Updates in the Law for Nonprofit Organizations

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RECENT DEVELOPMENTS IN THE LAW

Updates in the Law for Nonprofit Organizations

Treasury and IRS Regulations, Rulings, and Other Pronouncements, Court Opinions, Proposed and Enacted Legislation, and other Current Developments

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Updates of this outline are available, on an ongoing basis, at www.nonprofitlawcenter.com. Click on Resources, then on Current Developments Outlines.
This outline consists of nine parts: summaries of (1) the Internal Revenue Service’s Exempt Organizations FY 2015 Program Letter (very brief summary); (2) the Treasury Department-IRS 2014-2015 Priority Guidance Plan, as updated; (3) current developments in the law pertaining to tax-exempt organizations in general; (4) current developments in the federal law of particular pertinence to public charities and private foundations; (5) current developments pertaining to unrelated business activities of exempt organizations; (6) current developments relating to the tax law of charitable giving; (7) current developments relating to the law of fundraising; (8) recent legislation; and (9) miscellaneous other current developments in the law concerning nonprofit organizations.

I. IRS EXEMPT ORGANIZATIONS PROGRAM LETTER

A. IRS’s Exempt Organizations Division, on January 25, 2013, issued its fiscal year 2012 annual report and fiscal year 2013 workplan.

B. FY 2013 annual report and FY 2014 workplan was not issued.

C. TE/GE Program [Management] Letter for FY 2015 was issued on November 4, 2014.

II. TREASURY-IRS 2014-2015 PRIORITY GUIDANCE PLAN (UPDATED ON APRIL 28, 2015) PROJECTS

A. Tax-Exempt Organizations Law Projects

1. Regulations to allow IRS to adopt streamlined application process that eligible organizations may use to apply for recognition of tax-exempt status (by means of Form 1023-EZ) (IRC §§ 501(a), 501(c)(3), 508); final, temporary, and proposed regulations have been issued.

2. Development of revenue procedure setting for the procedures for issuance of determination letters as to exempt status (IRC § 501(c)(3)) for eligible organizations that filed Form 1023-EZ; revenue procedure has been published (Rev. Proc. 2014-40).

3. Proposed regulations (under IRC § 501(c)) pertaining to political campaign activities.

4. Guidance regarding methods of allocating expenses relating to dual-use facilities (IRC § 512(a)(1)).

5. Final regulations on additional requirements that tax-exempt hospitals must satisfy to remain exempt (IRC §§ 501(r), 6033); final regulations issued.

6. Procedures for hospital organizations to use to correct and disclose failures to meet requirements of IRC § 501(r) (issued as Rev. Proc. 2015-21).

8. Revenue procedures updating grantor and contributor reliance criteria (IRC §§ 170, 509).

9. Guidance relating to exempt organizations’ reporting of contributions (IRC § 6033).

10. Final regulations concerning application for recognition as qualified nonprofit health insurance issuer (IRC § 501(c)(29)); these have been published, along with procedures (Rev. Proc. 2015-17).

11. Promulgation of additional guidance on supporting organizations (IRC § 509(a)(3)).

12. Final regulations on reliance standards for making good-faith determinations (IRC §§ 4942, 4945); proposed regulations have been published.

13. Regulations concerning program-related investments (IRC § 4944); proposed regulations have been published.

14. Guidance regarding private foundation’s investment in partnership in which disqualified persons are also partners (IRC § 4941).


16. Final regulations concerning church tax inquiries and examinations; proposed regulations were issued in 2009.

17. Regulations explaining computation of unrelated business taxable income of voluntary employees’ beneficiary associations (IRC §§ 501(c)(9), 512); proposed regulations issued.

18. Final regulations concerning IRS authority to disclose exempt organization information to state officials (IRC § 6104(c)); proposed regulations were published in 2011.

19. Regulations concerning fractions rule (IRC § 514(c)(9)).

20. Guidance on changes in procedures due to realignment of Tax Exempt and Government Entities Division and Office of Division Counsel/Associate Chief Counsel (Ann. 2014-34); IRS delegated authority to Office of Chief Counsel to perform all technical functions performed by TE/GE Division, including letter rulings and revenue rulings (Del. Order 30-7).

21. Notice providing advance notification of provision anticipated to be included in proposed regulations to be issued to accompany IRC § 529A.
B. Charitable Giving Law Projects

1. Final regulations concerning the recordkeeping, substantiation, and appraisal requirements for cash and noncash charitable contributions in reflection of legislative enactments in 2004 and 2006; proposed regulations were published in 2008.

2. Publication of regulations regarding donee substantiation of charitable contributions (IRC § 170(f)(8)).

3. Regulations concerning uniform basis of charitable remainder trusts (IRC § 1014); proposed regulations issued on January 16, 2014.

4. Final regulations regarding issues pertaining to net investment income tax (IRC § 1411); proposed regulations have been issued.

III. LAW PERTAINING TO TAX-EXEMPT ORGANIZATIONS IN GENERAL

A. Tax-Exempt Status in General

Tax-exempt charitable (IRC § 501(c)(3)) organizations have been the subject of many IRC rulings and court opinions.

1. Qualification for tax exemption in IRC § 501(c)(3) setting:
   
   a. IRS rulings favorable to organizations, in general:

      (1) Public charity held lessening burdens of state’s political subdivision, a commission, because it is operating stream mitigation bank pursuant to delegation of authority from commission; IRS found objective manifestation that commission considers operation of bank to be its burden; organization held to be actually lessening burden by operating bank and protecting natural resources of watershed, which is part of nature reserve leased by commission to charity (IRS Private Letter Ruling (PLR) 201408031).

      (3) “Dormant shell” held qualified to remain as exempt charitable organization because of its “specific plan” to resume charitable operations in future (PLR 201448026).

   b. IRS rulings denying recognition of exemption as to or revocation of exemption of organizations, in general; such action because of:

      (1) Operation in substantially commercial manner (PLRs 201403017, 201404012, 201405022, 201407015, 201415006, 201416010, 201409016, 201420021, 201424027, 201428022, 201445018, 201446028, 201450022, 201452020, 201510059, 201511023, 201514013).
(2) Failure to operate primarily for exempt purposes (violation of operational test) (PLRs 201402016, 201405017, 201405021, 201405022, 201414021, 201414025, 201415007, 201433018, 201451037, 201514014, 201517008, 201517012, 201517015).

(3) Failure to provide records or documentation (see IV M 8).

(4) Inactivity (PLRs 201402017, 201406013, 201414026, 201414032, 201418058, 201435015, 201442057, 201445012, 201449001, 201451034, 201509040, 201514010, 201514012, 201517009, 201517011, 201518021).

(5) Failure to file annual information returns (see IV I 2).

(6) Failure to maintain adequate records (PLRs 201402015, 201418056, 201449001).

(7) Provision of consulting services for fee, with services at or above costs (PLRs 201403017, 201405022).

(8) Operation of conservation easement entity with inadequate documentation and enforcement (PLR 201405018).

(9) Provision of Internet security services to nongovernmental organizations and other entities; organization held to not be defending human and civil rights secured by law (PLR 201405022).

(10) Facilitating transfers of money from merchants to exempt schools, by means of software application and website, in ways that cause entity to be operated in commercial manner and provide private benefit to merchants (PLR 201407014).

(11) Operation of fee-based health care cooperative, where IRS concluded it is “ordinary business” operating in commercial manner and for private benefit of members and participating physicians (PLR 201409012).

(12) Conduct of raffles, which was ruled to be a commercial business (PLR 201410035).

(13) Provision of consulting and travel services to synagogues nationwide in commercial manner (PLR 201411038).

(14) Conduct of festival and other events that are more social than charitable (PLR 201411042).

(15) Conduct of bingo games as primary activity (PLR 201428019).
(16) Conduct of beauty pageants (PLR 201432037).

(17) Operation of faculty practice plan where faculty not employees of organization and medical school does not control organization (PLR 201433016).

(18) Provision of “business-sponsored” free wireless networks in technologically underserved urban areas (PLR 201434023).

(19) “Automated fundraising online marketplace,” enabling shoppers to contribute to charities, ruled not exempt as charity principally because it is commercial activity (PLR 201503016).

(20) Development and distribution of open source software (because software can be used for commercial ends, undertakings do not serve charitable class, educate individuals, or amount to scientific research (PLR 201505040).

(21) Provision of Web marketing assistance to small businesses affected by natural disasters (PLR 201509039).

(22) Operation as credit counseling organization (PLRs 201405023, 201410043, 201410044, 201412022, 201414033, 201417023, 201419018, 201419019, 201422027, 201426035, 201503017, 201515034).

(23) Operation as mortgage counseling or foreclosure-related service organization (PLR 201445014).

(24) Operation of nonprofit residential construction company (PLR 201446028).

(25) Failure to exercise adequate discretion and control over funds sent to organization operating schools in foreign country (PLR 201511033).

(26) Operation of down payment assistance programs (PLRs 201418055, 201428021, 201428023, 201428028, 201452019, 201506011).

(27) Violation of private inurement doctrine (see IV B).

(28) Violation of private benefit doctrine (see IV C).

Other types of tax-exempt organizations have been the subject of many IRS rulings and court opinions.
2. Qualification for tax exemption in other settings:

   a. Developments concerning single-parent title-holding companies (IRC § 501(c)(2) entities) [no current developments].
      
      (1) Exemption revoked for failure to engage in title-holding company functions (PLR 201338045).

   b. Developments concerning tax-exempt social welfare organizations (IRC § 501(c)(4) entities):
      
      (1) Organizations held to not qualify for exemption where their primary activities constitute participation in political campaigns (PLR 201424028).

      (2) Organization that maintains common areas associated with condominium properties, and enforces covenants, held to not qualify as social welfare entity (PLRs 201429030, 201442058).

      (3) Organization of members of faith held ineligible for exemption because it was not promoting common good and general welfare (PLR 201409013).

      (4) Organization ruled ineligible for exemption because its primary purpose was qualification of referendum to overturn legislation adversely affecting its primary donor; benefit to community held incidental; private inurement and private benefit found (PLR 201411039).

      (5) Organization’s exemption revoked because it is operating primarily as social club (PLR 201414028).

      (6) Organization’s exemption revoked because its sole activity became furniture rental operation (PLR 201425013).

      (7) Organization of individuals servicing automobiles built by particular manufacturer failed to qualify as exempt social welfare organization because it is operating primarily for convenience of its members, their employer dealerships, and manufacturer rather than promote common good and general welfare of a community (PLR 201431032).

      (8) Organization’s exempt status revoked for providing prepaid vision services where it primarily benefited its enrollees (PLR 201443020).

      (9) Organization formed to assume business of for-profit health maintenance organization does not qualify for this exemption because it
does not arrange or administer health care services for a community but instead primarily for its subscribers (PLR 201451033).

(10) Organization’s exemption revoked; it was operating snack bar at nursing home and rehabilitation facility but facility’s owner and operated, once charitable entity, has been replaced by for-profit entity (PLR 201511025).

(11) Organization’s exemption revoked; it is operating essentially as homeowners’ association for members owning recreational residences in National Forest (PLR 201518018).

c. Developments concerning tax-exempt labor, agricultural, horticultural organizations (IRC § 501(c)(5) entities):

(1) Organization of individuals servicing automobiles built by particular manufacturer failed to qualify as exempt labor organization because its activities are training services for member, their employer dealerships, and manufacturer rather than betterment of conditions for those engaged in labor (PLR 201431032).

(2) A farmers’ market organization was ruled to not qualify as an exempt agricultural organization because it is not aimed at overall betterment of conditions within farming industry but rather it operates to aid vendors in selling goods and provides them, for a fee, promotion and a location to do what they would otherwise have to do themselves (PLR 201508011).

d. Developments concerning tax-exempt trade, business, and professional associations (IRC § 501(c)(6) entities):

(1) Reporting exception amount for associations with nondeductible lobbying expenses (IRC § 6033(e)(3)) is no more than $108 for 2015 (IRS Revenue Procedure (Rev. Proc.) 2014-61).

(2) IRS wrote that, for entity to be exempt business league, its members must “have a voice in [its] operation” and there must be “meaningful extent of membership support” (PLR 201242016).

(3) Exemption revoked where organization evolved into multiple listing service; private interests of participating members advanced (PLR201405025).

(4) Recognition of exemption denied to organization that is promoting new technology standard for controlling and storing of items on Internet, to be licensed in competition with current standards (PLR 201349019; likewise PLR 201425014).
(5) Organization failed to achieve exemption because its (nonvoting) membership is not involved in entity's activities at “meaningful level” (PLR 201349021).

(6) Exempt business league ruled able to reacquire control and operation of series of tournaments and other events involving a game without adversely affecting its exemption (PLR 201406020).

(7) Organization of physicians and other medical professionals held to not qualify as exempt business league where its primary activity, negotiating managed-care contracts on behalf of its members, primarily benefited membership rather than promoting line of business (PLR 201411040).

(8) Organization members of which are professionals in geographic area who meet to exchange referrals held to not qualify an exempt business league because it provides services to its members rather than serve line of business (PLRs 201424023, 201432026).

(9) Organization conducting certification program by means of laboratory testing and inspection of products held engaging in exempt functions (PLR 201426029).

(10) Plan of Federal Energy Regulatory Committee-designated regional electricity transmission organization (an IRC § 501(c)(6) entity) to establish central counterparty structure for transactions occurring in its markets ruled to not adversely affect its tax-exempt status (PLR 201430018).

(11) Organization of individuals servicing automobiles built by particular manufacturer failed to qualify as exempt business league because its activities are directed to performance of services for manufacturer rather than to improvement of business conditions of one or more lines of business (PLR 201431032).

(12) Business league exemption revoked because its revenue came from life insurance sales to members, various closely held corporations, which did not constitute line of business (PLR 201502015).

(13) Real estate association failed to qualify for exemption as business league because its activities, primarily publication of magazine offering homes for sale and operation of multiple listing service, provide particular services to members (PLR 201451038).

(14) Organization denied recognition of this exemption for variety of reasons, principal one being it is rendering particular services to individual members (provision of insurance products) (PLR201502015).
(15) Exemption revoked because organization failed to document its operations or finances (PLR 201509041).

(16) Organization formed to promote wedding-service industry businesses failed to qualify for exemption because its membership is restricted and its activities benefit members; businesses (PLR 201514019).

(17) Court of appeals, on July 21, 2014, held that organization, affiliated with American Bar Association, that promotes and facilitates operation of tax-qualified retirement plans for lawyers, does not qualify as tax-exempt business league largely because it failed line-of-business standard and engages in business ordinarily conducted for profit (ABA Retirement Funds v. United States (7th Cir.)).

(18) National Football League announced, on April 28, 2015, that it is relinquishing its tax-exempt status.

e. Developments concerning tax-exempt social clubs (IRC § 501(c)(7) entities):

   (1) Clubs lost exemption due to excessive nonmember income (PLRs 201445027, 201448021, 201448022, 201451039, 201501015, 201517016, 201517017).

   (2) Social club operating golf course and other sports facilities plans to provide limited public access to course pursuant to agreement with municipality while public course is renovated; organization ruled to not open its facilities to public so as to endanger its tax-exempt status (PLR 201414029).

   (3) Sale by social club of conservation easement to city, limiting development and preventing pollution, held to not jeopardize club’s tax exemption (PLR 201425016).

   (4) Social club’s exemption held not endangered because of its support of program of social welfare organization; gross receipts of social welfare entity will not be attributed to club for purposes of nonmember income limitation; reimbursement from social welfare entity held not nonmember gross receipts (PLR 201428009).

   (5) Exempt club held to meet activities test because substantially all of its activities are traditional, normal and usual activities; nonmember income test met; raffle receipts held exempt function revenue (TAM 201430019).

   (6) Online sorority for students of online university held to not qualify for tax exemption inasmuch as it does not have meetings, other
gatherings, or facilities that promote mingling and fellowship among its members (PLR 201434022).

(7) Exemption revoked because organization, operating recreational vehicle temporary residential community, engaging in business activities, such as holding of mortgages, sale of propane, and provision of RV storage facilities; 81 percent of income was from nontraditional sources (PLR 201450023).

(8) Organization operating website, open to public, promoting company’s firearms and other products, held to not constitute exempt social club, in that it is not a club, in that it lacks a membership and thus no mingling (PLR 201451030).

(9) Organization subletting restaurant and selling beer and wine to public ruled not exempt social club; anyone who drinks there is automatically a member; IRS found lack of requisite mingling (PLR 201515035).

f. Rulings concerning fraternal organizations (IRC § 501(c)(8) entities) [no recent developments].

g. Rulings and court opinion concerning voluntary employees’ beneficiary associations (IRC § 501(c)(9) entities):

(1) In instances of distribution of assets of VEBAs on dissolution by allocation to participating employers, for use in providing medical and dental or insurance benefits to participant employees, IRS ruled that transactions will not jeopardize VEBAs’ exempt status (or generate unrelated business income) (PLRs 201410037, 201410038).

(2) Plan of VEBA, covering employees pursuant to collective bargaining agreements, to add non-union common law employees of industry league members as participants held to not adversely affect exemption (PLR 201415008).

(3) Plan of VEBA to extend health care benefits to nondependent domestic partners ruled to not adversely affect exemption, as long as these impermissible benefits do not exceed three percent of total annual benefits paid (PLR 201415011).

(4) Proposal of VEBA to provide welfare benefits to certain actively employed and retired non-member staff of state and local affiliates of national labor union that established it ruled to not adversely affect exemption because proposed participants share employment-related common bond with members of affiliates who are also members of VEBA (PLR 201422025).
(5) Proposed transfer of excess assets between two VEBAs, resulting from consolidation of welfare benefit obligations with respect to category of employees under single VEBA, ruled to not adversely affect exemption of either VEBA (PLR 201450029); likewise, PLR 201513004.

(6) Trust fund cost-of-living adjustment payments for retirees participating in pension plan ruled ineligible for this exemption because COLA benefits are excluded from those permissible for VEBA (PLR 201451040).

(7) IRS ruled that entity, in aftermath of company’s shutdown, remains exempt and maintained pursuant to collective bargaining agreement (IRC § 419A(f)(5)); income received by VEBA ruled to be exempt function income (IRC § 512(a)(3)(B)) (PLR 201512006).

(8) Plan sponsored by exempt educational institution benefits members of institution’s faculty hired after certain date; IRS ruled that this entity is not exempt VEBA because its membership is not voluntary in that non-faculty employees are excluded and plan is discriminatory (PLR 201515036).

h. Rules concerning domestic fraternal societies (IRC § 501(c)(10) entities) [no recent developments].

i. Rules concerning teachers’ retirement fund associations (IRC § 501(c)(11) entities) [no recent developments].

j. Rules concerning cooperatives (IRC § 501(c)(12) entities):

   (1) Organization failed in effort to obtain recognition of exemption as entity like mutual or cooperative telephone company because it does not have characteristics of a cooperative, does not satisfy activities test because it does not facilitate requisite communication, and failed income source test (PLR 201431031).

k. Rulings, etc., concerning cemetery companies (IRC § 501(c)(13) entities):

   (1) Plan of cemetery association maintaining historically significant family cemetery to purchase adjacent acreage from trusts benefiting several members of its board, at price to be determined by independent appraisal, ruled to not adversely affect organization’s exempt status (PLR 201428011).

   (2) Organization failed to qualify as exempt cemetery company because it could not prove lack of private inurement; organization is effectively controlled by nonmembers (PLR 201428029).
I. Developments concerning credit unions (IRC § 501(c)(14) entities):

   (1) Recognition of exemption as state-chartered credit union rejected because organization formed under law of foreign country (PLR 201416009).

m. Rulings, etc., concerning small property and casualty insurance companies (IRC § 501(c)(15) entities):

   (1) Exemption revoked where income exceeds statutory limits (PLRs 201405028, 201447040-201447042).

   (2) Exemption revoked because organization failed to provide insurance (PLR 201445016).

   (3) Organization failed to qualify for exemption where its sole policyholder is real estate consulting firm owned by its co-founders (PLR 201428025).

   (4) Exemption of reinsurance organization revoked, where entity has no participating carriers and receives only investment income (PLR 201450021).

n. Rulings, etc., concerning crop operations finance corporations (IRC § 501(c)(16) entities [no recent developments].

o. Rulings, etc., concerning supplemental unemployment benefit trusts (IRC § 501(c)(17) entities):

   (1) Trust failed to qualify for exemption where its wage and benefit continuation plan was mechanism for covering employees of multiple unrelated employers without meeting exemption requirements (PLR 201406018).

   (2) Single trust intended to provide benefits to employees of multiple employers ruled ineligible for exemption (PLR 201411041).

p. Rulings, etc., concerning veterans' organizations (IRC § 501(c)(19) entities):

   (1) Exemption revoked where organization’s primary activity is gaming (PLR 201450020).

   (2) Exemption revoked where organization’s non-veterans membership exceeds permitted percentage (PLR 201414027).

   (3) Exemption revoked where organization is operating bar in commercial manner (PLRs 201451041, 201451042).
q. Rulings, etc., concerning black lung benefits trusts (IRC § 501(c)(21) entities) [no recent developments].

r. Rulings, etc., concerning multi-parent title-holding companies (IRC § 501(c)(25) entities) [no recent developments].

s. Rulings, etc., concerning qualified health insurance issuers (IRC § 501(c)(29) entities) [no recent developments, other than application procedure]

t. Rulings, etc., concerning farmers’ cooperatives (IRC § 521 entities):

  (1) Exempt cooperative’s qualified written notices of allocation should be treated as preferred equity interests rather than liabilities; notices extinguished when cooperative restructured as corporation, then converted to LLC treated as partnership (CCAM 201511020).

u. Rulings, etc., concerning political organizations (IRC § 527 entities) [no recent developments].

v. Rulings, etc., concerning homeowners’ associations (IRC § 528 entities):

w. Developments concerning qualified tuition plans (IRC § 529 entities) [no recent developments]

x. Rulings concerning the tax status of political subdivisions, state instrumentalities, integral parts of state, and the like:

  (1) By reason of exclusion rule of IRC § 115: trust used by public employers to fund post-employment health and welfare benefits (PLRs 201441003, 201515016, 201516031); operation of home financing program (PLRs 201425001, 201425010); entity formed by county and state agency to administer electricity sale contracts from power plants (PLR 201442037); state nonprofit cooperative (PLR 201509001, modifying 201338029).

  (2) By reason of doctrine of intergovernmental immunity [no recent developments].

  (3) By reason of being integral part of state or city [no recent developments].

  (4) By classification as state instrumentality [no recent developments].

a. Additional requirements for tax-exempt charitable hospitals (IRC § 501(r)):

(1) Entities covered by new requirements.

(2) Community health needs assessments.

(3) Potential of $50,000 excise tax (IRC § 4959).

(4) Financial assistance policy.

(5) Emergency medical care policy.

(6) Limitation on charges.

(7) Billing and collection rules.


(9) Mandatory IRS review.

(10) Effective dates.

(11) IRS annual report.

(12) IRS trends study and report.

b. Final regulations to accompany these rules issued on December 29, 2014 (T.D. 9708); IRS corrections to rules issued on March 10, 2015.

c. Tax exemption for transitional applicable reinsurance entities (Act § 1341(c)(3)).

d. Changes in Blue Cross and Blue Shield rules (IRC § 833(c)(5)); IRS extended interim guidance on interpretation and application of these rules (Notice 2011-51).

e. Tax credit for small exempt organizations employers (IRC § 45R).

f. Religious exemptions to mandatory insurance coverage.

g. Religious exemptions to contraceptive mandate.

h. States may establish American Health Benefit Exchanges (which may be nonprofit organizations) to facilitate purchase of qualified health plans.

i. Building and expansion of community health centers.
j. Grants for support of school-based health centers.

k. Community transformation grant program.

l. Health care workforce development grant program.

m. Variety of training and demonstration projects programs.

n. Expansion of eligibility for Medicaid.

o. Accountable care organizations.

p. IRS issued report to Congress, made public on March 9, 2015, on tax-exempt, taxable, and government-owned hospitals; report mandated by Patient Protection and Affordable Care Act § 9007(e)(1)); data for calendar year 2011:

(1) Charity care provided by exempt hospitals was in excess of $12 billion; $8.9 billion provided by government-owned hospitals; $1.4 billion provided by taxable hospitals.

(2) Non-Medicare bad-debt expenses of exempt hospitals totaled $8.7 billion; government-owned hospitals’ expenses were $4.6 billion; expenses for taxable hospitals were $1.9 billion.

(3) Costs of community benefit activities of exempt hospitals were $62.5 billion, comprising 9.67 percent of total expenses.

q. IRS issued guidance regarding correction and disclosure procedures for hospital organizations to follow so that certain failures to meet IRC § 501(r) requirements will be excused for purposes of IRC §§ 501(r)(1) and 501(r)(2)(B) (Rev. Proc. 2015-21).

4. Status of many court challenges to ACA’s contraceptive mandate (see IX B 1 h-j, 2 c, 3 b, d.

5. Public charity economic development company engaging in fish harvest allocation activities held to continue to be exempt because it is lessening burdens of government (PLR 201413012).

6. Treasury Department, on August 23, 2014, issued interim final regulations enabling religious organizations that object to contraceptive mandate to not authorize coverage but instead notify DHHS of their objection, which will notify insurees and third-party administrators to provide coverage without cost-sharing to enrollees (T.D. 9690, REG-129786-14, REG-129507-14).

7. IRS ruled that organization did not qualify as exempt faculty group practices entity because it engaged only in administrative functions and failed test for vicarious exemption under integral part doctrine (PLR 201433016).
8. Import of inquiries in connection with Treasury, IRS proposed regulations concerning political activities of social welfare organizations:

   a. Proportion of organization’s activities that must promote social welfare for organization to qualify for tax exemption as social welfare organization.

   b. Whether additional limits should be imposed on any or all activities that do not further social welfare.

   c. How to measure activities of organizations seeking to qualify as exempt social welfare organizations.

   d. Whether same or similar approach, reflected in proposal, should be adopted in addressing political activities of other types of tax-exempt (IRC § 501(c)) organizations, particularly charitable entities, labor organizations, and business leagues.

   e. Whether this same or similar approach should be used in defining exempt function activity of political organizations.

   f. Breadth of proposal.

   g. Impact on measurement of program activities of various types of exempt organizations.

   h. IRS training materials made public on January 23, 2014, reveal that IRS first looks to expenditures allocable to functions, then time expended by directors, officers, employees, volunteers, and agents allocable to functions, and way in which organization describes itself to public.

   i. Assignment of percentages in real life may be problematic; one organization could not assign percentages of “time and money” because “it is extremely difficult to separate these activities from each other and estimate timing [sic] and resource allocation” (PLR 201405022).

   j. Organization with primary purpose of managing portions of significant investment portfolio of health care system held not qualified organization for unrelated debt-financed income purposes (IRC § 514(c)(9)(B)(vi)) because its operation of schools represented only 13 percent of functional expenses, involved 20 percent of employees, entailed 6 percent of revenue, and generated 7 percent of total gifts (TAM 201407024).

   k. Also two examples at IV F 5, 6 (political activities).
B. Private Inurement

The doctrine of private inurement, proscribing unreasonable transactions with insiders, is applicable to charitable organizations and many other categories of tax-exempt organizations.

1. Private inurement led to revocation of exemption (PLRs 201402016, 201405017, 201406012, 201442057, 201450022, 201447049, 201451032, 201451035, 201451043, 201451045, 201503020, 201517010, 201517014, 201518020).

2. Private inurement led to denial of recognition of exemption (PLRs 201403018, 201414024, 201415004, 201415006, 201417017, 201417019, 201417024, 201421022, 201424024, 201433019, 201433020, 201440020, 201440021, 201446029, 201504017, 201507023, 201507025, 201507026).

3. Church organization held ineligible for exemption where substantial portion of its revenue is paid to lease currently unusable warehouse, to be used for religious services, from its president (PLR 201411037).

4. Trust held ineligible for exemption because its function is to pay family’s medical expenses in aftermath of automobile accident (PLR 201428026).

5. Organization established by regulated utility that operates charitable project ruled to not be violating private inurement doctrine because beneficiaries are members of charitable class (PLR 201436051).

6. Organization formed to benefit children with special medical needs failed to qualify for charitable exemption where it is operated for benefit of one individual (PLR 201505039).

7. Organization formed to develop open source software denied exemption as charitable entity because of private inurement involving organization’s directors’ use of code they own (PLR 201505041).

8. Organization formed for benefit of specific child with autism, with child’s parents as sole officers, failed to qualify for exemption (PLR 201511026).

9. Bonus paid to for-profit corporate executive held to be unreasonable compensation; $1 million of $2 million disallowed (Midwest Eye Center v. Commissioner (Tax Ct., Mar. 23, 2015).

C. Private Benefit

The doctrine of private benefit, proscribing unreasonable transactions with anyone, is applicable to charitable organizations. IRS is enamored with private benefit doctrine; the agency applies it in selective ways.

1. Organizations held to not qualify for recognition of tax exemption by reason of private benefit doctrine (PLRs 201404013, 201407019, 201407020, 201408029,
2. IRS wrote: “There is general agreement that [private] inurement is a subset of private benefit” (PLR 201044025).

3. IRS revoked exempt status of IRC § 501(c)(3) organization because operations as donee and enforcer of conservation easements was actually undertaken to generate large deductions for accountant’s practice, which was held to be private benefit to him and his clients (PLR 201405018).

4. IRS denied recognition of exemption as charitable entity, in part because its fundraising program was providing private benefits to contributing merchants (PLR 201407014).

5. IRS denied recognition of exemption to fee-based health care cooperative, in part because it was providing private benefit to its members, participating physicians, and board members (PLR 201409012).

6. Successor organization to planned merger of two related health care organizations ruled to be ineligible for exemption in that it does not meet community benefit standard because it operates primarily to benefit its member enrollees (PLR 201412018).

7. Charity having administrative services agreement with for-profit company covering payroll services and employee benefits held not engaged in private benefit activity because of lack of control relationship and other factors indicating that benefit is incidental (PLR 201419015).

8. Organization of individuals servicing automobiles built by particular manufacturer failed to qualify as exempt educational organization because it is operating primarily for private benefit of its members, their employer dealerships, and manufacturer (PLR 201431032).

9. Healthcare entity denied recognition of exemption in part because it has two (of three) noncharitable founders who have contributed all of its funds so far and thus have “financial interest and influence” (PLR 201436050).

10. Organization providing “scholarships” to beauty pageant contestants denied recognition of exemption as charitable entity because of private benefit it provides to IRC § 501(c)(4) entity that conducts pageants and private benefit provided to contestants in form of various types of “compensation” (PLR 201438030).

11. Pursuant to agreement, public charity is providing its research results to major for-profit media corporation, for fees, is formatting information specifically for company, has licensed rights to derivative works to company, has agreed to let company use information for its internal business purposes, has agreed to not deliver information to
company’s competitors, and has agreed that company will have perpetual license to use
information; this package of private benefits found incidental (PLR 201440023).

12. Artists’ organization that operates shops and holds art shows where works of
its members are sold held ineligible for exemption due to private benefit provided to
members (PLRs 201441017, 201516066).

13. Public charity to restore social club’s historic building; public held to be given
substantial access to facility; private benefit ruled incidental (PLR 201442066).

14. Nonprofit organization with new technology to combat world hunger ruled
ineligible for exemption as charitable entity because of private benefit entailing founder’s
for-profit company (PLR 201443021).

15. Nonprofit organization seeking to facilitate contribution to public charities by
means of website ruled to be operating primarily as conduit of business for related for-
profit company in violation of doctrine (PLR 201452017).

16. Nonprofit organization operating “time banking community network,”
facilitating exchange of volunteer services among its members, ruled to be serving
private interests of membership (PLR 201452018).

17. Charitable status denied to organization sponsoring golf outing to raise funds
for education of specific, preselected individual (PLR 201502017).

18. Organization formed to organize and promote farmers’ market failed to
qualify for exemption inasmuch as it operates for private benefit of its members (PLR
201510058).

19. Exemption recognition denied to entity involved in research, manufacture, and
retailing of pharmaceuticals in conjunction with for-profit corporation owned by its
founder (PLR 201510059).

20. Softball umpires’ association failed to qualify for exemption because it
operates primarily to certify umpires and aid in their employment, assisting members in
their private business ventures (PLR 201511024).

21. Organization formed to provide funds to members of community, families of
which are unable to provide adequate support, failed to qualify for exemption inasmuch
as benefits have gone solely to two families, both with incomes exceeding federal poverty
guidelines (PLR 201511034).
D. Intermediate Sanctions

The intermediate sanctions rules are applicable with respect to public charities and social welfare organizations. Developments concerning these rules shape the law of self-dealing, private inurement, and private benefit.

1. IRS concluded that first-tier excise tax due under intermediate sanctions rules on disqualified person’s automatic excess benefit transaction may not be abated, because person did not exercise ordinary business care and prudence when it relied on oral advice of public charity’s legal counsel (IRS Technical Advice Memorandum (TAM) 201503019).

2. IRS (was) looking at use of rebuttable presumption of reasonableness and initial contract exception, in aftermath of findings in final reports on hospitals, colleges, and universities; as to former, focus on use of appropriate comparability data when setting compensation.

3. Interplay with private inurement doctrine, private benefit doctrine, and self-dealing rules.

E. Influencing Legislation

Public charities are not allowed to engage in a substantial amount of activities that constitute attempts to influence legislation.

1. Annual per-person, -family, or -entity dues limitation to qualify for reporting exception regarding certain exempt organizations with nondeductible lobbying expenditures is $111 or less for 2015 (Rev. Proc. 2014-61).

2. Organization denied tax exemption as public charity because substantial portion of its activities, in pursuit of social justice, can only be accomplished by legislative action (although IRS erred in including attempts to influence activities of administrative agencies) (PLR 201408030).

3. Organization formed to protect human rights of “defenseless victims” from various forms of mind-control attacks denied recognition of exemption as charitable entity principally because it is action organization, in that it is advocating legislation to prohibit or regulate use of these weapons on public (PLR 201430014).

4. Organization formed to promote transparency in government through technology failed to qualify for charitable exemption because its primary activity is advocating adoption of theory or doctrine that can only become effective through enactment of legislation, rendering it action organization (PLR 201505042).

F. Political Campaign Activity

Public charities are not allowed to participate in political campaign activities. Other tax-exempt organizations may be able to engage in limited political campaign activity, although certain
expenditures may be taxable as exempt functions under the political organizations rules (IRC § 527(f)).

1. IRS denied recognition of exemption as social welfare organization because it spent about 60 percent of its revenue in first year and over 87 percent of its revenue in second year on political campaign activity (PLR 201403019).

2. IRS denied recognition of exemption as social welfare organization because it devoted 90 percent of its time and resources to conduct of political campaign activities (PLR 201403020).

3. Public charity had its tax exemption retroactively revoked for engaging in political campaign activity, in form of numerous statements on website and in fundraising solicitations; organization’s “defenses” – that statements were “unimportant” or made solely for fundraising purposes – failed (PLR 201416011).

4. IRS announced, on May 22, 2014, that it will propose revised package of rules concerning political campaign activities by tax-exempt social welfare and other organizations; public hearing deferred until new proposal is issued.

By letter dated April 13, 2015, Senate Finance Committee Chairman Orrin Hatch warned Commissioner Koskinen that, if he proceeds with this proposal, he will start “down a very dangerous road” and asked him to not do so, just as IRS is beginning to “recover its reputation” and its “trust from lawmakers,” because it is a “quixotic and bizarre mission”; if IRS does proceed, Chairman wants document retention policy put in place.

5. Organization held not entitled to recognition of exemption as social welfare organization because substantial portion of its activities consist of direct or indirect political campaign involvement (PLR 201424028).

G. Structural Issues

Public charities may, within limitations, participate in partnerships and other joint ventures.

1. Charitable organizations allowed to participate in partnerships without loss of tax-exempt status [no recent developments].

2. Charitable organizations allowed to participate in joint ventures with taxable partner(s) without loss of tax-exempt status [no recent developments].

Public charities and other tax-exempt organizations may, within limitations, utilize taxable subsidiaries. Tax-exempt organizations may be involved in mergers. There are special rules concerning conversions of for-profit entities to exempt organizations.

3. Charitable organizations held able to utilize taxable subsidiaries without endangering their tax-exempt status:
a. Tax-exempt HMO established two taxable subsidiaries to offer insurance products on state’s health benefits exchange; IRS ruled that separate existence of subsidiaries will be respected, with no attribution of their activities to parent for tax exemption or unrelated business income purposes (PLR 201406019).

b. Tax-exempt cemetery association (IRC § 501(c)(13) entity) held able to have taxable subsidiary that operates funeral home, where boards and records are separate, and leasing and expense reimbursements are at fair value (PLR 201409009).

c. Funds ruled able to be transferred by exempt charitable organization to subsidiary (PLR 201438032).

d. Exempt university’s for-profit subsidiary’s operations ruled not attributable to university for tax law purposes; subsidiary will maintain separate facilities, address, telephone numbers, bank accounts, financial records; it will have majority unrelated board and unrelated president (PLR 201503018).

4. IRS denied recognition of exemption as charitable entity in part because its activities were unduly integrated with affiliated social welfare organization (IRC § 501(c)(4) entity); IRS faulted applicant organization for being controlled by social welfare entity, sharing employees and equipment, and having similar names (PLR 201408030).

5. Application of constructive ownership rules (IRC §§ 318, 512(b)(13)(D)(ii)) to conclude that tax-exempt organization controls other entities [no recent developments].

6. Status of developments pertaining to whole-hospital (entity) joint ventures [no recent developments].

7. Rulings as to mergers:

   a. IRS approved merger of three public charities into exempt hospital, undertaken to simplify organizational and governmental structures, thereby creating more effective oversight by board of directors of surviving corporation (PLR 201445015).

   b. IRS approved merger of IRC § 501(c)(4) entity into IRC § 501(c)(6) entity, ruling that surviving corporation continues to qualify under IRC § 501(c)(6) (PLR 201446026).

8. Pension Protection Act revised law concerning taxation of certain payments from controlled organizations to controlling organizations; no taxation in instances of arm’s-length payments during 2006-2007 for preexisting arrangements (IRC §§ 512(b)(13), 482); provision extended through 2009 on signing, on October 3, 2008, of § 306 of Tax Extenders and Alternative Minimum Tax Relief Act of 2008; provision extended through 2011 by 2010 tax relief legislation; provision extended through 2013

9. Developments concerning use of limited liability companies [see reference to PLR 201444043 in VI].

H. Exemption Recognition Application Process and Notice Requirements

Nearly all organizations, to be recognized as tax-exempt charitable entities, are required to file an application for recognition of tax exemption with the IRS (IRC § 508(a)).

1. At beginning of 2014, IRS updated “alternative version” of Form 1023 – i1023 (interactive application).


3. Organizations failed to achieve recognition of tax exemption because (at least in part) they did not provide sufficient information to IRS (PLRs 201427018, 201433017, 201433019).

4. Organization that is seeking recognition of exemption as charitable entity prevailed in litigation where court ruled it has jurisdiction over issue as to whether IRS acted improperly in its processing of application; organization is alleging viewpoint discrimination in violation of First Amendment (Z Street, Inc. v. Koskinen (D.D.C. 2014)).

5. IRS revoked exemption of charitable entity because it dissolved without informing IRS; new organization formed using same name held unable to use EIN of dissolved organization and required to file application for recognition of exemption (PLR 201415005).

6. IRS, in course of processing application for recognition of exemption, took into consideration remarks made by founder in social media; application was denied (PLR 201417017).

7. IRS ruled that conversion of “public nonprofit corporation” (entity created by statute) to state-law-based nonprofit corporation (by filing certificates of “conversion” and “formation”) did not create new legal entity and thus entity did not have to file new application for recognition of exemption (PLR 201426028).

8. IRS examination revealed that organization stopped functioning primarily as exempt school and began leasing of property to charter schools; exemption revoked retroactively to year in which change of activities occurred (TAM 201438034).
9. IRS ruled that change in state of domicile of exempt organization will not create new legal entity that would require filing of application for recognition of exemption (PLR 201446025).

10. As result of realignment of TE/GE Division, at beginning of 2015, technical responsibility for preparing revenue rulings, revenue procedures, and certain other forms of guidance, and issuing technical advice and certain letter rulings, shifted from TE/GE to Office of Associate Chief Counsel (TE/GE); Exempt Organization office of TE/GE retained authority to issue determination letters, including those as to exempt status under IRC §§ 501(c) and 521 (Ann. 2014-34).

11. Final regulations issued, on January 26, 2015, authorizing IRS to prescribe procedures by which nonprofit health insurance issuers may apply to IRS for recognition of tax exemption (IRC § 501(c)(29)) (T.D. 9709); procedures issued on February 3, 2015 (Rev. Proc. 2015-17); IRS issued corrections to procedures on March 10, 2015.

12. Court ordered IRS to produce list of putative class member organizations to plaintiff organizations seeking to certify class, for class action lawsuit, of aggrieved applicants for recognition of exemption (NorCal Tea Party Patriots v. IRS (S.D. Oiho, April 1, 2015).

13. As of April, 2015, IRS reduced year-old inventory of applications (74,000) by 91 percent; backlog (1023, 1023-EZ, 1024) now is 20,000; over last six months, 95 percent of 1023-EZs have been approved.


I. Annual Information Returns, e-Postcards, and Political Organization Reports

Nearly all tax-exempt organizations are required to file annual information returns (Form 990, 990-EZ, or 990-PF) with the IRS (IRC § 6033).

1. IRS revoked (or proposed revocation of) tax-exempt status of organizations for failure to file annual information returns (PLRs 201406014, 201406015, 201406017, 201407025, 201418058, 2014450011, 201445012, 201449001, 201517013).

2. Organizations qualified for exemption from annual information return filing requirement (PLR 201509001).

3. IRS, on January 2, 2014, published revised procedures for reinstatement of tax-exempt status of organizations that had exemption revoked by operation of law for failure to file or submit annual information returns or notices for three consecutive years (Rev. Proc. 2014-11).

J. Disclosure Requirements

1. Form 990 disclosure statute (IRC § 6104) does not supersede Freedom of Information Act (Public.Resource.org v. Internal Revenue Service (N.D. Cal., June 20, 2014).

2. Court opinion surveyed various application of FOIA to tax-exempt organizations; most decisions adverse to IRS (Sea Shepherd Conservation Society v. IRS (D.D.C., Mar. 31, 2015).

3. Court held that California’s attorney general may require submission of unredacted Form 990, Schedule B, as part of fundraising registration; requirement not contrary to freedom of association principles and disclosure requirement was not preempted by federal tax law (Center for Competitive Politics v. Harris (9th Cir., May 1, 2015).

K. Governance Developments

1. State nonprofit corporation acts and other state law developments, including litigation; principles of fiduciary responsibility; board member liability.

2. Board composition and federal tax law rules.

3. Sources of nonprofit governance principles:
   a. Watchdog agencies.
   d. Committee for Purchase proposed best practices (Dec. 16, 2005)
   e. IRS’s draft Model Good Governance Practices for charitable organizations (Feb. 2, 2007); these practices abandoned in Feb. 2008.
   g. The American National Red Cross Governance Modernization Act of 2007 (H.R. 1681) was signed into law on May 11, 2007.
   h. On February 14, 2008, IRS replaced draft of Model Good Governance Practices with paper on governance of charitable organizations.
   i. Form 990 for 2008, particularly Part VI (see III).
j. Panel on Nonprofit Sector recommendations (“Principles for Good Governance and Ethical Practice”) (2015 ed.).

k. Import of IRC § 501(q) (concerning boards of tax-exempt credit counseling organizations).

l. Issuance by IRS of annual report, FY 2011 work plan (see l).

m. California Nonprofit Accountability Act.

4. Governance policies, procedures, protocols, practices:

   a. Ones that are generally suitable:

      (1) Conflict-of-interest.

      (2) Document retention and destruction.

      (3) Whistleblower.

      (4) Travel and other reimbursement (accountable plan).

      (5) Executive compensation.

      (6) Gift acceptance.

      (7) Investment.

      (8) Form 990 review.

   b. Others:

      (1) Charity care, community health needs assessment, billing and collection (hospitals).

      (2) Conservation easement.

      (3) Joint venture.

      (4) Documentation of meetings.

      (5) International and domestic grantmaking.

      (6) Chapters, affiliates, branches.

      (7) Fundraising.

      (8) Tax-exempt bond compliance.
5. Governance issues:
   a. Governing board size.
   b. Governing board composition.
   c. Role of governing board.
   d. Organization effectiveness and evaluation.
   e. Board effectiveness and evaluation.
   f. Frequency of board meetings.
   g. Term limits.
   h. Board member compensation.
   i. Audit committee.
   j. Other committees.
   k. Compliance with law.
   l. Categories of expenditures.
   m. Disclosures to public.
   n. Mission statement.
   o. Code of ethics.
   p. Fundraising practices.

6. U.S. Tax Court, on December 16, 2013, held organization is ineligible for exemption as charitable or educational entity; organization faulted for not having independent board of directors and formal business plan (The Council for Education v. Commissioner).

7. Role of IRS in nonprofit governance:
   a. IRS use of private benefit doctrine (see IV C).
   b. IRS: Organization cannot qualify as exempt charitable entity if it has small board:
      (1) Organization cannot qualify as tax-exempt, charitable entity inasmuch as it has board of directors consisting of only two individuals,
automatic unwarranted private benefit found (PLRs 200736037, 200737044).

(2) Organization cannot qualify as tax-exempt, charitable entity, in part because it was not operated by “community-based board of directors” (or because board “lacks members who are representative of the community”) (PLR 200828029).

(3) Organization cannot qualify as tax-exempt, charitable entity, in part because it lacked independent board (PLRs 200830028, 201252021).

(4) Organization cannot qualify as tax-exempt, charitable entity, in part because two individuals exercise “absolute control” over organization (PLR 200843032).

(5) Organization cannot qualify as tax-exempt, charitable entity, in part because its three directors have “unfettered control” over organization and its assets (PLR 200845053). Query: Where is legitimate control supposed to be?

(6) One-person boards are evidence of private benefit (PLRs 201016088, 201242016 (entity attempted to qualify as business league)).

(7) Organization did not constitute an exempt synagogue, in part because there is no “public oversight” of its board (PLRs 201242014, 201325017). Query: How does this square with First Amendment’s Religion Clauses?

(8) Organization denied exemption because one individual held all officer positions and there was no public oversight of it (PLR 201252021).

(9) Organization with board of five individuals held ineligible for exemption in part because entity is governed by “small group of individuals,” who have “exclusive control over the management of [the entity’s] funds and operations” (PLR 201421022).

(10) Organization seeking to qualify as exempt synagogue denied recognition of exemption in part because it has three-individual board (PLR 201427018).

(11) Health care organization denied recognition of exemption as charitable organization because its six-member board of directors “does not have a majority of directors representing the community” (PLR 201436050).

(12) Health care organization denied recognition of exemption in part because its 28-person board (nearly all physicians) does not represent “broad interests of community” (PLR 201440020).
c. IRS: Organization cannot qualify as exempt charitable entity if it has board of related individuals:

(1) Organizations held to not qualify as charitable entity because all of their board members are members of same family (PLR 200916035, 201016088).

(2) President of organization engaged in many forms of private inurement, all of which happened, IRS concluded, because there was a “family-based governing board” (201113041).

(3) Board of nonprofit organization, with majority of related individuals, held to constitute per se evidence of violation of private benefit doctrine (PLR 201203025).

(4) Two classes of members in ostensible social club held to constitute private inurement (PLR 201204018).

(5) Organization said by IRS to be unduly controlled by members of a family, with the governing body consisting of president’s “family members or professional friends” (PLR 201209011).

(6) Organization was denied recognition of exemption as charitable organization, in part because it refused to expand its three-person board of directors, two of whom are related, to “place control in the hands of unrelated individuals” (PLR 201218041).

(7) Organization was denied recognition of exemption, in part because it did not expand its closely related board (of five) (PLR 201221022).

(8) Organization was denied recognition of exemption, in part because it would not expand its two-person related board; organization’s board did not do so on ground that “no one shares our vision” (PLR 201236033).

(9) Organization denied recognition of exemption in part because it is governed by board, with all members from same family; that was held indicative of private inurement (PLR 201302040).

(10) Organization denied recognition of exemption in part because its governing board is comprised of five related individuals (PLR 201421022).

d. IRS: Tax exemption is to be denied where entity did not adopt a policy:

(1) Private benefit found in part because entity did not have conflict-of-interest policy (PLRs 200830028, 200843032, 201221022).
(2) Organization failed to gain recognition of exemption in part because it lacked executive compensation policy (PLR 200843032).

e. Inconsistent (and correct) determinations:

(1) Small governing body controlled by founders does not preclude exemption but creates need for organization to be “open and candid” (PLR 200846040).

(2) Organization had board of three family members; IRS wrote that “this factor alone is not enough to deny [recognition of] exemption” (PLR 201232034).

(3) IRS was not troubled by four-person board of private foundation, all of whom are members of same family (PLR 201244020).

(4) IRS: “While an organization will not be denied exemption merely because it is controlled by related individuals, such a situation provides an obvious opportunity for abuse and calls for an open and candid disclosure of your organization and operations” (PLR 201332013).

f. Lifetime board positions:

(1) Arrangement where board members have lifetime appointments held organization ineligible for recognition of exemption in part because it constituted potential for private inurement (PLR 201233017).

(2) Same, although private benefit doctrine was invoked (PLR 201236033).

g. Focus on directors’, officers’ lack of competence:

(1) IRS disparaged qualifications of applicant’s director, conjuring significant voice test (PLR 201332013).

(2) President of conservation easement donee organization held to “not possess the knowledge, training or experience to make educated decisions on whether each conservation easement serves a contribution purpose” (PLR 201405018).

h. Does IRS have the authority (jurisdiction) to regulate in field of nonprofit governance? Implications of Loving v. Internal Revenue Service (see IX B 2 e).
L. **Procedural Rules and Practices**

1. IRS issued administrative procedures for 2015:


   b. Revised procedures explaining when and how Associate Chief Counsel offices provide technical advice to Director or Appeals Area Director, and explaining rights that taxpayer has when field office requests TAM (Rev. Proc. 2015-2, 2015-1 I.R.B. 105).

   c. Revised inventory of domestic issues on which IRS will not issue letter rulings or determination letters (Rev. Proc. 2015-3, 2015-1 I.R.B. 129).


   g. Revised guidance on foundation status, including operating foundation status and exempt operating foundation status (Rev. Proc. 2015-10, 2015-2 I.R.B. 262).

M. **IRS Audit Activity**

1. IRS audit authority (IRC § 7602).

2. IRS audit plans sometimes revealed in Exempt Organizations work plans (see I).

3. Types of IRS audits:

   a. Conventional – direct contact with one or more revenue agents.

   b. Office examination.

   c. Correspondence examination.

   d. Team examination.
4. Compliance check projects:
   a. Organizations maintaining group exemption (questionnaire Form 14414).
   b. IRC § 501(c)(27) entities (Form 14395).
   c. Status of charitable spending initiative.
   d. Self-declarers (questionnaire Form 14449).

5. Other areas of inquiry:
   a. International grantmaking activities.
   b. Employee/independent contractor classification.
   c. Employment taxes.
   d. Private foundations.

6. Church audit rules (IRC § 7611):
   a. Church tax inquiries.
   b. Church tax examinations.
   c. Appropriate high-level Treasury official (magistrate judge held, on November 18, 2008, that the Director, Examinations has been improperly designated by IRS as that official (United States v. Living Word Christian Center (D. Minn.)); IRS filed objections on December 3, 2008; church responded to them on December 15, 2008; district court adopted magistrate’s report on January 30, 2009; IRS decided to not appeal this decision (appeal deadline expired on March 31, 2009).
   d. IRS proposed regulation changes on July 31, 2009 (REG-112756-09); high-level official proposed is Director, Exempt Organizations; hearing held on January 20, 2010.
   e. Status of IRS church inquiries/examinations.

7. In case involving IRS’s non-enforcement of law prohibiting religious organizations from involvement in political campaign activity, where plaintiff is contending establishment clause and equal protection clause violations, court held plaintiff has standing to sue and case not barred by doctrine of sovereign immunity (Freedom From Religion Foundation, Inc. v. Shulman (W.D. Wis. 2013)).
8. IRS revoked tax-exempt status for failure to respond to IRS request for information (PLRs 201330042, 201333016, 201338054, 201340021, 201404012, 201414022, 201414026, 201418054, 201418057, 201428024, 201445011, 201445012, 201451046, 201502016, 201505043, 201514010).

9. Following examination, IRS retroactively revoked exempt status of organization that has been operating materially differently than was represented in its application for recognition of exemption (TAMs 201409010, 201413013).


11. IRS is revising exempt organization examination function to stress identification of Form 990 data analysis to identify issues; “pillars” are compliance with exemption rules, unrelated business income tax compliance, international law compliance (filing Report of Foreign Bank and Financial Accounts and Foreign Account Tax Compliance Act), and asset protection (compliance with self-dealing and excess benefit transaction rules).

12. IRS is developing knowledge management system, purpose of which is to retain institutional memory; will have repositories of information based on input from “networks”; objective is consistency of quality of technical expertise.

N. Other Federal Tax Law Developments

1. IRS granted organization’s request for extension of time within which to file election by tax-exempt controlled entity to not be treated as an exempt entity (IRC § 168(h)(6)(F)(ii)(I)) (PLRs 201303001, 201316006, 201316007, 201332008, 201425002, 201447018, 201505029-201505033, 201506007, 201507014, 201507015, 201508004-201508007, 201516021, 201516052).

2. Trusts that are treated as grantor trusts (IRC §§ 671-679) are disregarded as entities separate from their owners (Chief Couns. Adv. Mem. 201343021).

3. Tuition reduction benefits provided by university-controlled corporation under tuition assistance program for children of faculty members held eligible for exclusion from employees’ gross income (PLR 201516030).
IV. MATTERS PERTAINING TO PUBLIC CHARITIES AND PRIVATE FOUNDATIONS

A. Public Charity/Private Foundation Classification Rules

Charitable (IRC § 501(c)(3)) organizations are presumed to be private foundations (IRC § 508(b)). This presumption is rebutted by qualification as a public charity (IRC § 509(a)). Public charities are principally of three types: (1) institutions (e.g., churches, colleges, universities, health care entities (IRC §§ 170(b)(1)(A)(i)-(v), 509(a)(1)), (2) publicly supported charities (IRC §§ 170(b)(1)(A)(vi) and 509(a)(2)), and (3) supporting organizations (IRC § 509(a)(3)).

1. Pension Protection Act of 2006 changes in law concerning supporting organizations:

   a. Now have four types of supporting organizations: Type I, II, III (functionally integrated), III (non-functionally integrated).

   b. Automatic excess benefit transaction concept grafted onto supporting organizations rules for certain payments (including compensation and reimbursements) by supporting organization to substantial contributors.

   c. Loans by supporting organization to disqualified persons are also automatic excess benefit transactions.

   d. Supporting organizations must file annual information returns, irrespective of amount of gross receipts.

   e. Supporting organizations must annually certify that disqualified persons do not control them.

   f. Excess business holdings rules apply in certain instances to Type II and Type III (non-functionally integrated) supporting organizations.

   g. Payout regulations to be rewritten as they apply to non-functionally integrated supporting organizations.

   h. Type III supporting organizations cannot support charity not organized in U.S.

   i. Type III supporting organizations must provide certain information to supported organization(s).

   j. Gift to Type I or III supporting organization from person who controls supported organization causes supporting organization to be private foundation (unless it can otherwise qualify as public charity).

   k. Private foundation cannot make qualifying distribution to non-functionally integrated supporting organization or other supporting organization.
controlled by disqualified person with respect to foundation; payments considered taxable expenditures.

2. Department of Treasury and IRS, on December 22, 2012, issued final regulations to implement certain of the statutory rules enacted in 2006 applicable to Type III supporting organizations, concerning relationship tests, including definition of term *functionally integrated*, reiteration of a responsiveness test and integral part tests for these entities, and spelling out other rules for Type III organizations, including content of the annual notification that Type III supporting organizations must provide to supported organizations (T.D. 9605):

   a. Meaning of *operated in connection with* (Type III rules) (Reg. § 1.509(a)-4(i)(1)).

   b. Revised responsiveness test, involving relationships with trustees, directors, and officers of supporting and supported organizations, and *significant voice* requirement favoring supported organizations (Reg. § 1.509(a)-4(i)(3)).

   c. Definition of *functionally integrated* (IRC § 4943(f)(5)(B); Reg. § 1.509(a)-4(i)(4)(i)).

   d. Integral part test for functionally integrated Type III supporting organizations; focus on *direct furtherance* activities; also, supporting organization can be parent of supported organization(s) or support governmental entity (Reg. § 1.509(a)-4(i)(4)(ii)).

   e. Integral part test for non-functionally integrated Type III supporting organizations (payout requirement (see below) and revised attentiveness test) (Reg. § 1.509(a)-4(i)(5)(ii), (iii); Reg. § 509(a)4T(i)(5)(B)).

   f. Notification requirement (IRC § 509(f)(A); Reg. § 1.509(a)-4(i)(2)).

   g. Prohibition on support of foreign charities (IRC § 509(f)(B); Reg. § 1.509(a)-4(i)(10)).

   h. Entity cannot be Type I or III supporting organization if supported organization is controlled by certain donors (IRC § 509(f)(2); Reg. § 1.509(a)-4(f)(5)(i)).

   i. Seven additional regulation projects are embedded in discussion of final regulations or in final regulations themselves, involving clarification of application of responsiveness test, clarification of significant voice test, new rules for supporting organizations with respect to governmental entities, new definition of *parent*, expansion of rules describing expenditures of non-functionally integrated Type III supporting organizations, rules as to whether program-related investments will count toward distribution requirement, and definition of *control* in connection with Type I or III relationship test.
3. Also, on December 22, 2012, Treasury and IRS issued temporary regulations establishing (revised) payout requirement for non-functionally integrated Type III supporting organizations; 85-percent-of-net-income payout; set-aside feature (REG-155929-06).

4. Director, EO Rulings and Agreements, in February 1, 2013, memorandum, stated that EO Determinations may issue determination letters as to functionally integrated and non-functionally integrated Type III supporting organizations on basis of final and temporary regulations; memo notes that determinations as to whether organization is functionally integrated Type III supporting organization because it supports government entity are on hold.

5. IRS, on December 23, 2013, issued interim guidance for Type III supporting organizations seeking to qualify as functionally integrated entities by supporting governmental entity (see V A 2 i) (Notice 2014-4).

6. IRS revoked tax exemption of supporting organization supporting business league because of private benefit to league’s membership (PLR 201338059).

7. Supporting organization that is parent of health care system was advised by IRS that its participation in capital improvement project involving facilities and equipment will not adversely affect its public charity status (PLR 201424025).

8. Pension Protection Act of 2006 changes in law concerning donor-advised funds:

A donor-advised fund is a fund within a charitable organization, to which a person contributes, with the gift placed in the fund, often named after the donor, where the donor or other designee has the ability to advise as to charitable grantees and/or investment options.

   a. Donor-advised fund formally defined (IRC § 4966); other rules in IRC § 4967.

   b. Employer-sponsored disaster relief assistance funds are not donor-advised funds (Notice 2006-109).

   c. Evidence of advisory privilege.

   d. Contributions, for maintenance in donor-advised fund, to certain sponsoring organizations are not deductible.

   e. Donor required to obtain certain contemporaneous written acknowledgement.

   f. Excess business holdings rules are applicable.

   g. Certain transactions are automatic excess benefit transactions.
h. Certain distributions from donor-advised fund are taxable.

i. Reporting and disclosure rules.


10. Donor-advised fund ruled to be utilized to facilitate tax avoidance (PLR 201313034).

11. Developments as to church status:

a. Organization lost its status as church, even though it satisfied some of IRS’s 14-point criteria, because it failed associational test (Foundation of Human Understanding v. United States (U.S. Ct. Fed. Cl. (2009), aff’d, (Fed. Cir. 2010)), cert. den., 3-21-11)).

b. IRS ruled that entity could not qualify as (virtual) church because it failed associational test (PLR 201232034).

c. Organization held to not qualify as church because it did not meet associational test and failed majority of IRS criteria (PLR 201221022).

d. IRS ruled that entity with no place of worship and no regular worship services cannot constitute church (PLRs 201235022, 201242014, 201251018).

e. IRS stated that synagogue (and, by extension, all churches) should be subject to “public oversight” (PLRs 201242014, 201325017).

f. Organization held to not qualify as church because it did not meet IRS 14-element criteria (Good v. Commissioner (2012)).

g. IRS ruled that public policy doctrine precludes practice of polygamy, being illegal, in apostolic (IRC § 501(d)) entity (PLR 201310047).

h. IRS ruled that, to be exempt, church must have “regular worship services conducted at a regular location with a regular congregation” (PLR 201325017); likewise (PLR 201327018).

i. Electronic ministry held religious organization but not church due to failure to meet associational test (PLR 201420020).

12. Trust and nonprofit corporation, operating in tandem, ruled to collectively qualify as community foundation (single entity, rather than aggregation of funds) (PLR 201307008, superseded by PLR 201322046, superseded again by PLR 201403016).

13. IRS revised public charity status of entity from § 509(a)(2) status to § 509(a)(1) status (PLR 201418067).
14. Organization held to be § 509(a)(2) publicly supported charity because majority of its support is in form of fees (PLR 201445013).

15. Proposed grant to community foundation held unusual grant in that all criteria for this type of grant (Reg. §§ 1.170A-9(f)(g)(ii), 1.509(a)-3(c)(4)) are satisfied (PLRs 201507024); other favorable unusual grant rulings (201512004, 201516069).

16. Planned transfer of artwork and other property to public charity operating museum and sculpture park held to qualify as unusual grant (PLR 201516069).

B. Self-Dealing Rules

A private foundation generally may not engage in an act of self-dealing with a disqualified person (IRC § 4941).

1. In the following situations, the IRS ruled that the transaction or transactions did not constitute self-dealing:

   - Self-dealing exceptions: where reasonable compensation is paid for personal services, where benefit is incidental and tenuous, or certain transactions involving an estate.

   a. Acquisition of interest in company by gift, with foundation unable to control company, where company’s sole asset is promissory note from company/foundation founder’s daughter and company plans to retain note, held not indirect self-dealing (PLR 201407023).

   b. For-profit company formed private foundation to administer company’s employee gift matching program; IRS ruled that (1) self-dealing not involved because foundation will not match any gifts made prior to termination of company’s program and is not relieving company of any financial burden and (2) good will accruing to company from creation of foundation is incidental benefit (PLR 201417022).

   c. Series of grants mandated by disqualified persons with respect to private foundation and two charitable lead trusts held not self-dealing because each of grants involve obligations running from grantor to grantee, and are not obligations of disqualified persons personally (PLRs 201421023, 201421024).

   d. Revised asset allocation plan of estate, whereby amount of assets to be received by disqualified persons was increased and amount to be transferred to private foundation was decreased, was held not to be self-dealing (IRC § 4941(d)(1)(E)) inasmuch as court approved reallocation, all interested parties consented to reformation, and state attorney general consented (PLR 201432025).

   e. Co-located property arrangement held not self-dealing because benefit to disqualified persons, including road access, is incidental and tenuous (PLR 201435017).
f. Son of decent/disqualified person allowed to purchase real property, otherwise destined for private foundation, inasmuch as all requirements of *estate administration exception* were satisfied (PLR 201441020).

g. Sale of property to disqualified person with respect to private foundation held to not result in direct or indirect self-dealing, latter avoided in part because of rule that brothers and sisters are not disqualified persons, because of that relationship, in this context (PLR 201510050).

### C. Mandatory Distributions

A private foundation must pay out for charitable purposes, with respect to a year, an amount equal to 5 percent of its investment asset base, in the form of qualifying distributions (IRC § 4942).

1. Set-asides, and modifications and extensions of set-asides, approved (PLRs 201449003, 201452021, 201501016, 201503022, 201503023, 201512002).

2. Proposed regulations issued on September 23, 2012, in connection with standards applicable to private foundations for making good faith determination that foreign organization is charitable organization, grants to which may constitute qualifying distributions and not taxable expenditures (REG-134974-12).

3. Tax Section of ABA submitted comments on foregoing proposed regulations on August 14, 2013.

4. Private foundation, holding parcel of real estate for economic appreciation, is permitting government agency to grow and harvest hay on it, with hay used to feed livestock at historical working farm park owned by agency; this was found to be lessening burden of government and thus charitable undertaking, so that land is exempt function property that is excluded in determining foundation’s mandatory payout (PLR 201419017).

5. IRS ruled that foundation grants will be qualifying distributions because they will qualify as *out-of-corpus* distributions (PLR 201437014).

### D. Excess Business Holdings

A private foundation may not have excess business holdings in a business enterprise, unless it is a functionally related business (IRC § 4943).

1. Foundation’s interest in limited liability company, holding only promissory note of disqualified person, held not excess holding because LLC not a *business enterprise* (PLR 201407023).

2. Foundation allowed to correct excess business holdings by granting to public charities requisite amount of stock to bring foundation’s holdings to two percent de
minimis amount (IRC § 4943(c)(2)(C)); foundation’s directors are also members of board of some of these grantees (PLR 201414031).

3. Foundation owning apartment complex generating millions of dollars in rental income held not to have excess business holding because of lack of business enterprise, although one activity for tenants was held to produce unrelated business income (PLR 201422027).

4. Foundation wholly owning blocker corporation in foreign country held to not have excess business holding because operation not business enterprise (PLR 201430017).

5. Securities owned by founders of charitable lead trusts before their deaths ruled not countable in determining whether excise taxes are due on any excess business holdings (PLRs 201433021-201433024).

6. Foundation’s ownership of limited liability company held not excess business holdings because LLC not business enterprise (PLR 201435017).

7. Foundation receiving S corporation stock by gift held to have five years from date its holdings in company exceed two percent to reduce its entire holdings in company to two percent or less to avoid tax (IRC § 4943(c)(6)) (PLR 201441018).

8. IRS Chief Counsel advised against abatement of first-tier taxes in excess business holdings case, taking position that private foundation failed to demonstrate requisite reasonable cause, in absence of reliance on directly provided legal advice (TAM 201441021).

9. IRS Chief Counsel advised that first-tier taxes in excess business holdings case should be abated, observing that foundation sought advice from “well-respected” tax preparer, received “specific advice” that excess business holdings did not exist, and thus satisfied reasonable cause standard (TAM 201448032).

10. IRS granted five-year extensions of time for private foundations to dispose of excess business holdings (PLRs 201510055, 201510056).

E. Jeopardy Investments

A private foundation may not engage in speculative (jeopardizing) investments; program-related investments are not covered by these rules (IRC § 4944).

1. Rulings that grants and loans constitute program-related investments [no recent developments].

2. IRS proposed regulations providing nine new examples of qualifying program-related investments (REG-144267-11).
3. Foundation’s ownership of blocker corporation in foreign country held not a jeopardizing investment (PLR 201430017).

F. Taxable Expenditures

A private foundation may not expend funds for lobbying (with exceptions), for political activity (with exceptions), for grants to individuals (without prior IRS program approval), or for noncharitable purposes (taxable expenditures) (IRC § 4945).

1. Awards of scholarships and/or fellowships held to comply with IRC § 4945(g)(1) and thus not constitute taxable expenditures (PLRs 201404014, 201408033, 201409011, 201410036, 201411043, 201411044, 201414030, 201415012, 201418062, 201420022, 201421025-201421027, 201422026, 201424026, 201425017, 201425018, 201426027, 201426030, 201427020-201427022, 201428010, 201430015, 201430016, 201431033, 201432023, 201432024, 201433025, 201433026, 201436052, 201436053 201437016-201437020, 201438031, 201441022-201441027, 201442059, 201442060, 201442062, 201444041, 201444042, 201442063, 201443022-201443028, 201446023, 201445019-201445031, 201446027, 201447044-201447048 201448029, 201448030, 201450024-201450027, 201450030-201450033, 201451047-201451061, 201449004, 201449005, 201449007, 201501017-201501024, 201502018, 201502019, 201504018, 201504019, 201505044, 201506012, 201507027-201507038, 201508012-201508020, 201509042-201509064, 201510048, 201510049, 201510054, 201510057, 201511027-201511032, 201512003, 201512005, 201514017, 201514018, 201516067, 201516068, 201516070-201516079, 201517020-201517025, 201518019).

2. Proposed regulations concerning private foundations’ good faith determinations (see V C 2).

3. Private operating foundation operating museum held to satisfy various statutory exceptions to self-dealing rules, payout rules, and jeopardizing investment rules (PLR 201415010).

G. Termination of Status

By a variety of means, a private foundation may terminate its private foundation status (IRC § 507).

1. Transfers of private foundation's assets to other or new private foundations held to qualify under IRC § 507(b)(2) (PLRs 201417020, 201417021, 201418060, 201427019, 201438033, 201448026, 201513005, 201514016).

H. Tax on Net Investment Income

1. Foundation’s income from S corporation will not be taxed at net investment income because it is treated as unrelated business income (PLR 201441018).

A private foundation must pay a 2 percent tax on its net investment income (IRC § 4940).
I. Disqualified Persons

1. Settlers of charitable lead annuity trusts, where children’s foundations will receive annuities, ruled not to be substantial contributors or otherwise disqualified persons with respect to foundations (PLRs 201433021-201433024).

2. Sale of stock of company by private foundation to employee stock ownership plan ruled not self-dealing because ESOP is not disqualified person; plan holds stock as trustee; owners of stock are ESOP’s participants (PLR 201441018).

Insiders with respect to private foundations are termed “disqualified persons” (IRC § 4946). They include trustees, directors, officers, key employees, family members, controlled entities, and substantial contributors.

J. Split-Interest Trusts [no recent developments]

V. MATTERS PERTAINING TO UNRELATED BUSINESS

A. Unrelated Business Rules in General

A tax-exempt organization generally must pay tax on net income derived from the conduct of a business that is regularly carried on and that is not substantially related to exempt purposes (IRC §§ 511-514).

1. Interrelationship of commerciality doctrine and unrelated business rules.

2. The following are recent instances where the IRS ruled that a tax-exempt organization may participate in a partnership or limited liability company without incurring any unrelated business income tax: [no recent developments].

3. The following are recent instances where the IRS ruled that an activity is not an unrelated business or otherwise that a transaction will not cause imposition of unrelated business income tax:

   a. Tax-exempt universities enable charitable remainder trusts, as to which they are trustee and remainder interest beneficiary, to participate in the investment return generated by universities’ endowment fund; universities will not be receiving any economic return by reason of arrangements and thus is not engaged in business (PLRs 201408032, 201408034).

   b. Business league is reacquiring control and operation of tournaments and other events pertaining to a game; IRS ruled that sale of tickets to public, operation of food and beverage concessions, sales of uniforms to volunteers, and licensing of broadcasting rights will not generate unrelated business income (PLR 201406020).
c. Liquidation of holding of rights to millions of intellectual property addresses acquired decades ago by gift for use in exempt functions held, in absence of marketing activities and use of outside firm to negotiate with prospective buyers, to not be property held primarily for sale to customers in ordinary course of business and thus resulting income will not be unrelated business income (PLR 201407022).

d. Stream mitigation activities undertaken for watershed preservation by public charity that manages nature preserve pursuant to perpetual conservation easement imposed by governmental commission held substantially related activities; income from sale of mitigation credits within governmental environmental conservation program held not taxable (PLR 201408031).

e. Tax-exempt educational institution has plan to revise its global business education program so that it is managed by foreign foundation, which is controlled by foreign for-profit company that is institution’s founder; student fees held to not be unrelated business income (PLR 201417018).

f. Contributions to parent of exempt health care system by insurance plan that acts as system’s third-party administrator for charitable projects ruled to not be unrelated business income (PLR 201424025).

g. Sale by social club of conservation easement to city, limiting development and preventing pollution, held to not generate taxable income because club is reinvesting proceeds of sale in property furthering exempt purposes (IRC § 512(a)(3)) (PLR 201425016).

h. Hospital’s performance of laboratory testing with respect to patients of private-practice physicians is conduct of related business, inasmuch as testing takes place in hospital’s rural service area where alternative testing services are not available, thus creating requisite “unique circumstances” supporting this conclusion (TAM 201428030).

i. Income realized by exempt museum from gift shop sales of toys, books, and documentary videos held not unrelated business income because all items sold relate to exempt purpose of providing education pertaining to outer space (PLR 201429029).

j. Private foundation wholly owning blocker corporation in foreign country, where at least 95 percent of income will be from passive investments (IRC § 4943(d)(3)(B)) and where no income is attributable to insurance activity. Received ruling that Subpart F income (IRC §§ 951-964) to be received from corporation will not be subject to unrelated business income tax and that income foundation will receive from corporation will be dividend income and therefore excluded from unrelated business income taxation (IRC § 512(b)(1)) (PLR 201430017).
k. Plan of Federal Energy Regulatory Committee-designated regional electricity transmission organization (an IRC § 501(c)(6) entity) to establish central counterparty structure for transactions occurring in its markets ruled to not give rise to unrelated business income (PLR 201430018).

4. The following are recent instances where the IRS or court ruled that an activity is an unrelated business or otherwise that a transaction will cause imposition of unrelated business income tax:

   a. Sale by exempt fraternal beneficiary society of life insurance policies to non-member widows of deceased members within one year following member’s death, where widow can name as beneficiary someone other than member’s dependent, held unrelated trade or business (TAM 201320023).

5. Finding that an activity is not a business (see VI A 2 a).

6. In colleges and universities compliance check final report (April 25, 2013), IRS stated that examinations resulted in increases to unrelated business taxable income in 90 percent of institutions examined; primary reasons for increases were lack of profit motive (disallowance of losses because undertakings not businesses), improper expense allocations between exempt and unrelated functions, errors in computations, lack of substantiation, and reclassification of exempt activities as unrelated activities.

7. IRS, on February 6, 2014, issued proposed regulations providing guidance on how certain organizations that provide employee benefits must calculate unrelated business income tax (REG-143874-10).

8. Court held that private equity fund was engaged in business (as term is applied in context of multiemployer pension termination liability law) using “investment plus” concept (Sun Capital Partners III, LP v. New England Teamsters & Trucking Industry Pension Fund (4th Cir.), cert. den. Mar. 3, 2014 ).

9. IRS ruled that educational organization’s website meets definition of term periodical (Reg. § 1.513-4); thus, organization can use unrelated business income tax cost allocation rules (Reg. § 1.512(a)-(f)) (PLR 201405029).

10. Settlement to be paid to VEBA formed in bankruptcy case of employer, to cover retiree health care reimbursements, ruled to be exempt function income (IRC § 512(a)(3)(B)) and thus not unrelated business income (PLR 201434025).

11. IRS statistics for 2009 (most recent data):

   a. Unrelated business income tax returns filed by 42,469 tax-exempt organizations.

   b. Gross unrelated business income reported was $9.7 billion.

   c. Deductions totaled $9.8 billion.
d. Gross income was 5.8 percent decrease in relation to amount reported for 2008.

e. About one-half of reporting organizations reported unrelated business income tax liability.

f. Unrelated business income tax paid was $263.1 million, including certain other taxes.

**B. Exceptions to Unrelated Business Taxation**

A tax-exempt organization generally does not have to pay the unrelated business income tax on dividends, royalties, rents from real property, interest, capital gain, and certain other income.

1. Instances where IRS or court ruled that income was exempt from unrelated income taxation because it constituted *royalties* (IRC § 512(b)(2)) [no recent developments].

2. For 2015, limitation regarding exemption of annual dues required to be paid by member to an agricultural or horticultural organization (IRC § 512(d)(1)) is $160 (Rev. Proc. 2014-61).

3. For 2015, exception from unrelated business taxation involving low-cost articles is applicable with respect to articles with a cost of no more than $10.50 (Rev. Proc. 2014-61).

4. Provision introduced by Pension Protection Act eliminating unrelated business income tax on certain payments to controlling tax-exempt organizations made during 2006 and 2007 was extended through 2009 by enactment of Tax Extenders and Alternative Minimum Tax Relief Act of 2008, which is Division C of financial markets stabilization legislation (H.R. 1424) signed into law on October 3, 2008; extended through 2011 by 2010 tax relief legislation; extended through 2013 by American Taxpayer Relief Act of 2012; extended through 2014 by Tax Increase Prevention Act of 2014.

5. Rental income held not unrelated business income (IRC § 512(b)(3)(A)(i)); proceeds from sale of capital property held not taxable (IRC § 512(b)(5)) (PLR 201435017).

**C. Unrelated Debt-Financed Income Rules**

Income derived from debt-financed property may be taxable as unrelated business income (IRC § 514).

1. Organization with primary purpose of managing portions of significant investment portfolio of health care system held not *qualified organization* (IRC § 514(c)(9)(B)(vi)) because its operation of schools represented only 13 percent of
functional expenses, involved 20 percent of employees, entailed 6 percent of revenue, and generated 7 percent of total gifts (TAM 201407024).

2. Borrowing of stocks by funds structured as partnerships, in which charity is invested, in entering into short positions held to not result in acquisition indebtedness incurred by organization (inasmuch as this entails borrowing of property, not money), so that none of distributive shares of funds’ income or gain derived from these trading activities is treated as debt-financed property; purchase of long positions in stocks in accounts at one or more affiliates of broker using any cash proceeds from short sales made through funds’ accounts at these affiliates held to not result in acquisition indebtedness, so that none of distributive share of funds’ income or gain derived from these trading activities will be treated as debt-financed property; use of long positions in stocks, including those purchased with short-sale proceeds, as collateral to secure performance by funds of their obligations to deliver stock to broker to cover its open short positions will likewise not result in acquisition indebtedness (PLRs 201418061, 201434024, 201434026).

D. Enacted and Proposed Legislation [no recent developments]

VI. MATTERS PERTAINING TO CHARITABLE GIVING

A. Contribution Rules in General

Income, gift, and estate tax deductions are available for contributors to charitable organizations (IRC §§ 170, 2522, and 2055).

1. IRS or court determined in the following instances that a transfer of money or property qualified for the general federal income, estate, or gift tax charitable contribution deduction:

   a. Contributions made to state university system designated for youth club, not separate legal entity and overseen by system, ruled deductible (PLR 201415009).

   b. Contribution to organization held deductible because it is not mere conduit of grants to foreign organization; funds kept in separate account, grantor maintains control of them, and foreign charity can only function in furtherance of grantor’s charitable purposes (PLR 201438032).

2. IRS or court determined in the following instances that a transfer of money or property did not qualify for the general federal income, estate, or gift tax charitable contribution deduction:

   a. Group of persons held to have overvalued qualified conservation easements; state tax credits they sold in connection with easements held to not qualify for long-term capital gain treatment (Esgar Corp. v. Commissioner (10th Cir. 2014)).
b. Payments made to charitable organization in order to comply with rules of governmental entity ruled not deductible as charitable gifts; classic illustration of mandatory gift (PLR 201437004).

3. Rulings as to special rules concerning deductibility of certain publicly traded securities to private foundations [no recent developments].

4. IRS issued rules as to inflation-adjusted amounts for 2015 (Rev. Proc. 2014-61): Insubstantial benefit limitations for contributions associated with charitable fundraising campaigns (IRC § 513(h)):
   a. Low-cost article ($10.50).
   b. Guidelines using $5, $25, and $50 limits ($10.50, $52.50, and $105).


6. Donor failed to convince court that gifted conservation easement diminished underlying property’s after-fair-market value; $4.6 million charitable deduction disallowed; accuracy-related penalties imposed (Mountanos v. Commissioner (2013)); motion to reconsider denied on March 6, 2014.

7. Organization had its tax exemption revoked for lacking capacity for holding and enforcing conservation easements; entity was held to be “conduit” for accountant’s tax practice, enabling him to help his clients obtain “sizeable” charitable deductions (PLR 201405018).

8. Tax Court held that law of North Dakota, that limits duration of conservation easements to 99 years, precludes federal charitable contribution deduction for all of them because it prevents easements from qualifying in perpetuity (Wachter v. Commissioner).

9. Tax Court held value of donated conservation easement to be $19.6 million (rather than claimed deduction of $23.9 million and IRS’s position of $7 million) and refused to sustain accuracy-related penalty (Palmer Ranch Holdings Ltd. v. Commissioner (2014)).

10. Charitable contribution deduction for gift of conservation easements disallowed because grant of easements was part of quid pro quo transaction where donor failed to identify or value all of consideration received in transaction (Seventeen Seventy Sherman Street, LLC v. Commissioner (Tax Ct. 2014)).

11. Company’s contributions of wrinkle creams, hair gels, perfumes, hair sprays, hair texturizers, curling irons, hair dyes, nail polishes, epilators, and hair restoration treatments held not qualified contributions eligible for enhanced deduction for gifts of inventory (IRC § 170(e)(3)) because they are not gifts in aid of the needy (CCA 201414014).
12. After denying donor’s motion for summary judgment, where donor asked Tax Court to hold that concepts of sham and lack of economic substance have no applicability in context of deductible charitable giving (May 22, 2014), court held (August 11, 2014) that intermediate limited liability company, wholly owned by donor (also an LLC) and holder of title to underlying property, was not disregarded entity for purposes of valuation of contributed interest; court suggested gift transaction involves tax shelter (RERI Holdings I, LLC v. Commissioner).

13. Tax Court denied charitable deduction for 2004 for gift of façade easement placed on townhouse in New York, on ground that easement only took effect, pursuant to state law, as of date of its recordation, which occurred in 2005 (Zerlengo v. Commissioner (2014)).

14. Scholarship payments made by trust held not deductible as charitable contributions by those who funded trust (Kalapodis v. Commissioner (Tax Ct. 2014)).

15. Developers of golf community held not entitled to charitable deduction for conservation easement encumbering golf course because defined parcel was not, in fact, contributed due to substitution clause (Belk v. Commissioner (4th Cir. 2014)).

16. Tax penalty held properly imposed by IRS in connection with charitable deduction carryover claimed on tax return for 2006, even though penalty did apply with respect to deductions for same gift taken for 2004 and 2005; case hinged on penalty regime as altered by Pension Protection Act (IRC § 6664(c)(3)) (Reisner v. Commissioner (Tax Ct. 2014)).

17. Donors of conservation easement to charity held not entitled to charitable deduction because, at time of gift, easement was subject to unsubordinated mortgage and risk of foreclosure under these facts was not so remote as to be negligible (Mitchell v. Commissioner (10th Cir.)).

18. Estate denied charitable contribution deduction (under IRC § 642(c)(2)), even though gift would be amount from estate’s gross income and be made pursuant to governing instrument (will), because gift amount was not permanently set aside for charitable purposes, inasmuch as under particular circumstances possibility that amount set aside will not be so devoted was not so remote as to be negligible (Estate of Belmont v. Commissioner (Tax Ct., Feb. 19, 2015)).

19. Conservation easement that allowed for future boundary adjustments held not qualified real property interest eligible for charitable contribution deduction (Balsam Mountain Investments, LLC v. Commissioner (Tax Ct., March 12, 2015)).

20. IRS inventoried its expectations for public charities administering charitable gift easement programs (PLR 201514010).

21. Donors held to pay accuracy-related penalty for claiming charitable deduction for worthless historic preservation easement on their home (Kaufman v. Commissioner (1st Cir., April 24, 2015)).
B. Planned Giving

Certain forms of partial-interest giving result in a charitable contribution deduction (e.g., IRC § 170(f)(2)(A)).

1. The IRS issued the following private letter rulings with respect to charitable remainder trusts (IRC § 664):
   a. Tax-exempt universities held not engaged in unrelated business when it enables charitable remainder trusts, as to which it is trustee and remainder interest beneficiary, to participate in investment return generated by university’s endowment fund (see VI A 2 a).
   b. Reformation of trust to correct scrivener’s errors approved [no recent developments].
   c. IRS approved merger (“consolidation”) of two “substantially identical” charitable remainder unitrusts (PLR 201420010).

2. Successful qualified reformations of remainder trusts (PLRs 201426005, 201450003).

3. Unsuccessful qualified reformations of remainder trust [no recent developments].

4. IRS, on January 16, 2014, issued proposed regulations for determining basis, in the case of taxable beneficiaries, in charitable remainder trusts term interests on disposition of all interests in trust, where that basis consists of share of adjusted uniform basis (REG-154890-03); proposal result of transaction-of-interest project announced in 2008 (Notice 2008-99).

5. IRS, on January 16, 2014, made public draft of 2013 version of split-interest trust information return (Form 5227), incorporating taxation of net investment income; 19 pages of draft instructions made public on January 17, 2014.

6. Developments concerning pooled income funds (IRC § 642(c)(5) entities):
   a. Public charity created fund to raise contributions to purchase undivided interest or entire interest in land and/or one or more buildings owned by charity; IRS ruled that depreciation deduction will be allocable to fund’s income beneficiaries and fund’s trustee (a supporting organization) on bases of fund income (in excess of income set aside for reserve) allocable to each (PLR 201450016).

7. Developments concerning charitable lead trusts [no recent developments].

8. IRS, on August 7, 2013, released draft of 2013 Form 8960 by which individuals, trusts, and estates will use in computing 3.8% surtax on net investment income.
income (IRC § 1411); charitable remainder trust beneficiaries are subject to this tax to extent distributions to them are considered items of investment income subject to the tax.

C. Gift Recordkeeping, Substantiation, and Appraisal Rules

These rules are the subject of IRC § 170(f)(8), (10), and (17)

1. Recordkeeping requirements (IRC § 170(f)(17)) [no recent developments]

2. Substantiation requirements (IRC § 170(f)(8)):
   a. Ostensible donors of $37,315 in noncash property held to fail requirements for all gifts, assessed accuracy-related penalty (Kunkel v. Commissioner (Tax Ct., 2015)).
   b. Donor held to have engaged in valid bargain-sale transaction; substantiation requirement held satisfied (Davis v. Commissioner (Tax Ct., May 6, 2015).
   c. Form of substantiation:
      (1) Usually provided by charitable donee by letter.
      (2) Substantiation rules may be satisfied by provision in deed.
      (3) Tax Court held that substantiation rules may be satisfied by provision in conservation easement agreement.
      (4) Tax Court held that letter signed by mayor of township constituted requisite substantiation of bargain sale.

3. Appraisal requirements (IRC § 170(f)(11)):
   a. Tax Court will be vacating portion of Rothman, holding that appraisal did not contain valuation method (and basis for determining property’s after value), because of decision in Scheidelman but nonetheless held that appraisal was not qualified due to additional significant defects in document (Rothman v. Commissioner).
   b. Tax Court held that claimed deduction for gift of property to charity is not allowed because donors’ two appraisals are not qualified appraisals; they “suffer from a number [at least 14] of material deficiencies”; appraisers held unqualified; noncompliance held not excusable under substantial compliance doctrine (Alli v. Commissioner (2014)).
   c. Donors denied $5.5 million deduction for grant of land preservation easement on farmland property because appraisal was not qualified (and because
grant was quid pro quo transaction, not gift) (*Costello v. Commissioner*, Tax Ct., May 6, 2015)

4. Valuation disputes:

   a. Tax Court adhered to original position, in case concerning value of façade easement, notwithstanding remand from U.S. Court of Appeals for Fifth Circuit, holding that value of easement is $1.8 million rather than claimed $7.5 million; penalty for gross valuation misstatement upheld (2012); Fifth Circuit held, on June 11, 2014, that decision was not incorrect, did not find acts of judicial insubordination, and vacated imposition of penalty (*Whitehouse Hotel Limited Partnership v. Commissioner*).

   b. Tax Court found to have applied correct highest-and-best-use standard in valuing conservation easement (*Ésgar Corp. v. Commissioner* (10th Cir. 2014)).

   c. IRS, on March 19, 2014, announced that the Office of Professional Responsibilities has entered into settlement agreement with group of appraisers accused of aiding in understatement of federal tax liabilities by overvaluing façade easements for charitable contribution deduction purposes (IR-2014-31).

   d. Tax Court, on March 31, 2014, held that there was no deduction for gift of easement because easement lacked any value, in that it is no more restrictive than standards imposed under designated historic district criteria (*Kaufman v. Commissioner*).

   e. Tax Court, on May 6, 2014, disagreed with IRS as to significance of home builder’s failure to obtain approval for higher density development of land underlying donated conservation easement, where that type of development was basis for donor’s appraisal; court held easement’s value was $19.9 million, rather than donor’s claim of $23.9 million and IRS’s assertion of $7 million (*Palmer Ranch Holdings Ltd. v. Commissioner*).

   f. Tax Court, on May 14, 2014, held that there was no allowable charitable deduction for gift of façade easement because landmark commission’s powers “closely approximate” those of charitable donee, so that easement lacked value (*Chandler v. Commissioner*).

   g. U.S. Court of Appeals for Second Circuit held, on June 18, 2014 (affirming Tax Court), that charitable deduction not available for gift of conservation easement because it did not have negative impact on value of underlying property (*Scheidelman v. Commissioner*).

   h. Tax Court, on August 6, 2014, disregarded both parties’ experts and concluded donor entitled to charitable deduction for gift of conservation easement, with valuation determined using subdivision development method;
value of easement set at $1.2 million, as opposed to claimed $1.6 million and IRS position that value was zero (*Schmidt v. Commissioner*).

i. Donor of conservation easement claimed charitable deduction in amount of $7.4 million; IRS proposed reduction of contribution amount by $4.9 million; Tax Court, on April 2, 2015, reduced contribution amount by $48,333 (*SWF Real Estate, LLC v. Commissioner*).

5. IRS, on August 6, 2008, issued proposed and temporary regulations concerning charitable deduction substantiation and reporting requirements (REG-140029-07); IRS held hearing on these proposals on January 23, 2009 (Ann. 2008-122); regulations address:
   a. Gift recordkeeping requirements.
   b. Gift substantiation requirements, principally for noncash gifts.
   c. Qualified appraisals.
   d. Qualified appraisers.
   e. Rules as to gifts of clothing and household items (IRC § 170(f)(16)).

D. **Enacted and Proposed Legislation**

VII. **FUNDRAISING REGULATION**

A. **State Regulation**

1. State charitable solicitation act developments.

2. Court opinions [no recent developments].

B. **Federal Regulation**

1. Tax exemption as charitable organization for entities that solely engage in fundraising and grantmaking to public charities; application of commensurate test (most recently, PLR 201103057).

2. Application of exceptions from unrelated business rules (e.g., activity not regularly carried on, volunteer exception, donated goods exception).

3. Ostensible fundraising operations held commercial:
   
   a. Tax Court, on January 28, 2013, held that an organization selling flowers online to public at market prices, where customers can designate charitable organizations to receive sales transactions profits, is operating in commercial manner and thus cannot be exempt, fundraising component notwithstanding (*Zagfly, Inc. v. Commissioner* (on appeal)).
b. Operation of networking and fundraising website, where primary activity is advertising (PLR 201309016).

c. Operation of fundraising program, involving sale of coffee and hot chocolate products (PLR 201310046).

d. Operation of fundraising program, where individuals can post on website details of goods they are willing to provide or services they are willing to perform in exchange for gift to charity (PLR 201323037).

e. Operation of program that allows individuals to “donate” property and claim charitable deduction, while retaining control of donated property and the ability to repurchase it at discounted price (PLRs 201323038, 201323039).

f. Operation of online program to facilitate charitable giving to variety of charitable entities (PLR 201350042).

g. Operation of program facilitating contributions by merchants to tax-exempt schools by means of software application and organization’s website; organization held to be functioning as intermediary rather than fundraiser (PLR 201407014).

h. Conduct of online raffles as sole fundraising activities, where IRS asserted the ticket prices were too high; raffle activity analyzed against rules of charity (PLR 201410035).

i. Organization that primarily exists to hold weekly Motto games and made virtually no charitable grants ruled to violate commensurate test and thus unable to qualify for tax exemption as charitable entity (PLR 201415003).

j. Nonprofit organization formed to promote mobile giving and fundraising using other technology programs to encourage charitable giving by younger donors denied recognition of exemption as charitable entity because it is direct outgrowth of application service provider company, (ostensibly) operates in commercial manner and relieves administrative burdens of participating wireless mobile telephone carriers (PLR 201429027; likewise PLR 201438029).

k. Organization operating website on fee-for-service basis to act as social network to facilitate gifts from individuals to public charities; website will also allow for fundraising and public relations activities; organization contracted for services with for-profit company owned by its three directors (PLR 201452017).

l. Organization, operating “automated fundraising online marketplace,” enabling purchasers of goods to direct profits on transactions to public charities, ruled engaged in commercial and nonexempt business (PLR 201503016).
4. IRS revoked exemption of fraternal organization (IRC § 501(c)(8) entity), in part for violation of commensurate test, because about 90 percent of fundraising proceeds went to fundraising company functioning on behalf of lodges (PLR 201332015).

5. Recordkeeping, substantiation, and appraisal rules (VII C).

6. U.S. Tax Court, on August 26, 2013, held that gymnastics booster club was not operating exclusively for exempt purposes, that its net earnings inured to benefit of its fundraising parent members, and that it conferred substantial private benefit on children of those fundraising families (Capital Gymnastics Booster Club, Inc. v. Commissioner).

7. IRS revoked exemption of organization using its website to facilitate donations for benefit of specific individuals, which was held to violate private benefit doctrine (PLR 201338052).

VIII. STILL OTHER DEVELOPMENTS

| There are a variety of federal law developments, other than in the tax law, of direct and indirect relevance to tax-exempt organizations. |

A. Final and Proposed Treasury/IRS Regulations, Rules, etc.


   a. Tax rate tables, reflecting the marginal tax rate of 39.6 percent (imposed on individuals’ income in excess of $413,200 ($464,850 for married couples filing jointly)

   b. Other marginal rates (10, 15, 25, 28, 33, and 35 percent) and related income tax thresholds described.

   c. Limitation on allowable itemized deductions applicable to individuals with income of at least $258,250 ($309,900 for married couples filing jointly)

   d. Personal exemption amount is $4,050, with phase-out beginning with incomes of $258,250 ($309,900 for married couples filing jointly); phase-out is complete at $380,750 ($432,400 for married couples filing jointly)

   e. Standard deduction amount is $6,300 ($12,600 for married couples filing jointly)

   f. Decedent’s estates have a basic exclusion amount of $5,430,000.

   g. Annual exclusion for gifts is $14,000.
B. Court Opinions

1. United States Supreme Court:

   a. Court, on January 24, 2014, enjoined Administration from enforcing said mandate against said nuns, if employer applicants inform HHS that they are religious organizations and have religious objections to provision of said coverage; case to be reconsidered by Tenth Circuit; Court said that its injunction should not be construed as expression of Court’s views on the merits (*Little Sisters, supra*).

   b. Court, on February 24, 2014, heard arguments in cases concerning extent of president’s ability to create law by agency regulations (e.g., *Utility Air Regulatory Group v. Environmental Protection Agency*).

   c. Court, on April 2, 2014, struck down cap on total amount an individual can contribute to federal candidates in two-year election cycle (*McCutcheon v. Federal Election Commission*).

   d. Court, on May 5, 2014, held that town may open its monthly board meetings with practices including prayer given by clergy serving congregations in locality, without contravening Establishment Clause, even though nearly all of participating prayer givers have been Christian (*Town of Greece v. Galloway*).

   e. Court, on June 30, 2014, ruled that “partial public employees” may elect to not join union representing them and are not required to pay union fees (*Harris v. Quinn*).

   f. Court, on June 30, 2014, ruled that for-profit corporations (closely held ones) cannot be required to pay for insurance coverage for contraceptive services as required by HHS regulations (contraceptive mandate) because mandate is violation of Religious Freedom Restoration Act (*Burwell v. Hobby Lobby Stores, Inc.*).

   g. Court, on July 3, 2014, ruled, on application for emergency injunction, that applicant religious college need only inform HHS of its objection to contraceptive mandate; Administration enjoined from enforcing HHS regulations against college (*Wheaton College v. Burwell*).

2. United States Courts of Appeals:

   a. Court, on January 27, 2014, held that Fannie Mae and Freddie Mac are not subject to state and local real estate transfer and recordation taxes, and that general exemption from state and local taxes is constitutional as exercise of Congress’s Commerce Clause power (*Montgomery County, Maryland v. Federal National Mortgage Association* (4th Cir.)).
b. Court, on February 11, 2014, held that IRS regulations concerning plan to regulate paid tax-return preparers are invalid because IRS lacks authority (jurisdiction) under pertinent statute; regulations held to fail both prongs of deference standard (Loving v. Internal Revenue Service (D.C. Cir.)).

c. Execution of government form as means to accommodate nonprofit religious organizations held, in challenge to Affordable Care Act’s contraceptive mandate’s regulations as being violation of Religious Freedom Restoration Act, held not substantial burden on religious beliefs (University of Notre Dame v. Sebelius (7th Cir., February 21, 2014)).

d. On remand from Supreme Court, court, on July 15, 2014, held that public university’s affirmative-action race-influenced admissions program is constitutional (Fisher v. University of Texas at Austin (5th Cir.)).

e. Tax credit subsidy provided by Patient Protection and Affordable Care Act held, on July 22, 2014, available only to individuals who purchase insurance coverage on state-operated exchanges, not on marketplaces run by federal government (Halbig v. Burwell (D.C. Cir.)). Note: Only 14 states operate exchanges.

f. In relation to previous item, U.S. Court of Appeals for Fourth Circuit ruled to the contrary on the same day (King v. Burwell).

g. Court held, on November 13, 2014, that organization challenging constitutionality of income tax exclusion in form of rental allowance paid to minister of gospel as part of minister’s compensation (IRC § 107(2)) lacked standing to bring action, because its members had not suffered “judicially cognizable injury” (Freedom From Religion Foundation v. Lew (7th Cir.)).

h. Court held, on November 14, 2014, that contraceptive mandate opt-out in Patient Protection and Affordable Care Act for religious entities is lawful, under Religious Freedom Restoration Act, and is constitutional (Priests for Life v. Department of Health and Human Services (D.C. Cir.)).

3. United States District Courts:

a. Execution of government form as means to accommodate nonprofit religious organizations held, in challenge to Affordable Care Act’s contraceptive mandate’s regulations as being violation of Religious Freedom Restoration Act, held not substantial burden on religious beliefs (Zubik v. Sebelius (W.D. Pa. 2014)).

b. Court, on January 15, 2014, held that provision in Affordable Care Act that allows individuals to receive premium tax credits and other subsidies when they purchase health insurance coverage by means of state-operated exchange is also applicable where exchange is federally facilitated (Halbig v. Sebelius (D.D.C.)).
c. On February 5, 2014, a lawsuit was filed, requesting delay of IRS’s work on proposed regulations concerning political activity by social welfare organizations until plaintiff receives Freedom of Information Act information it requested (Cause of Action v. Internal Revenue Service (D.D.C.)).

d. Court, on March 7, 2014, held that the individual mandate in Patient Protection and Affordable Care Act does not violate takings clause of U.S. Constitution (Association of American Physicians & Surgeons v. Sebelius (D.D.C.)).

e. Court, on April 17, 2014, enjoined Administration from enforcing, against religious organization, regulations implementing Patient Protection and Affordable Care Act’s contraceptive mandate (Dobson v. Sebelius).

f. Court, on May 19, 2014, ruled that atheist organizations seeking to enjoin IRS from enforcing provisions of federal tax law that are preferential with respect to religious organizations lack standing to assert their claims (American Atheists, Inc. v. Shulman (E.D. Ky.)).

g. Court, on June 25, 2014, ruled that elected state official lacked standing to challenge constitutionality of individual health insurance mandate, including exemption from mandate for those who object to it on religious grounds (Cutler v. Dep’t HHS (D.D.C.)).

h. Court, on July 16, 2014, held IRS lacks statutory authority to regulate preparation and filing of ordinary refund claims (Ridgely v. Lew (D.D.C.)).

i. Execution of government form as means to accommodate nonprofit religious organizations held, in challenge to Affordable Care Act’s contraceptive mandate’s regulations as being violation of Religious Freedom Restoration Act, held substantial burden on religious beliefs (Louisiana College v. Sebelius (W.D. La., August 13, 2014)).

j. Court, on December 17, 2014, held that plaintiffs lacked standing to challenge constitutionality of exemption for certain religious organizations from requirement of filing annual information returns (Freedom From Religion Foundation v. Koskinen (W.D. Wis.)).

k. Court, on February 5, 2015, denied director’s request for reimbursement of costs incurred in fighting penalty assessed against him for nonprofit organization’s failure to pay payroll taxes because (1) costs incurred in defending his license before state board were not proceeding against U.S. (IRC § 7430(a)) and (2) value of his time, which mitigated his lawyer’s time, was not “incurrence” of debt to pay (IRC § 7430(c)(1)(B)) (Carriker v. Department of Treasury (W.D.N.C.).
1. Court, on February 24, 2015, dismissed claims against Lois Lerner, in part because plaintiff failed to prove that court had personal jurisdiction over her (*Freedom Path, Inc. v. Lerner* (N.D. Tex.).

4. United States Tax Court:

   a. Court, on March 27, 2014, issued opinion concerning circumstances under which trust may be said to *materially participate* in a business; decision may pertain to 3.8 percent tax on net investment income of estates and trusts, because tax is inapplicable where underlying business is not passive undertaking (as determined by passive activity loss rules of IRC § 469) (IRC § 1411(c)(2)(A)) (*Frank Aragona Trust v. Commissioner*).

   b. Court, on September __, 2014, held that money received by pastor from church he controls is gross income, notwithstanding his vow of poverty (*Cortes v. Commissioner*).

5. United States Bankruptcy Courts [no recent developments]

C. **Enacted and Proposed Legislation**

1. Tax Reform Act of 2014 (made public on February 26, 2014, by then-Ways and Means Committee Chairman Dave Camp; not introduced):

   a. Tax exemption law provisions:

      (1) Taxation of all tax-exempt organizations (IRC § 501(a)) on their unrelated business income, notwithstanding entities’ exemption under another IRC provision (§ 5001).

      (2) Treatment of name and logo royalties as per se unrelated income (§ 5002).

      (3) Requirement that exempt organizations separately calculate net taxable income of each unrelated business, with any loss from a business used only to offset income from that business (§ 5003).

      (4) Narrowing of research exclusion (IRC § 512(b)(9)) to fundamental research where results are available to public (§ 5004).

      (5) Introduction of parity as to charitable contribution deduction limitation used in computing taxable unrelated business income (IRC § 512(b)(11)); limitation would be 10 percent for corporations and trusts (§ 5005).

      (6) Increase in specific deduction (IRC § 512(b)(12)) in computing taxable unrelated business income, from $1,000 to $10,000 (§ 5006).
(7) Repeal of exclusion from unrelated business income of gain or loss from disposition of real property (IRC § 512(b)(16)) (§ 5007).

(8) Modification of corporate sponsorship rules (IRC § 513(i)) (§ 5008).

(9) Increase in information return penalties (§ 5101).

(10) Introduction of manager-level penalty when exempt organization is subject to accuracy-related penalty for substantial understatement of unrelated income (§ 5102).

(11) Application of excess benefit transaction excise tax rules to IRC § 501(c)(5) and (6) entities (§ 5201).

(12) Revision of intermediate sanctions rules by eliminating rebuttable presumption of reasonableness and professional advice reliance safe harbor rule for managers, and expansion of definition of disqualified person to include athletic coaches and investment advisors (id.).

(13) Introduction of 2.5 percent excise tax on private foundations in cases of self-dealing; elimination of professional advice reliance safe harbor rule for managers (§ 5202).

(14) Mandate that donor-advised funds distribute contributions within five years of receipt; imposition of penalty for failures to do so (§ 5203).

(15) Reduction of private foundation tax on net investment income to one percent; repeal of exemption from that tax for exempt operating foundations (§ 5204).

(16) Subjection of private operating foundations to excise tax for failure to distribute income (§ 5205).

(17) Subjection of larger private colleges and universities to one percent excise tax on their net investment income (§ 5206).

(18) Repeal of tax exemption (pursuant to IRC § 501(c)(6)) for professional sports leagues (§ 5301).

(19) Repeal of tax exemption (IRC § 501(c)(15)) for qualified property and casualty insurance companies (§ 5302).

(20) Repeal of tax exemption (IRC § 501(c)(29)) for qualified health insurance issuers (id.).

(21) Imposition of in-state requirement for certain tax-exempt workers’ compensation insurance organizations (§ 5303).
(22) Repeal of law authorizing Type II and III supporting organizations (§ 5304).

(23) Requirement that organizations seeking to be tax-exempt social welfare organizations (IRC § 501(c)(4) entities) file notice with IRS; would apply to existing organizations (§ 6001).

(24) Extension of declaratory judgment procedures to social welfare organizations (§ 6002).

(25) Restriction on contribution reporting for certain social welfare organizations (§ 6003).

(26) Requirement that all tax-exempt organizations file Form 990 series returns electronically (§ 6004).

(27) Mandatory termination of employment of IRS employees for taking official actions for political purposes (§ 6006).

(28) Prohibition for one year on issuance of final regulations concerning social welfare organizations’ involvement in political activities; retention of facts-and-circumstances test in interim (§ 6011) (see IX C 2)).

b. Charitable deduction law provisions:

(1) Individuals would be permitted to deduct charitable contributions made after close of tax year but before April 15 for year covered by return (§ 1403).

(2) Harmonization of 50-percent and 30-percent limitations on deductibility at single limit of 40 percent (id.).

(3) Harmonization of 30-percent and 20-percent limitations on deductibility at single limit of 25 percent (id.).

(4) Imposition of two-percent AGI floor under deductible charitable gifts (id.).

(5) Confinement of amount of charitable deduction for most types of gifts of property to donor’s adjusted basis (id).

(6) Percentage limitations as to conservation easement gifts by farmers and ranchers would be made permanent (id.).

(7) College athletic event seating rights charitable deduction rule (IRC § 170(l)) would be repealed (id.).
(8) Income from intellectual property contributed to charity would no longer be deductible as additional contribution (IRC § 170(m)) (id.).

2. Congress passed Tax Increase Prevention Act of 2014 (H.R. 5771), which extended (through 2014) special rules for contributions of capital gain real property made for conservation purposes, rule for tax-free distributions from certain individual retirement plans for charitable purposes, enhanced charitable deduction for contributions of food inventory, extension of modification of tax treatment of certain payments to controlling exempt organizations, and extension of basis adjustment to stock of S corporations making charitable contributions of property; legislation also brought tax exemption for qualified ABLE accounts (IRC § 529A).

3. House of Representatives, on February 12, 2015, passed America Gives More Act (H.R. 644), which would make permanent rules concerning tax-free distributions from individual retirement accounts for charitable purposes, contributions of food inventory, and qualified conservation contributions, plus reduce rate of excise tax on investment income of private foundations.

4. House of Representatives, on February 13, 2015, passed America’s Small Business Tax Relief Act (H.R. 636), which includes provision making permanent rules on basis adjustments to stock of S corporations making charitable contributions of property.

5. Senate Committee on Finance, on February 11, 2015 approved 17 tax bills, three of which would provide special treatment for qualified agricultural research organizations, create exception to excess business holding rules for philanthropic business holdings; and require IRS to notify exempt organizations that are about to lose their exemption for failures to file annual returns; measures subsequently introduced as S. 908, S. 909, S. 918.

6. House, on February 25, 2015, passed bill (H.R. 529) to improve qualified prepaid tuition plan rules.

7. Slain Officer Family Support Act signed into law on April 2, 2015 (P. L. 114-7); measure allows deductible cash gifts even though contribution made for specific families.

8. On April 15, 2015, House passed Preventing Targeting at IRS Act (H.R. 709), Taxpayer Bill of Rights (H.R. 1058), Fair Treatment for all Donations Act (H.R. 1104), measure requires organizations seeking social welfare status (IRC § 501(c)(4)) to give IRS notice and adds them to declaratory judgment rules (IRC § 7428) (H.R. 1295), and measure allowing appeal rights for unsuccessful applicants for recognition of exemption (H.R. 1314).

D. **Other Developments**

1. Joint Committee on Taxation staff, on August 5, 2014, issued estimates of tax expenditures for fiscal years 2014-2018 (JCX-97R-14); charitable contribution deduction is eleventh largest tax expenditure ($251.8 billion).

2. Treasury Inspector General for Tax Administration found that more than 64,200 tax-exempt organizations had nearly $875 million of federal tax debt (such as payroll taxes) as of June 16, 2012, with some simultaneously receiving federal funding (“Some Tax-Exempt Organizations Have Substantial Delinquent Payroll Taxes” (2014-10-012), dated July 3, 2014, made public on August 13, 2014).


4. House of Representatives, on January 5, 2015, passed rules for new Congress (H. Res. 5), which include mandatory use of macroeconomic analysis (aka dynamic scoring) in assessing major tax and other legislation.

**IX. LOOKING AHEAD: IRS INITIATIVES AND OTHER COMING DEVELOPMENTS**

A. IRS Initiatives:

1. Involvement in nonprofit governance.

2. Charitable spending initiative.

3. Import of college and university compliance check.

4. Aftermath of Form 990 revision.

5. Supporting organizations regulations.


7. Gift substantiation and recordkeeping regulations.

8. Other compliance checks.


11. Websites examination.

B. Other Coming Developments:

1. Consequences of brouhaha concerning IRS processing of applications for recognition of tax exemption.
2. Consequences of hearings held by House Subcommittee on Oversight on tax exemption and charitable deductions; initial hearing occurred on May 16, 2012.

3. Health care system reform legislation and its aftermath, including Supreme Court decision.

4. Treatment of categories of organizations, including hospitals, churches, supporting organizations, and organizations maintaining donor-advised funds.

5. Members of Congress thinking about distinctions between public charities and private foundations, enhancement of charitable activity in rural areas, and extent of societal “return” on charitable exemptions and deductions.

6. Campaign finance law challenges on constitutional law grounds.

7. Implications of pending tax reform.

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