
How to Obtain an Employer Identification Number .....	8
What Other Responsibilities Does a Lodge Have Due to Its Tax Exempt Status? .....	8-9
Should Each Lodge Have an Accountant? .....	9
Are Contributions to Lodges Tax Deductible? .....	9
Are Lodge Membership Dues Fully or Partially Deductible? .....	9
Solicitation Campaigns .....	10-11
Can a Lodge Make Political Contributions? .....	11
What Special Provisions Must Be in the Articles of Incorporation of an Affiliate Lodge? .....	11-12
IV. FOP TRADEMARKS .....	12
Introduction .....	12
Pertinent Provisions in Constitution and By-Laws .....	12-13
In What Situation Is a License Required? .....	13
Conclusion .....	14
V. RESPONSIBILITIES OF THE TREASURER .....	14
Setting Up Your Lodge Bank Accounts .....	14
Employer Identification Number .....	14
Corporate Letter .....	14
Type of Account .....	14
Number of Authorized Signatures .....	14
Authorized Signatures .....	14
Type of Checks .....	15
Bank Statements .....	15

Expense Vouchers.....	15
Voucher Information.....	15
Voucher Authorization.....	15
Voucher Copies.....	15
Maintaining Your Records.....	15
Ledger.....	15
Receipts.....	15
Monthly Folders.....	15-16
Budget.....	16
Financial Reports.....	16
Computerized Record Keeping.....	16
Record Retention.....	17-18
Sample Record Retention Schedule.....	18-20
 VI. EMPLOYEES V. INDEPENDENT CONTRACTORS.....	 20-25
 VII. FORMS.....	 25
990.....	26-31
990-EZ.....	32-33
990-T.....	34-37
SS-4.....	38-39
1096.....	40-41
W-9.....	42-45
1099-MISC.....	46-52

## I. INTRODUCTION

The Grand Lodge Fraternal Order of Police has a long and rich history of providing for the advancement of law enforcement personnel. The strength of the Fraternal Order of Police lies as much in the diversity as in the similarities among its members.

The FOP welcomes all law enforcement officers who are willing to associate under and adhere to the Constitution and By-Laws of the Grand Lodge. The Grand Lodge is as proud of its small affiliate lodges as it is of the large urban lodges.

We realize that smaller and newer lodges may be unfamiliar with legal and accounting matters affecting the organization and operation of a local lodge, and the following general information is offered to assist those who may not have had to deal with questions of corporate law.

**WARNING:** The following information is offered as general assistance and should not be relied upon as correct legal or accounting advice for every lodge under its respective state law. While general concepts may be uniform, each state's corporate law is different. Lodges are strongly urged to consult an experienced legal counsel and accountant for assistance.

**SUGGESTION:** The determination of the right organizational form (profit or nonprofit, corporation or association, etc.), the determination of tax status and other important issues relating to the organization and existence of each lodge, should be carefully reviewed by the lodge's counsel and accountant. The selection of counsel should be based upon the capability of the lawyer to deal with *corporate* and *tax issues*. Many law enforcement officers become familiar with criminal defense counsel, prosecutors and labor lawyers. While these lawyers are often extremely skilled in their respective specialties, specific inquiries should be made to determine whether he/she has the requisite experience, knowledge and training to advise the lodge in its business affairs. While most lodges may have need for skilled experienced labor counsel, when considering *corporate* and *tax issues*, obtain counsel who is experienced in *these issues*. Likewise, accountants vary greatly in skill, experience and specialty. Some accountants are certified public accountants (CPAs) while others are not. Some states require certified financial statements which can only be issued by a CPA. In any case, a lodge accountant should be familiar with issues confronting a non-profit, tax-exempt organization—*not* simply personal income tax issues.

If properly selected, the lodge attorney and accountant can be invaluable resources to the lodge. If improperly selected, the lodge can be faced with problems that threaten the survival of both the local lodge and its parent.

The following information is offered to provide assistance to the new or smaller lodges which may not have dealt with these issues and to provide answers to important questions for all lodges. While each state's law varies and every lodge is different, the following information will provide general information which should be useful in evaluating your situation. The Grand Lodge stands ready to assist you in whatever way it can. Some local lodges operate as unincorporated associations; that is, simply a group of individuals joined only by common interest or purpose. An alternative to this form of organization exists. Every local lodge can incorporate under its respective state's corporation laws.

## II. CORPORATION STATUS

### WHAT IS A CORPORATION?

A corporation is a legal entity created by state statute. So long as the various formalities (described below) are followed, the law treats the corporation as though it were a separate “person.” It is easier to view the corporation as a distinct body, separate from its members. A corporation can sue and be sued, execute contracts (through its agents or officers), and own property, all according to the specific rules of the state in which it is incorporated.

A traditional for-profit corporation pays corporate tax on its profits (and its shareholders pay personal income tax on any profits distributed as dividends).

Unlike traditional corporations which distribute their profits to their shareholders through dividends, local FOP lodges are not organized to make profits for their members. Because FOP lodges do not distribute profits to their members, they can organize as nonprofit corporations under their respective state laws and become eligible to be tax exempt under state and federal laws.

Most people are familiar with traditional corporations. Traditional “for-profit” corporations (such as IBM, Sears, General Motors, etc.) have shareholders, each of whom owns shares of stock in the corporation. Each shareholder is an “owner” of the corporation. Each shareholder is entitled to vote upon the election of a board of directors. Each shareholder’s voice in the corporation is proportionate to the amount of ownership or number of shares that he/she owns. The board of directors of a traditional for-profit corporation generally elects the officers (e.g., president, treasurer, etc.) of the corporation. Generally, the board of directors is also responsible for setting policy and approving significant actions affecting the corporation. The officers of the corporation are responsible for carrying out the day-to-day operations of the corporation and the policies of the board of directors. In some cases, a shareholder may serve as an officer and/or director. In small corporations, the majority shareholder will often serve as a director and an officer (usually president).

### HOW IS A NONPROFIT CORPORATION STRUCTURED?

The formal structure of a nonprofit corporation is similar to, but not the same as, a “for-profit” corporation. Instead of shareholders, a nonprofit corporation is made up of “members.” Because nonprofit corporations are established to accomplish some good, they are not “owned” by shareholders. The members elect a board of trustees or directors which, like the for-profit corporation, sets policy for and makes significant decisions concerning the entire organization. Like the for-profit corporation, the board of trustees or directors may be elected annually by the organization’s members. Either the members of the corporation or the elected board of trustees or directors then elects officers. A member of the nonprofit corporation may serve as a member of the board and/or an officer, just as a shareholder of a for-profit corporation may serve on the board of directors and/or as an officer.

Each state’s corporation laws (whether for profit or nonprofit) require that a corporation formed in that state have at least certain corporate officers. For example, many states require any corporation formed in that state to have, *at a minimum*, a president, a treasurer and a secretary. States’ corporate laws generally *allow* additional

officers, but *require* certain essential officers. In order to exist as a subordinate lodge of the FOP, local and state FOP lodges (whether incorporated or not) must have certain officers provided for in the Constitution and By-Laws, namely: President, Vice President, Secretary, Treasurer, 2<sup>nd</sup> Vice President and Sergeant at Arms. These officers carry out the day-to-day business of the local and state lodge, as well as the policies set by the board.

### **WHY SHOULD A LOCAL LODGE INCORPORATE?**

The corporate form protects lodge members from most kinds of liabilities arising out of the lodge's activities. If a local lodge were to breach a contract, cause injury or have an injury occur on the lodge's property, the "lodge" would be responsible for the resulting damage. If the local lodge is an unincorporated association, it has no separate legal existence and, if sued, the *individual* members of the lodge could be held personally liable for debts of or damages caused by the lodge or its agents.

The biggest advantage of the *nonprofit corporation* form is the limited liability it affords. Some state laws specifically exempt members of a nonprofit corporation from personal liability from most corporate obligations. In other states, the general principles of corporate law protect members from corporate obligations. Thus, members of a nonprofit corporation (like shareholders of a traditional, for-profit corporation) are rarely liable for the debts or acts of their corporation or its agents. Instead, the corporation is responsible for its own debts and/or acts giving rise to liability. If the nonprofit corporation has insufficient assets to cover its debts or liabilities, however, the members of the nonprofit corporation may not be responsible for those debts.

In addition, insurance may be available to cover potential liability of trustees and officers. This insurance, when available at all, is generally quite expensive. Further, this insurance covers liability of directors and/or trustees for errors and omissions; it is *not* to be confused with fidelity or dishonesty insurance (which insures against misappropriations by lodge employees, officers or trustees).

In addition, the federal income tax laws impose personal liability on the "responsible persons" of any organization for the amount of employee payroll taxes and social security taxes withheld from an employee's pay but not paid over to the IRS. This provision applies to all employers, whether incorporated or not. Accordingly, it is *extremely important* that lodge officials accurately determine whether persons who work for the lodge are "employees" or independent contractors. If the lodge has employees, the lodge's accountant should be consulted to determine the correct procedure to be followed with respect to payroll taxes and social security withholding. As a whole, the risk that members may be accountable for lodge obligations can be substantially reduced by choosing to operate as a nonprofit corporation.

Except as noted above, in order for a corporation's shareholders or members to be held personally liable, the creditor would have to "pierce the corporate veil": i.e., convince a court that the existence of the corporation should be ignored. This rarely occurs unless the corporate formalities (discussed below) are ignored.

In addition to insurance and observation of corporate formalities, usually set forth in the By-Laws, a corporation might consider specific agreements to indemnify their officers and trustees against potential liabilities, to the extent permitted by local laws.

## **WHAT ARE THE DISADVANTAGES OF THE CORPORATE FORM?**

As previously discussed, the corporation has a formal hierarchy consisting of a board of trustees/directors, officers and members. The members or the trustees/directors adopt regulations or by-laws governing the operation of the corporation. These rules must be followed for the corporation to act legally. This process may decrease the lodge's operating flexibility. Further, choosing the corporate form may increase governmental regulation of lodge activity and create higher operating costs caused by greater formal organization.

In order to maintain its corporate status, a nonprofit corporation must follow certain formalities relating to its organization and record keeping. The burden of following corporate formalities is not significant in the case of a FOP lodge because the Constitution and By-Laws require many of the same formalities. Generally, corporations are required to formally record any significant action or decision of its governing board. This procedure is already followed by most FOP lodges through their minutes. Finally, certain administrative actions are required by a corporation in order to maintain its corporate status (e.g., filings with the Secretary of State, payment of corporate franchise fees and the appointment of a statutory agent). Although these administrative requirements are foreign to most police officers, they are easily accomplished by one experienced in such matters.

## **III. TAX STATUS**

### **WHAT IS A NONPROFIT CORPORATION?**

A nonprofit corporation is generally a corporation formed under a state's specific statutes authorizing the formation of a corporation organized not-for-profit. Organizing under a state's not-for-profit corporation statutes often exempts the corporation from certain *state* and *local* taxes, such as corporate income taxes. These exemptions vary from state to state, and you should consult with a tax advisor in your particular state.

It is critical to understand that, although a local lodge may be formed as a nonprofit corporation and, although by doing so, the lodge may therefore be exempt from state and local taxes, simply becoming a nonprofit corporation: (a) does not make the lodge "charitable"; and (b) does not exempt the lodge from federal tax.

In order to become exempt from federal tax, the lodge must fall within certain exceptions to the Internal Revenue Code. The federal government's determination as to whether a corporation is nonprofit is completely independent of any determination as to whether a corporation is nonprofit under state or local tax laws. Often, there is substantial overlap between the federal, state, and local tax laws, but this is not always the case.

The Grand Lodge has been determined by the Internal Revenue Service to be an exempt organization under Section 501(c)(8) of the Internal Revenue Code. Because the FOP has been determined by the IRS to be *tax exempt* under Section 501(c)(8), however, does not mean the FOP is *charitable*. The section of the tax code authorizing an exemption for charitable, educational and scientific organizations is Section 501(c)(3). The FOP has not been determined to be exempt under Section 501(c)(3) and is not, therefore, a charitable organization. Being a *tax exempt* organization is not the same as being a *charitable* organization!

Payments by a lodge, as a fraternal beneficiary society, into a state sponsored reinsurance pool that protects participating insurers against excessive losses on major medical health and accidental insurance, will not preclude exemption as a 501(c)(8) organization.

### **HOW DOES A LOCAL LODGE OBTAIN FEDERAL TAX EXEMPT STATUS?**

Many local FOP lodges and members have experienced confusion as to a lodge's tax status under federal tax law. In 1952, the Internal Revenue Service (IRS) issued a "group exemption" letter to the Grand Lodge on behalf of all its affiliated lodges. A group exemption letter is a ruling issued to a central organization which recognizes, on a group basis, the tax exemption of the central organization and its subordinate units. Therefore, the Grand Lodge must submit to the IRS each year a list of subordinate lodges which the Grand Lodge recognizes and believes should benefit from the Grand Lodge's tax exempt status under Section 501(c)(8). If a local and state lodge is listed by the Grand Lodge with the IRS as a subordinate lodge (and so long as the lodge is properly organized and conducts its affairs properly), the local and state (like the Grand Lodge) is excused from paying federal income tax on most kinds of income. On the other hand, if a local or state lodge is not listed by the Grand Lodge in its filing with the IRS, then the local or state lodge is not exempt from federal income tax on most kinds of income (regardless of the lodge's incorporation as a nonprofit corporation). Accordingly, lodges should check with the Grand Lodge to determine whether their unit has been included in the group exemption list.

In other words, local and state lodges' federal tax exempt status is derived from the Grand Lodge's federal tax exempt status. Not only must the local lodge let the IRS know that it is affiliated with the Grand Lodge, the Grand Lodge must let the IRS know the local or state lodge derives its tax exempt status from the Grand Lodge.

**NOTE:** Even though exempt from federal income tax, a lodge may still have to file a tax return. If required, as discussed below, the tax return must be filed by the 15<sup>th</sup> day of the fifth month after the close of the lodge's fiscal year. A lodge with a calendar year end (December 31) must file a return by May 15<sup>th</sup> of the following year.

If a lodge has average annual receipts (all forms of income) greater than \$100,000 or assets greater than \$250,000, the lodge must file Form 990 (see pages 26-31), Return of Organization Exempt Form Income Tax.

Form 990-EZ is a shortened version of Form 990. It is designed for use by small organizations. A lodge may file Form 990-EZ (see pages 32-33), instead of Form 990, if it meets both the following requirements:

1. Its gross receipts during the year were less than \$100,000, and
2. Its total assets at the end of the year were less than \$250,000.

If a lodge does not meet either of these conditions, it must file Form 990.

If a lodge has gross receipts (all forms of income) in each tax year that are normally less than \$25,000, no tax return is required. However, even if no tax return is required, detailed records must be kept for six (6) years in the event of an IRS audit. Additionally, if you have annual gross receipts of less than \$25,000 and the lodge receives Form 990-EZ or Form 990 in the mail, do the following:

1. Attach the pre-addressed label to the name and address space on the return;
2. Check the box in the heading of Form 990, or Form 990-EZ, to indicate that the lodge's gross receipts are normally not more than \$25,000;
3. Have an officer of the lodge sign the return; and
4. Send it to the appropriate Internal Revenue Service Center.
5. The Lodge does not have to complete Parts I through IX on Form 990, or Parts I through V of Form 990-EZ.

Each lodge is required to make Form 990 available for public inspection for a period of three (3) years beginning with the due date of the return. Substantial penalties are imposed for not complying with this requirement. Any organization that fails to comply with this provision is subject to a penalty of \$20 for each day that inspection is not permitted, up to a maximum of \$10,000. Any organization that willfully fails to comply shall be subject to an additional penalty of \$1,000. Each lodge should consult a tax advisor about this requirement.

If a lodge has unrelated trade or business income, it will be required to file Form 990-T, Exempt Organization Business Income Tax Return (see pages 34-37). Unrelated trade or business income is the gross income derived from any trade or business that is regularly carried on, and not substantially related to the organization's exempt purpose or function. This area of tax law is extremely complex and fluid; therefore, careful attention should be paid to it. If a lodge has income from **ANY SOURCE** (variety shows, balls, advertisements, etc.) other than membership dues and assessments, a review by a tax accountant or attorney should be conducted.

#### **WHAT FILINGS ARE REQUIRED FOR PAYMENTS MADE TO EMPLOYEES?**

If a lodge has employee(s), numerous federal, state and local filings are required. The federal requirements include obtaining proof of citizenship (Form I-9), authorization for withholding taxes (Form W-4), quarterly payroll tax reports (Form 941) and annual payroll tax reports (Forms W-2, W-3, and 940). In addition, each state and local government has its own payroll withholding taxation and filing requirements. If a lodge has employee(s), all federal, state and local filing requirements should be reviewed with a tax accountant or attorney.

#### **DOES QUALIFYING FOR FEDERAL TAX EXEMPT STATUS MEAN A LOCAL LODGE WILL NOT HAVE TO PAY ANY FEDERAL INCOME TAXES?**

Even though a lodge receives an income tax exemption from the IRS, the lodge still may be liable for taxes on its "unrelated business taxable income" ("UBTI"). If a lodge has UBTI under Section 511 of the Code, the lodge must file Form 990-T, Exempt Organization Business Income Tax Return (see pages 34-37), *in addition to* its Form 990 tax return. Like Form 990, this return must be filed by the 15<sup>th</sup> day of the fifth month. However, an Exempt Corporation with UBTI may have to pay estimated income tax each quarter. Consult your lodge counsel for application of the Estimates Income Tax rules if you believe your lodge might have UBTI.

Congress enacted the Unrelated Business Income Tax in order to eliminate a perceived source of unfair competition by placing the unrelated business activities of

certain exempt organizations on the same tax basis as non-exempt businesses with which they compete. Thus, a lodge that is determined to have Unrelated Business Income will be taxed on that income, less related deductions and a \$1,000 specific deduction, at the same rates a non-exempt corporation is taxed.

Generally, if a lodge engages in activities that produce income on a regular basis, and those activities are *not* substantially related to the purpose for which the lodge was granted the tax exemption under Section (c)(8), the lodge may be subject to the Unrelated Business Income Tax. “Substantially related” means the activity contributes importantly to the exempt purpose of the lodge. Specifically, the activity will be “substantially related” if it promotes fraternity among lodge members.

FOP lodges engage in a variety of income producing activities. An activity in which many local lodges engage that commonly gives rise to UBTI is the selling of advertisements in state and local magazines. If an advertisement looks like commercial advertising found in magazines and other publications sold for profit, the income generated by the lodge that sells such advertising is probably UBTI. There are a couple of exceptions to this rule that *may* apply in some circumstances. However, the rules regarding the taxation of advertising income as UBTI are still evolving and it is extremely difficult and often impossible to structure the receipt of advertising income as exempt income. *Lodges who receive advertising revenues should consult their counsel and/or their accountants to determine the proper tax reporting method.*

The general rule that selling magazine ads creates UBTI does not apply to the sale of advertising not regularly carried on. Therefore, selling ads in the annual Policeman’s Ball program, for example, may not give rise to UBTI.

Of course there are many other types of income producing activities in which local lodges engage that may give rise to UBTI. However, as long as these activities promote the fraternal purpose of the lodge, UBTI will generally not arise. Likewise, if the activity is not engaged in on a continuous and regular basis or the activity is conducted entirely by volunteers, a UBTI problem is unlikely.

In general, any income other than member dues should be examined by your accountant and/or counsel to determine if such income is UBTI. Although several exceptions exist, the determination of the applicability of such exceptions should be made by your accountant or tax counsel.

If you make a good faith determination that a lodge activity is not an Unrelated Business and therefore you do not file Form 990-T, you still should disclose specifically the nature of the activity and receipts there from on your Form 990. This enables the IRS to determine liability if they find the activity should be an Unrelated Business. Disclosure in this manner will likely prevent application of the tax penalty provisions for failure to file Form 990-T and will start the running of the statute of limitations for purposes of assessment of the Unrelated Business Income Tax. Should you have concerns that an income producing activity may give rise to UBTI, consult your lodge counsel.

## **WHAT SPECIAL TAX RETURNS ARE REQUIRED FOR PAYMENTS MADE TO INDEPENDENT CONTRACTORS?**

If any lodge pays \$600 or more per person to individuals or partnerships, the lodge may be subject to withholding and information reporting requirements. The legal distinction between whether a person is an employee or an independent contractor is

subject to much disagreement and depends upon specific facts. Therefore, each lodge should check with its individual attorney and accountant for specific advice.

First, if the lodge has not received the taxpayer identification number of the person being paid by the lodge, the lodge must withhold thirty-one (31) percent of all payments made to him/her. The taxpayer identification number of an individual is his/her social security number. The taxpayer identification number of a partnership is called an Employer Identification Number (EIN). Withholding is also required if the IRS notifies the lodge that the taxpayer identification number furnished by the person being paid by the lodge is incorrect. To avoid withholding, before paying a non-employee every lodge should obtain the taxpayer identification number of the person to be paid by using IRS Form W-9, Payer's Request for Taxpayer Identification Number (see pages 42-45) provided for this purpose by the IRS. Copies of Form W-9 may be obtained from the affiliate lodge's tax advisor or the local IRS office.

In addition to withholding requirements, a lodge may also be required to file "information returns" with the IRS for payments of \$600 or more to noncorporate persons. This information return must be filed *even if the person being paid has given you his taxpayer identification number*. The lodge must deliver an IRS Form 1099-MISC (see pages 46-52) to such person by January 31<sup>st</sup> of the year following the year in which the payment was made. Form 1099-MISC, along with Form 1096 (see pages 40-41) must then be sent to the IRS by February 28<sup>th</sup> of the year following the year in which payment was made. The lodge's tax advisor or accountant should be consulted to ensure compliance.

#### **WHAT STATE AND LOCAL GOVERNMENT FILINGS ARE REQUIRED?**

Every lodge should determine whether any of the numerous and varied state and/or local laws requiring filings and/or registration with various governmental agencies apply. Some states require the filing of a copy of Form 990 (or 990-EZ) and/or copies of Form 1096 and Form 1099. Other states require registration with the State Attorney General. Some requirements apply only on a one-time basis; others must be done annually. Some states direct certain specific registration and/or filing requirements as "police organizations." Some states regulate fundraising activities by nonprofit organizations: because state and local laws will vary, each lodge should consult its attorney for local specific advice concerning such requirements. It is impossible to convey within this booklet all of the possible state and local filing and registration requirements. *Each lodge must identify the state and local laws affecting it and what it must do to comply with those laws.*

#### **WHAT IS AN EMPLOYER IDENTIFICATION NUMBER?**

Every entity (person, corporation, etc.), filing a tax return with the IRS must be separately identified by number. This separate and specific number is commonly referred to as the "Taxpayer Identification (I.D.) Number." **NOTE:** *Every lodge, whether or not incorporated, must obtain an Employer I.D. Number, even if it has no employees.*

Some states require nonprofit corporations to have a state taxpayer identification number in addition to the employer identification number required by the IRS.

## **DOES EACH LODGE NEED ITS OWN EMPLOYER IDENTIFICATION NUMBER?**

Because *every* FOP lodge must be identified by the Grand Lodge on its group exemption listing with the IRS in order to be recognized as tax exempt, *every* lodge must obtain *its own* Employer I.D. Number—even though it may not have employees. **NOTE:** A local or state lodge *must not* use the Grand Lodge’s Employer I.D. Number. Use of the Grand Lodge’s Employer I.D. Number will confuse the IRS and will misidentify the lodge, thereby creating unnecessary trouble and unwarranted attention from the IRS.

All lodges (local and state) should inspect their records to find their Employer I.D. Number. Each should have its own number and should ensure that it is not using the Grand Lodge’s number.

## **HOW TO OBTAIN AN EMPLOYER IDENTIFICATION NUMBER**

To apply for an Employer Identification Number, each lodge should obtain Form SS-4 (see pages 38-39) from the nearest Internal Revenue Service Office. The instructions for filling out the form are relatively straightforward.

## **WHAT OTHER RESPONSIBILITIES DOES A LODGE HAVE DUE TO ITS TAX EXEMPT STATUS?**

The Internal Revenue Code requires that each organization exempt from federal income tax make available for inspection its three most recent annual returns (Form 990) and its Application for Recognition of Exemption which was filed with the IRS. Thus, each lodge granted federal tax exempt status must make this information available at the lodge during regular business hours. Disclosure is not required of the names of any contributor. Failure to comply with these requirements may result in a \$1,000 fine and up to an additional \$10,000 if fraud is found.

## **SHOULD EACH LODGE HAVE AN ACCOUNTANT?**

Yes! Each lodge should hire an accountant to help it make the filings with the IRS described above, to help determine the state and local filing and registration requirements and to generally help it keep its financial records in good order.

## **ARE CONTRIBUTIONS TO LODGES TAX DEDUCTIBLE?**

As earlier noted, just because the FOP is tax exempt does not make it a charitable organization. Under the tax code, the FOP is tax exempt under Section 501(c)(8), but the FOP is **NOT** a charitable organization under Section 501(c)(3). The difference between tax exempt and charitable has caused much confusion among FOP members. The principal importance of this difference is that *only contributions to a charitable, educational or scientific organization* (Section 501(c)(3)) are generally deductible by the donor. Contributions to a *tax exempt* organization are **NOT** generally deductible. Contributions from third parties to the local, state or Grand Lodge generally are **NOT** deductible to the donor. The reason donations to charitable organizations are tax deductible is to encourage donations to organizations having “charitable,” “educational,” or “scientific” purposes. On the other hand, the Internal Revenue Code recognizes tax exempt status for organizations in addition to charitable organizations. Fraternal organizations, such as the FOP, are allowed tax exempt status, but contributions to

fraternal organizations are not deemed by Congress to be sufficiently important that deductibility is afforded to the donors.

Although donations to a lodge may not be deductible as charitable, payments to a lodge, under certain circumstances, may be deductible as “business expenses” if the payer determines that the payment is an ordinary and necessary business expense. The local lodge should not advise payers as to whether or not payments are ordinary and necessary business expenses.

### **ARE LODGE MEMBERSHIP DUES FULLY OR PARTIALLY DEDUCTIBLE?**

To the extent that dues or other amounts paid to the lodge are allocable to lobbying expenditures or political contributions by the lodge, those amounts are not deductible as business expenses by the payer. Lobbying expenses are defined as expenditures in connection with influencing legislation, participation in any political campaign, or any attempt to influence the general public with respect to elections, legislative matters or referendums. Political contributions are those expenditures in connection with influencing the selection, nomination, election or appointment of any individual to any Federal, State or local public office.

The lodge must allocate the costs of its activities to lobbying and to nonlobbying activities in determining the amount that is nondeductible to its members or contributors. The lodge must report the portion of dues or other amounts that are allocable to nondeductible lobbying expenditures in a notice to each person who pays dues or similar amounts to the organization.

That notice must contain a reasonable estimate of the portion of the dues or other amounts to which lobbying expenditures are allocable. The notice requirements discussed in the section on Solicitation Campaigns also apply to notices required for lobbying expenditures.

If a lodge doesn’t meet this notification requirement, it is subject to a tax at the highest corporate rate (currently 35%) on the aggregate amount not included in the notices.

### **SOLICITATION CAMPAIGNS**

Many lodges solicit the public for funds to support lodge activities. These solicitations take many forms including the sale of tickets for variety shows and balls, advertisements in lodge publications, etc. These solicitations may be individualized appeals to selected persons or companies or may be part of a program or campaign conducted by the lodge or a professional fundraising organization.

Under Section 6113 of the Internal Revenue Code, every fundraising solicitation made *by or on behalf of* certain organizations (including fraternal organizations like local, state and the Grand Lodge, Fraternal Order of Police), **MUST** contain a statement in conspicuous and recognizable format that the contribution (or gift) is **NOT deductible as a charitable contribution**. FOP lodges *are subject* to this rule unless:

1. the annual gross receipts of the lodge are less than \$100,000 (gross receipts include all revenue from *any source*, including dues and solicitations, **NOT** simply solicitations); or
2. the contributions solicited are to be used exclusively for charitable purposes.

A fundraising solicitation is defined as any solicitation of contribution or gifts which is made in writing, by television or radio, or by telephone. For this purpose, letters and telephone calls are not fundraising solicitations if, and only if, they are *not* a part of a coordinated fundraising campaign soliciting more than ten (10) persons during a given calendar year.

The penalty for failure to make the disclosure required by Section 6113 is \$1,000 for each day on which such failure occurred. The maximum penalty which may be imposed in one calendar year is \$10,000. The penalty may be excused if the failure is due to reasonable cause; however, if the failure to comply with Section 6113 is due to intentional disregard, the daily penalty is the greater of \$1,000 or fifty percent (50%) of the aggregate cost of the solicitation.

In essence, the Internal Revenue Service is extremely concerned that fraternal organizations that are *not* 501(c)(3) charitable organizations are making solicitations and telling people that the contributions are tax deductible. As stated above, only contributions to charitable organizations may be treated as a charitable deduction. Hence, in order to ensure that fraternal organizations do not cause contributors to attempt to deduct contributions that are not legally deductible, Section 6113 requires those organizations and their fund-raisers to specifically tell potential contributors that contributions are not charitable deductions. Section 6113 applies to all solicitations made by fraternal organizations unless the solicitation is not part of a campaign. In other words, if a lodge makes a solitary solicitation of an individual, not as a part of an overall campaign, no disclosure is necessary. On the other hand, if a lodge sends out fliers, conducts a telephone campaign, or hires someone to do so on their behalf, these disclosures must be made. The only exception pertains to organizations that have gross receipts of less than \$100,000. Obviously, this will exempt certain smaller lodges; however, most state lodges and the larger urban lodges are subject to Section 6113.

The IRS applies the nondeductibility disclosure requirements of the Internal Revenue Code to **ALL** forms of requests for financial support from the general public *or members of organizations*, except that such requirements do not extend to insurance premium billings for the benefits to be provided to the members or the food and beverage charges at a social club operated by a lodge. Therefore, according to the IRS, a conspicuous statement of nondeductibility as a charitable contribution should be included on membership billings, renewals and solicitations. However, the IRS has acknowledged that billings to customers (such as publication advertisers or conference attendees) are not covered by Section 6113. Lodges should consult with their lodge counsel *and* should discuss this matter with any organization that is used by the lodge to solicit contributions. The failure of such an organization to make the required disclosures may cause the lodge to be subject to the statutory penalties discussed above.

### **CAN A LODGE MAKE POLITICAL CONTRIBUTIONS?**

If a lodge spends monies to influence the selection, nomination, or appointment of any person to *any* public office or office in any political organization, the lodge will not lose its tax exemption. *However*, the lodge will be subject to income tax because of these political expenditures. The lodge will be treated as having taxable income equal to the *lower* of the following two amounts: (a) the amount of the political expenditure; or (b)

the net investment income of the lodge. Indirect payments, such as salaries for employees, may also be treated as political expenditures under certain conditions. A lodge's net investment income generally its income from interest, dividends, rents, and gains from the sale of investment property, less expenses related to that income. The amount of the tax is then calculated by multiplying the appropriate amount by the highest corporate rate. A lodge may set up a segregated fund or a separate organization (e.g., political action committee—also known as a PAC) to make political contributions if certain requirements are met. The effect of such a segregated fund would be to limit the amount of tax on the political contributions to the amount of the net investment income of the fund, rather than the net investment income of the lodge. However, separate and often complex laws govern the formation and operation of political action committees. Before a lodge decides to set up a segregated fund or separate organization to make political contributions, it is imperative that it consult with its attorney and/or accountant.

### **WHAT SPECIAL PROVISIONS MUST BE IN THE ARTICLES OF INCORPORATION OF AN AFFILIATE LODGE?**

As previously noted, an affiliate lodge derives its tax-exempt status by reason of being affiliated with the Grand Lodge. The Grand Lodge notifies the IRS of this affiliation by listing its affiliate lodges with the IRS each year. When so listed, the affiliate lodges will qualify under the group exemption of the Grand Lodge.

In addition to being listed by the Grand Lodge, an affiliate lodge must meet all of the other requirements of Section 501(c)(8) (under which the Grand Lodge is exempt). Thus, an affiliate lodge must operate under the lodge system and provide for the payment of life, sick, accident or other benefits to its members or dependents. In other words, an affiliate lodge that otherwise conducts itself in violation of Section 501(c)(8) cannot maintain its tax exempt status simply because it is listed on the Grand Lodge's group exemption list.

Likewise, just as an affiliate lodge's Constitution and By-Laws must be consistent with the Grand Lodge's Constitution and By-Laws, an affiliate's Articles of Incorporation must also be consistent with *both* Section 501(c)(8) *and* the Constitution and By-Laws of the Grand Lodge. Hence, even if an affiliate lodge is listed under the Grand Lodge's group exemptions, *and* its Constitution and By-Laws are consistent with those of the Grand Lodge, an affiliate lodge still *may* not be tax exempt if its Articles of Incorporation are not consistent with the Grand Lodge's Constitution and By-Laws.

These requirements may be met in the Articles of Incorporation by:

1. stating that its principal purposes are to promote and/or cultivate a spirit of fraternalism, support and mutual helpfulness among the members and to provide for the payment of life, sick, accident or other benefits to its members;
2. stating that the corporation shall operate under the lodge system and shall be subordinate to the state lodge (if applicable) and the Grand Lodge and the Constitution and By-Laws of both and will adhere to all requirements of both.

You should consult with your attorney as to the exact expression of your lodge's purposes. Remember, if the conduct, Constitution and By-Laws *and* the Articles of Incorporation are not consistent with Section 501(c)(8) (and the Grand Lodge's Constitution and By-Laws), the affiliate lodge may not be tax exempt.

## **IV. FOP TRADEMARKS**

### **INTRODUCTION**

What's in a name? Among the most valuable and visible assets of the Grand Lodge, Fraternal Order of Police are the various collective marks, trademarks and service marks with which the public is so familiar, including the famous FOP star logo (a copy of which is prominently pictured on the cover of this publication). While many may know that the Grand Lodge owns a federal registration for the FOP star logo for use in connection with the indication of membership in the National Fraternal Order of Police, the Grand Lodge also owns federal registration for the FOP star logo for use in connection with a broad variety of goods and services, as well as a federal registration for the words "FRATERNAL ORDER OF POLICE."

Under the Lanham Act, the owner of a federal trademark, service mark or collective mark registration is afforded nationwide exclusive priority use of that mark in connection with the goods, services or collective organization described in the registration. As such, the owner of such a registration is entitled to stop anyone from using the same or a confusingly similar mark anywhere in the United States. The Grand Lodge, by virtue of its long-standing use of its marks, has created immeasurable goodwill symbolized by such marks. Those marks, coupled with the federal registrations, add up to valuable intellectual property rights owned by the Grand Lodge which benefit all of its members.

### **PERTINENT PROVISIONS IN CONSTITUTION AND BY-LAWS**

The Grand Lodge Constitution and By-Laws strictly regulate the use of any of the collective membership marks, trademarks or service marks of the Grand Lodge. Article 1, Section 2 of the Constitution provides that:

"The National Board of Trustees shall have the sole and exclusive right to authorize, control, license and restrict the use of the name, insignia or emblem and mark, trademark or service mark of the Fraternal Order of Police. The National Secretary shall police the trademark of the Order and shall grant or refuse to grant permission to use the trademark of the Order as hereinafter set forth as may be, from time to time, prescribed by the National Board of Trustees."

An exception to this general prohibition against the use of any of the marks is set forth in Article 1, Section 3: "State and subordinate lodges, by virtue of their affiliation with the Grand Lodge, shall have the right to use the name, insignia, emblem and mark, trademark or service mark of the Fraternal Order of Police *in order to signify or denote their affiliation therewith.*" (Emphasis added)

However, that section of the Constitution further provides limitations on the use of the marks by state and subordinate lodges:

"In the case of prospective for profit uses of the name, insignia, emblem or mark, trademark or service mark of the Fraternal Order of Police, or such other use that may

place such state and subordinate lodges in competition with the Grand Lodge, such permission may be withheld by the National Board of Trustees.”

Article 8, Section 3 of the Constitution provides that the National Board of Trustees shall promulgate such rules and regulations as it deems necessary and appropriate to authorize, control, license and restrict the use of the name, insignia or emblem and mark, trademark or service mark of the Fraternal Order of Police, provided, however, that such use by state and subordinate lodges for identification purposes which are neither associated with profit making enterprises nor in competition with the Grand Lodge shall not be prohibited.

### **IN WHAT SITUATION IS A LICENSE REQUIRED?**

While state and local lodges may utilize the marks for purposes of identifying their lodge’s affiliation with the Grand Lodge or identifying their membership, any further use of the marks is expressly limited by the terms of the Constitution and By-Laws. Typical permissible uses would include signage at the lodge location, membership cards, membership certificates, bumper stickers and letterhead. *Any use* beyond the mere indication of membership in an affiliated lodge requires the permission of the Grand Lodge. Requests for such permissions should be submitted to the National Secretary.

Under U.S. trademark law, the owner of a trademark has an obligation to monitor and control the manner in which its marks are used. The failure of the owner of a mark to properly monitor and control such uses by third parties can result in a loss of trademark rights. Therefore, the Grand Lodge has an affirmative duty to control in very strict terms the manner in which its marks are used. It is important to remember that the exercise of exclusive control over the FOP marks by the Grand Lodge benefits all state and subordinate lodges. If the Grand Lodge were to fail to monitor and control its marks properly, an unaffiliated third party might be able to establish an abandonment of trademark rights and, consequently, adopt and begin using the FOP marks in direct competition with state or local lodges. This clearly would injure such lodges.

In situations where the proposed use would be for a non-profit purpose (but beyond mere indication of membership in the lodge), permissions to utilize the mark in such a manner typically will be granted by the National Secretary on a royalty-free basis, provided that the use of the mark is not otherwise objectionable to the image of the Grand Lodge. In situations where a state or local lodge wishes to utilize the mark for “for-profit” purposes, a royalty would be charged. Typical examples where permission would require a royalty would include use of the FOP insignia on articles of clothing or to endorse a product or service. *All* third parties (i.e., unaffiliated entities) requesting to make any use of the marks are required to secure license agreements from the Grand Lodge.

### **CONCLUSION**

The Grand Lodge’s merchandise program is a vital life blood of financial support for the programs provided by the Grand Lodge to its members. In fact, the vast majority of financial support for the Grand Lodge comes from its trademark licensing program. In order to allow the Grand Lodge to continue to provide its current level of service to its

members in the future without additional cost to members, it is imperative that these trademark rights be maintained.

## V. RESPONSIBILITIES OF THE TREASURER

### SETTING UP YOUR LODGE BANK ACCOUNTS

Prior to going to the bank to set up a lodge checking or savings account, the Treasurer will need to have the below information.

**Employer Identification Number:** This number is issued by the Internal Revenue Service after you submit Form SS-4. A copy is shown in this booklet (see pages 42-45). At no time should you use the Grand Lodge, State Lodge or any other lodge's Employer Identification Number.

**Corporate Letter:** Your bank may or may not require a corporate authorization letter or may have its own authorization form that you will need signed by your Lodge President and Lodge Secretary. The authorization letter or form simply shows the bank that you are authorized to open an account in the name of the organization. The authorization letter should be signed by the Lodge President and Secretary and state that a meeting of the Lodge Board of Trustees was held on (date), and the Board authorized the Lodge Treasurer (Name) to open an account(s) (type) with the bank (bank name).

**Type of Accounts:** What type of account(s) the lodge will need depends on the amount of current funds and the lodge's projected budget. The lodge may need just a checking account or may also want to start a savings account. The Treasurer should discuss all options with the banking representative. Most banks will give a not-for-profit organization interest bearing checking accounts with no fees. Don't be afraid to shop around.

**Number of Authorized Signatures:** This is a decision that should be made by the Lodge Board of Trustees. When deciding between one or two signatures, keep in mind how many checks may be written, how often they will be written, and how convenient it will be to obtain signatures in a reasonable amount of time. It does no good to require two signatures if one of the authorized officers signs several blank checks in advance, as the purpose of requiring two signatures is to verify to whom, for what amount and why a check is being issued. If the Board requires two signatures, remember to order checks that have two signature lines.

**Authorized Signatures:** This is up to the Lodge Board of Trustees, but a minimum of three is best. It is always good to have an extra name or two on file in case someone goes out of town or an emergency occurs and the usual signing officer(s) is not available. Normally, the Treasurer, President and Secretary are the signatures on file.

**Type of Checks:** Your banking representative can show you several styles of business checks. The least you should get is a business check with a voucher stub for

your records and balances. You may want to consider checks with a carbon copy. The Grand Lodge checks are computer printed and have two copies.

**Bank Statements:** The monthly bank statement with the canceled checks should be sent to whoever is going to balance the account. It is recommended that you also have a copy of the statement sent to your accountant.

## **EXPENSE VOUCHERS**

A voucher is simply a form authorizing the Treasurer to pay an expense. Your lodge should have expense vouchers printed and require that a voucher be filled out on all expenses before payment is made.

**Voucher Information:** The voucher should contain the date the voucher was filled out, name of payee, payee's address, payee's signature, reason for expense, who authorized the expense, check number, amount paid, date paid and your signature.

**Voucher Authorization:** Normally, the President has to authorize all expenses. However, on regular office-related expenses, the Secretary or Treasurer can authorize payment.

**Voucher Copies:** The number of copies is up to your Lodge Board of Trustees. The Grand Lodge requires a carbonless four copy voucher. When the member fills out the voucher, he/she keeps the bottom copy and forwards the remainder to the President for approval. After signing the voucher, the President keeps a copy for his/her records and then forwards the remaining copies to the Treasurer. After making payment, the Treasurer completes the voucher and attaches one copy to the check stub. The remaining copy is forwarded to the Secretary for his/her records.

## **MAINTAINING YOUR RECORDS**

It is extremely important that you maintain good record keeping procedures. Your lodge members, your lodge accountant, your lodge attorney or the IRS may need to review some of these records.

**Ledger:** Your accounting ledger should be kept neat and easy to read. The ledger should show dates, transaction numbers, description of the transactions, income column, expense column and balance. Ledgers can be handwritten or computerized. Keep your ledger safe by keeping it in a fire safe. Computer programs should be backed up at least weekly and the backup copy kept in a fire safe.

**Receipts:** You should require that receipts be submitted with all vouchers. Receipts should be attached to the Treasurer's copy of the voucher and then filed numerically by check for easy research of your records.

**Monthly Folders:** You can organize your files by keeping all expense vouchers in a monthly folder bearing the month and year. Copies or notes on all income should be kept in a similar monthly income folder. At the end of each fiscal year, both the expense and

income folders should be put in a box clearly marked “Financial Records for the Year of \_\_\_\_\_.” These records should then be stored at your lodge office. You can get boxes for financial records from any office supply store.

## **BUDGET**

At the beginning of each fiscal year, you should draw up a proposed budget for your Executive Board or Board of Trustees. The Board will review and either approve or make changes to your proposed budget. A budget is a guide to follow in regards to projected income and projected expenses for the next fiscal year. On a monthly basis, you should compare the budget v. actual expenses and income to see the financial progress of your lodge. A comparison of the budget v. actual figures will show the Board where it may need to make changes in regards to expenses or income during the year. The following is a list of some budgetary items:

### **Income:**

- Dues
- Fund Raiser
- Miscellaneous Income
- Total Income**

### **Expenses:**

- Rent
- Phone
- Utilities
- State Lodge Per Capita Tax
- Grand Lodge Per Capita Tax
- Travel
- Meals
- Hotels
- Donations
- Insurance
- Legal Fees
- Total Expenses**

**Income minus expenses = savings**

## **FINANCIAL REPORTS**

Financial reports can help keep your Board of Trustees and the membership aware of the financial status of the lodge. You should distribute a financial report at each meeting of your lodge. Computerizing your records will allow you access to several different kinds of reports.

## **COMPUTERIZED RECORD KEEPING**

The Grand Lodge highly recommends the computerization of financial records. There are several relatively inexpensive computer programs on the market today. Many of these programs are easy to learn and are acceptable to most accountants. At the end of each

month, a backup copy of your file can be given to your accountant and an additional copy can be placed in a secure location.

## **RECORD RETENTION**

Cost of storage space, as well as the administrative problems involved in retaining material beyond its useful life, are the main reasons that retention periods are set for various types of data. Consideration should also be given to the impact upon a lawsuit of the failure to have retained records. Determining the proper periods for retaining records is a major decision for practitioners. Records should be preserved for only as long as they serve a useful purpose or until all legal requirements are met. At the end of the retention periods, records should be destroyed so files and filing space remain manageable.

When establishing a record retention policy, ensure that it is sufficiently long and strictly followed. This can negate claims that the policy was intended or records were destroyed to remove any incriminating information from further review. Your policy should also be developed in such a way that longer retention periods can be maintained for records that are likely to be called upon at a later date.

Record retention periods vary among firms; however, record retention periods should generally correspond to the longest statute of limitations prevailing in each state for breach of contract, breach of fiduciary duty, and professional liability claims. Statutes of limitations for each state are as follows:

<b>State</b>	<b>Years</b>	<b>State</b>	<b>Years</b>
Alabama	6	Missouri	5
Alaska	6	Montana	8
Arizona	6	Nebraska	5
Arkansas	5	Nevada	4
California	4	New Hampshire	3
Colorado	6	New Jersey	6
Connecticut	6	New Mexico	6
Delaware	3	New York	6
D.C.	3	North Carolina	3
Florida	4	North Dakota	6
Georgia	6	Ohio	15
Hawaii	6	Oklahoma	5
Idaho	5	Pennsylvania	6
Illinois	10	Rhode Island	10
Indiana	10	South Carolina	3
Iowa	10	South Dakota	6
Kansas	5	Tennessee	3
Kentucky	15	Texas	4
Louisiana	10	Utah	6
Maine	6	Vermont	6
Maryland	3	Virginia	10
Massachusetts	6	Washington	6
Michigan	6	West Virginia	10

Minnesota	6	Wisconsin	6
Mississippi	3	Wyoming	10

When developing your record retention periods, determine whether your work product is being used by others in neighboring states. The statute of limitations prevailing in those states could impact any related litigation. *Because statutes of limitations vary state by state, consult lodge's legal counsel before establishing a record retention policy.*

### A Sample Record Retention Schedule

Accident reports & claims	7 years
Accounts payable ledgers and schedules	7 years
Accounts receivable ledger and schedules	7 years
Audit reports	Permanent
Bank reconciliations	7 years
Bank statements	7 years
Business licenses	Permanent
Canceled checks- <b>important</b> (i.e., taxes, purchases of property, special contracts, etc. Checks should be filed with the papers pertaining to the underlying transaction)	Permanent
Canceled checks- <b>other</b>	7 years
Capital stock and bond records; ledgers, transfer registers, stubs showing issues record of group interest, options, etc.	Permanent
Cash books	Permanent
Charts of accounts	Permanent
Construction records	Permanent
Contracts & leases-expired	7 years
Contracts & leases in effect	Permanent
Corporate board minutes	Permanent
Corporate bylaws	Permanent
Corporate shareholder records	Permanent
Corporate stock registers	Permanent
Corporate stock transactions	Permanent
Correspondence-customers & vendors (routine)	1 year
Correspondence-general	3 years
Correspondence-legal	Permanent
Deeds, mortgages and bills of sale	Permanent
Depreciation schedules	Permanent
Duplicate deposit slip	3 years

Employee personnel records after termination	7 years
Employee benefit plan records	Permanent
Employee payroll records	7 years
Employee pension/profit sharing plans	Permanent
Employment applications	3 years
Employment taxes	7 years
Expense analysis & distribution schedules	7 years
Financial statements-year end	Permanent
Financial statements-other	7 years
General ledgers & trial balances-year end	Permanent
Inherited property records & valuations	Permanent
Insurance policies-expired	3 years
Insurance records	Permanent
Insurance audit reports	Permanent
Internal reports	3 years
Internal audits (in some situations, longer retention periods may be desirable)	3 years
Inventory records	7 years
Invoices to customers	7 years
Invoices from vendors	7 years
Journals	Permanent
Leasehold improvements	Permanent
Low-income housing records	7 years
Minute books of directors & stockholders	Permanent
Notes receivable ledger	7 years
Option records	7 years
Patents and trademarks	Permanent
Payroll records and summaries, including payments to pensioners	7 years
Petty cash vouchers	3 years
Physical inventory tags	3 years
Plant cost ledgers	7 years
Property appraisals	Permanent
Property records including costs, depreciation reserves, end-of-year trial balances, depreciation schedules, blue prints and plans	Permanent
Purchase orders (purchasing department copy)	7 years

Purchase orders (except purchasing department copy)	1 year
Real estate purchases	Permanent
Receiving sheets	3 years
Requisitions	1 year
Sales records	7 years
Savings bond records-employee	3 years
Scrap & salvage records	7 years
Stenographer's notebooks	7 years
Stock and bond certificates (cancelled)	7 years
Stock room withdrawal forms	1 year
Subsidiary ledgers	7 years
Tax returns, worksheets & revenue agents' reports and other documents relating to determination of income tax liability	Permanent
Time books	7 years
Trade mark registrations	Permanent
Voucher registers and schedules	7 years
Vouchers for payment to vendors, employees, etc. (includes allowances and reimbursement of employees, officers, etc., for travel and entertainment expenses)	7 years
Wage Garnishments	7 years
Worker's Comp Reports	10 years

## VI. EMPLOYEES V. INDEPENDENT CONTRACTORS

One of the hottest and most controversial tax topics covered is the difference between an employee and an independent contractor. One of the reasons for the controversy is the additional payroll tax filings required when paying employees. Employers who pay taxable wages to workers who are employees must deduct and withhold federal income taxes and pay the withheld amount to the federal government. They also must withhold and deposit social security (FICA) from taxable wages paid to employees and pay an equal amount of FICA taxes. Employers also must pay federal unemployment (FUTA) taxes on wages paid to employees. Taxpayers that have employees must file a variety of forms and reports, such as Form 941, Forms W-2 and W-3, Form 940 or 940EZ. In addition, if workers are employees, they usually must be covered by the employer's qualified retirement plan and may have to be included in its fringe benefit plans as well.

There is no single all-inclusive definition of the word "employee" in the Internal Revenue Code. For income tax withholding purposes, the Code simply provides that the term includes corporate officers as well as officers, employees or elected officials of federal and state governments or their agencies and instrumentalities. Therefore, an

argument could be made that all elected officers of each lodge are employees of that lodge.

As a general rule, a worker is an independent contractor if he or she is subject to the direction or control of another merely as to the result to be accomplished by the work but not as to the means and methods by which the result is accomplished. Some of the typical hallmarks of an independent contractor are as follows:

1. cannot be fired so long as he or she produces a result that meets contract specifications rather than employer standards of performance;
2. provides own tools and supplies;
3. stands to make a profit or loss from the work; and
4. is free to contract with others.

As an aid to determining whether an individual is an employee under the common law rules, twenty factors or elements have been identified as indicating whether sufficient control is present to establish an employer-employee relationship. The twenty factors have been developed based on an examination of cases and rulings considering whether an individual is an employee. The degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed. The twenty factors are designed only as guides for determining whether an individual is an employee; special scrutiny is required in applying the twenty factors to assure that formalistic aspects of an arrangement designed to achieve a particular status do not obscure the substance of the arrangement (that is, whether the person or persons for whom the services are performed exercise sufficient control over the individual for the individual to be classified as an employee). The twenty factors are described below:

1. Instructions – A worker who is required to comply with other persons' instructions about when, where, and how he or she is to work is ordinarily an employee. The control factor is present if the person or persons for whom the services are performed have the *right* to require compliance with instructions.
2. Training – Training a worker by requiring an experienced employee to work with the worker, by corresponding with the worker, by requiring the worker to attend meetings, or by using other methods, indicates that the person or persons for whom the services are performed want the services performed in a particular method or manner.
3. Integration – Integration of the worker's services into the business operations generally shows that the worker is subject to direction and control. When the success or continuation of a business depends to an appreciable degree upon the performance of certain services, the workers who perform those services must necessarily be subject to a certain amount of control by the owner of the business.
4. Services Rendered Personally – If the services must be rendered personally, presumably the person or persons for whom the services are performed are interested in the methods used to accomplish the work as well as in the results.
5. Hiring, Supervising, and Paying Assistants – If the person or persons for whom the services are performed hire, supervise, and pay assistants, that factor generally shows control over the workers on the job. However, if one worker hires,

- supervises, and pays the other assistants pursuant to a contract under which the worker agrees to provide materials and labor and under which the worker is responsible only for the attainment of a result, this factor indicates an independent contractor status.
6. Continuing Relationship – A continuing relationship between the worker and the person or persons for whom the services are performed indicates that an employer-employee relationship exists. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals.
  7. Set Hours of Work – The establishment of set hours of work by the person or persons for whom the services are performed is a factor indicating control.
  8. Full Time Required – If the worker must devote substantially full time to the business of the person or persons for whom the services are performed, such person or persons have control over the amount of time the worker spends working and impliedly restrict the worker from doing other gainful work. An independent contractor, on the other hand, is free to work when and for whom he or she chooses.
  9. Doing Work on Employer’s Premises – If the work is performed on the premises of the person or persons for whom the services are performed, that factor suggests control over the worker, especially if the work could be done elsewhere. Work done off the premises of the person or persons receiving the services, such as at the office of the worker, indicates some freedom from control. However, this fact by itself does not mean that the worker is not an employee. The importance of this factor depends on the nature of the service involved and the extent to which an employer generally would require that employees perform such services on the employer’s premises. Control over the place of work is indicated when the person or persons for whom the services are performed have the right to compel the worker to travel a designated route, to canvass a territory within a certain time, or to work at specific places as required.
  10. Order or Sequence Set – If a worker must perform services in the order or sequence set by the person or persons for whom the services are performed, that factor shows that the worker is not free to follow the worker’s own pattern of work but must follow the established routines and schedules of the person or persons for whom the services are performed. Often, because of the nature of an occupation, the person or persons for whom the services are performed do not set the order of the services or set the order infrequently. It is sufficient to show control, however, if such person or persons retain the right to do so.
  11. Oral or Written Reports – A requirement that the worker submit regular or written reports to the person or persons for whom the services are performed indicates a degree of control.
  12. Payment by Hour, Week, Month – Payment by the hour, week, or month generally points to an employer-employee relationship, provided that this method of payment is not just a convenient way of paying a lump sum agreed upon as the cost of a job. Payment made by the job or on a straight commission generally indicates that the worker is an independent contractor.
  13. Payment of Business and/or Traveling Expenses – If the person or persons for whom the services are performed ordinarily pay the worker’s business and/or

- traveling expenses, the worker is ordinarily an employee. An employer, to be able to control expenses, generally retains the right to regulate and direct the worker's business activities.
14. **Furnishing of Tools and Materials** – The fact that the person or persons for whom the services are performed furnish significant tools, materials, and other equipment tends to show the existence of an employer-employee relationship.
  15. **Significant Investment** – If the worker invests in facilities that are used by the worker in performing services and are not typically maintained by employees (such as the maintenance of an office rented at fair value from an unrelated party), that factor tends to indicate that the worker is an independent contractor. On the other hand, lack of investment in facilities indicates dependence on the person or persons for whom the services are performed for such facilities and, accordingly, the existence of an employer-employee relationship.
  16. **Realization of Profit or Loss** – A worker who can realize a profit or suffer a loss as a result of the worker's services (in addition to the profit or loss ordinarily realized by employees) is generally an independent contractor, but the worker who cannot is an employee.
  17. **Working for More Than One Firm at a Time** – If a worker performs more than de minimis services for a multiple of unrelated persons or firms at the same time, that factor generally indicates that the worker is an independent contractor. However, a worker who performs services for more than one person may be an employee of each of the persons, especially where such are part of the same service arrangement.
  18. **Making Services Available to General Public** – The fact that a worker makes his or her services available to the general public on a regular and consistent basis indicates an independent contractor relationship.
  19. **Right to Discharge** – The right to discharge a worker is a factor indicating that the worker is an employee and the person possessing the right is an employer. An employer exercises control through the threat of dismissal, which causes the worker to obey the employer's instructions. An independent contractor, on the other hand, cannot be fired so long as the independent contractor produces a result that meets the contract specifications.
  20. **Right to Terminate** – If the worker has the right to end his or her relationship with the person for whom the services are performed at any time he or she wishes without incurring liability, that factor indicates an employer-employee relationship.

In an effort to clarify, through example, look at the three situations below when considering employee v. independent contractor.

***Situation 1*** – The Firm is engaged in the business of providing temporary technical services to its clients. The Firm maintains a roster of workers who are available to provide technical services to prospective clients. The Firm does not train the workers but determines the services that the workers are qualified to perform based on information submitted by the workers.

The Firm has entered into a contract with the client. The contract states that the Firm is to provide the Client with workers to perform computer programming services meeting specified qualifications for a particular project. The Individual, a computer programmer, enters into a contract with the Firm to perform services as a computer programmer for the Client's project, which is expected to last less than one year. The Individual is one of several programmers provided by the Firm to the Client. The Individual has not been an employee of or performed services for the Client (or any predecessor or affiliated corporation of the Client) at any time preceding the time at which the Individual begins performing services for the Client. Also, the Individual has not been an employee of or performed services for or on behalf of the Firm at any time preceding the time at which the Individual begins performing services for the Client. The Individual's contract with the Firm states that the Individual is an independent contractor with respect to services performed on behalf of the Firm for the Client.

The Individual and the other programmers perform the services under the firm's contract with the Client. During the time the Individual is performing services for the Client, even though the Individual retains the right to perform services for other persons, substantially all of the Individual's working time is devoted to performing services for the Client. A significant portion of the services are performed on the Client's premises. The Individual reports to the Firm by accounting for time worked and describing the progress of the work. The Firm pays the Individual and regularly charges the Client for the services performed by the Individual. The Firm generally does not pay individuals who perform services for the Client unless the Firm provided such individuals to the Client.

The work of the Individual and other programmers is regularly reviewed by the Firm. The review is based primarily on reports by the Client about the performance of these workers. Under the contract between the Individual and the Firm, the Firm may terminate its relationship with the Individual if the review shows that he or she is failing to perform the services contracted for by the Client. Also, the firm will replace the Individual with another worker if the Individual's services are unacceptable to the Client. In such a case, however, the Individual will nevertheless receive his or her hourly pay for the work completed.

Finally, under the contract between the Individual and the Firm, the Individual is prohibited from performing services for the Client and, under the contract between the Firm and the Client, the Client is prohibited from receiving services from the Individual for a period of three months following the termination of services by the Individual for the Client on behalf of the Firm.

***Situation 2*** – The Firm is a technical services firm that supplies clients with technical personnel. The Client requires the services of a systems analyst to complete a project and contracts the Firm to obtain such an analyst. The Firm maintains a roster of analysts and refers such an analyst, the Individual, to the Client. The Individual is not restricted by the Client or the Firm from providing services to the general public while performing services for the Client and in fact does perform substantial services for other persons during the period the Individual is working for the Client. Neither the Firm nor the Client has priority on the services of the Individual. The Individual does not report, directly or indirectly, to the Firm after the beginning of the assignment to the Client concerning (1)

hours worked by the Individual, (2) progress on the job, or (3) expenses incurred by the Individual in performing services to the Client. No reports (including reports of time worked or progress on the job) made by the Individual to the Client are provided by the Firm to the Client.

If the Individual ceases providing services for the Client prior to completion of the project or if the Individual's work product is otherwise unsatisfactory, the client may seek damages from the Individual. However, in such circumstances, the Client may not seek damages from the Firm, and the Firm is not required to replace the Individual. The Firm may not terminate the services of the individual while he or she is performing services for the Client and may not otherwise affect the relationship between the Client and the Individual. Neither the Individual nor the Client is prohibited for any period after termination of the Individual's services on this job from contracting directly with the other. For referring the Individual to the Client, the Firm receives a flat fee that is fixed prior to the Individual's commencement of services for the Client and is unrelated to the number of hours and quality of work performed by the Individual. The Individual is not paid by the Firm either directly or indirectly. No payment made by the Client to the Individual reduces the amount of the fee that the Client is otherwise required to pay the Firm. The Individual is performing services that can be accomplished without the Individual's receiving direction or control as to hours, place of work, sequence, or details of work.

***Situation 3*** – The Firm, a company engaged in furnishing client firms with technical personnel, is contacted by the Client, who is in need of the services of a drafter for a particular project, which is expected to last less than one year. The Firm recruits the Individual to perform the drafting services for the Client. The Individual performs substantially all of the services for the Client at the office of the Client, using materials and equipment of the Client. The services are performed under the supervision of employees of the Client. The Individual reports to the Client on a regular basis. The Individual is paid by the Firm based on the number of hours the Individual has worked for the Client, as reported to the Firm by the Client or as reported by the Individual and confirmed by the Client. The Firm has no obligation to pay the Individual if the Firm does not receive payment for the Individual's services from the Client. For recruiting the Individual for the Client, the Firm receives a flat fee that is fixed prior to the Individual's commencement of services for the Client and is unrelated to the number of hours and quality of work performed by the Individual. However, the Firm does receive a reasonable fee for performing the payroll function. The Firm may not direct the work of the Individual and has no responsibility for the work performed by the Individual. The Firm may not terminate the services of the Individual. The Client may terminate the services of the Individual without liability to either the Individual or the Firm. The Individual is permitted to work for another firm while performing services for the Client, but does in fact work for the Client on a substantially full-time basis.

Under the facts of Situation 1, the legal relationship is between the Firm and the Individual, and the Firm retains the right of control to insure that the services are performed in a satisfactory fashion. The fact that the Client may also exercise some degree of control over the Individual does not indicate that the Individual is not an

employee. Therefore, in Situation 1, the Individual is an employee of the Firm under common law rules.

In Situation 2, the Firm does not retain any right to control the performance of the services by the Individual and, thus, no employment relationship exists between the Individual and the Firm.

In Situation 3, the Firm does not control the performance of the services of the Individual, and the Firm has no right to affect the relationship between the Client and the Individual. Consequently, no employment relationship exists between the Firm and the Individual.

## **VII. FORMS**

The next several pages are examples of the forms referenced to in this book. For current year forms and instructions go to the Internal Revenue web site at: [www.irs.gov](http://www.irs.gov)

The forms listed below are printed in the book on pages 26 through 52

FORM 990	Pages 26-31
FORM 990-EZ	Pages 32-33
FORM 990-T	Pages 34-37
FORM SS-4	Pages 38-39
FORM 1096	Pages 40-41
FORM W-9	Pages 42-45
FORM 1099-MISC	Pages 46-52