

Non-Profits & Association Forums: Exempt Organizations (2014) Year in Review

Association of Corporate Counsel National Capital Region

January 22, 2015

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Celia Roady



Celia Roady is a partner in Morgan Lewis’s Tax Practice. Celia focuses her practice on tax and governance issues affecting tax-exempt organizations, including charities, foundations, colleges and universities, museums, and other nonprofit organizations. She was appointed by the Internal Revenue Service to be a member of its Advisory Committee on Tax-Exempt and Government Entities for 2010-2013. She has also been named by *Legal Times* as one of Washington, D.C.’s "leading lawyers" in the tax field and is listed in *Chambers USA: America’s Leading Lawyers for Business* (2005–2014) and *The Best Lawyers in America* (2007–2015). She chairs the annual conference on “Representing and Managing Tax-Exempt Organizations,” sponsored by the Georgetown University Law Center. In 2004-2005, Celia served on the Governance Work Group of the Panel on the Nonprofit Sector, which was convened by Independent Sector to provide comments to the Senate Finance Committee. Celia is a graduate of Duke University, Duke Law School, and Georgetown Law School (LL.M.).

Cindy Lewin



Cindy Lewin is Executive Vice President and General Counsel at AARP. Before joining AARP in June 2010, Cindy served as general counsel at two other large national nonprofit organizations, the National Wildlife Federation and Volunteers of America, for twelve years, where she also served as Secretary or Assistant Secretary and had human resources, office services, facilities, and information technology reporting to her at various times. Before moving in-house, she was a partner at Lichtman, Trister, Singer & Ross, where her practice focused exclusively on nonprofit organizations, and prior to that she practiced at Arnold & Porter. Cindy is past chair of the Exempt Organizations Committee of the D.C. Bar Tax Section and also past chair of the Nonprofit Organizations Committee of the Association of Corporate Counsel. She was named one of “Washington’s Most Influential In-House Counsels” by *Legal Times* in 2011. In 2013, under her leadership, the AARP Office of General Counsel was recognized for Best Outside Counsel Management by the *National Law Journal*, and in 2014, won the In-House Innovators Award from the Association of Corporate Counsel – National Capital Area. Cindy served on Independent Sector’s 2014 Ethics and Accountability Advisory Group, and is on the Board of Directors of the National Human Services Assembly. Cindy is a graduate of Yale Law School and Wellesley College.

Alexander Reid



Alexander Reid is of counsel in Morgan Lewis's Tax Practice. Alex advises tax-exempt organizations of all varieties, including charities, foundations, colleges and universities, museums, and other nonprofit organizations. He assists clients in structuring philanthropic enterprises and collaborations with commercial entities to accomplish charitable objectives. He represents taxpayers under audit and helps organizations improve governance and enhance tax compliance. Alex also counsels taxpayers seeking administrative guidance from the Internal Revenue Service and Treasury Department as well as on legislative matters with the U.S. Congress. Prior to joining Morgan Lewis, Alex served as legislation counsel for the Joint Committee on Taxation, where he advised members of Congress and staff regarding tax policy and drafted legislation, hearing publications, and technical explanations of tax legislation. Before his time with the government, he was a senior associate in the tax practice of a prominent international law firm. Alex is a graduate of Yale University and New York University School of Law (J.D. and LL.M.).

Significant Developments Affecting Exempt Organizations

- 2014 was an active year in the exempt organizations (“EO”) area, with significant developments on the Hill, at the IRS and Treasury, and in the courts.
- Legislative developments included introduction of a legislative proposal for comprehensive tax reform, including major and often adverse proposed changes in the EO area
- Treasury/IRS developments included issuance of highly controversial proposed regulations under Section 501(c)(4) and issuance of a new Form 1023-EZ that amounts to a self-certification of tax-exempt status for small 501(c)(3) organizations
- IRS restructuring developments included plans to transfer the IRS private letter ruling process to the Office of Chief Counsel and to transfer many of the employees of the “National Office” to Chief Counsel
- Many of the 2014 developments represent “unfinished business,” with final action to be deferred until 2015 (or later)

Legislative Developments

Legislative Developments in 2014

- On February 26, Dave Camp (R-MI), House Ways & Means Committee Chairman, released a discussion draft of a comprehensive tax reform package titled the “Tax Reform Act of 2014.” The 1,000-page bill affected nearly every aspect of the tax code. While no action was taken in 2014, provisions of the Camp bill are likely to receive continuing Congressional interest in the coming year(s). The Camp bill included the following provisions impacting the tax treatment of EOs and their donors:
 - Limit the deductibility of most charitable contributions of property to basis other than publicly traded stock, qualified conservation contributions, certain research and inventory, and property related to charitable purpose
 - Repeal special charitable deduction provisions for college athletic event seating rights and intellectual property used to generate additional income
 - Impose a 2% floor on charitable contributions
 - Permit taxpayers to claim a charitable deduction after the close of the tax year but before the due date of the return (e.g., April 15)
 - Simplify and lower the percentage of income that may be offset by charitable deductions
 - Impose a 25% excise tax on executive compensation more than \$1,000,000

Legislative Developments in 2014 (cont'd)

- Tax royalties from licensing an organization's name or logo as unrelated business income
- Require organizations to calculate the net unrelated taxable income of each unrelated trade or business separately such that loss from one business could only be used to offset income from that business
- Treat certain corporate sponsorship payments as taxable advertising revenue
- Impose a 10% excise tax on organizations that engage in excess benefit transactions, and eliminate the rebuttable presumption for reasonable compensation
- Apply intermediate sanctions rules to 501(c)(5) and 501(c)(6) organizations
- Impose a 2.5% excise tax on private foundations that engage in self-dealing transactions
- Require donor-advised funds to distribute contributions within five years of receipt
- Lower the excise tax on private foundation investment income to 1%
- Repeal the exception for private operating foundations failing to distribute income
- Impose a 1% excise tax on private colleges and universities with more than \$100,000 of assets per full-time student
- Repeal the tax-exempt status of professional sports leagues
- Repeal Type II and Type III supporting organizations

Expiring Tax Provisions

- Tax Increase Prevention Act of 2014, Pub. L. No. 113-295, enacted Dec. 19, 2014, extended “traditional extenders” from 1/1/14 to 12/31/14
 - They are now expired, again. (“This tax bill doesn't have the shelf life of a carton of eggs,” said Sen. Wyden)
- EO provisions include:
 - deduction for contributions of capital gain real property made for conservation purposes
 - tax-free distributions from individual retirement accounts (IRAs) for charitable purposes
 - the tax deduction for contributions of food inventory by taxpayers other than C corporations
 - the basis adjustment rule for stock of an S corporation making charitable contributions of property
 - extension of modification of tax treatment of certain payments to controlling exempt organizations

Congress Cuts IRS Budget

- Congress enacted a \$1.01 trillion omnibus spending bill (Consolidated and Further Continuing Appropriations Act, 2015, Pub. L. No. 113-235) on December 16, 2014 which cut the IRS's budget by \$346 million or 3%, to \$10.95 billion
- IRS must also must pay \$250 million to cover its share of a 1% pay increase for government employees and for increased benefit costs
- IRS Commissioner Koskinen said that the IRS will implement a hiring freeze, cut travel expenses, and cease overtime pay
- Wait times expected to increase for telephone assistance to taxpayers

New Leadership in House and Senate for 2015

- Rep. Paul Ryan (R-WI) replaces Rep. Dave Camp (R-MI) as chair of House Committee on Ways and Means
 - Rep. Sander Levin (D-MI) remains Ranking Member of Ways and Means
- Rep. Jason Chaffetz (R-UT) replaces Rep. Darrell Issa (R-CA) as chair of House Committee on Oversight & Gov't Reform
 - Rep. Elijah Cummings (D-MD) remains Ranking Member of the Oversight Committee
- Sen. Orrin Hatch (R-UT) assumes chairmanship of the Senate Finance Committee
 - Sen. Ron Wyden (D-OR) becomes Ranking Member

Key Congressional Staff for 2015

- Joint Committee on Taxation
 - Tom Barthold, Gordon Clay
- House Committee on Ways and Means
 - Majority staff: Harold Hancock, Mark Warren
 - Minority staff: Aruna Kalyanam, Karen McAfee
- Senate Finance Committee
 - Majority staff: Jim Lyons, Preston Rutledge
 - Minority staff: Kara Getz, Tiffany Smith

“Business Only” Tax Reform

- There is talk of splitting tax reform into two pieces, doing business tax reform first and individual tax reform separately
- Business only tax reform is unlikely to include charitable contribution deduction reforms, but may well include the other provisions discussed in the Camp proposal
- Senator Hatch has outlined 7 broad principles for tax reform: economic growth, fairness, simplicity, revenue neutrality, permanence, competitiveness, and incentives for savings and investment
 - Distributional neutrality is not among the principles, which suggests a departure from the principles underlying the 2014 House-led tax reform effort

White House to Release “Specific Proposals” in 6-12 Months

- A press conference of December 19, 2014, President Obama said that the White House will “put forward some pretty specific proposals” on business tax reform
- Mark Mazur, Assistant Secretary for Tax Policy, stated on December 16, 2014 that Treasury is working on a detailed proposal that may be released in a 6-12 month time frame
- White House tax reform proposals unlikely to be released prior to President’s budget, which is usually issued in February, March, or April

House Fails to Pass Supporting America's Charities Act (H.R. 5806)

- The bill included three provisions (10-year revenue estimates in parenthesis)
 - Modify and make permanent the special rule for qualified conservation contributions (\$1.2 billion)
 - Enhanced charitable deduction for contributions of food inventory generally expanded and made permanent (\$1.9 billion)
 - Tax-free distributions from IRAs to certain public charities for individuals age 70-1/2 or older, not to exceed \$100,000 per taxpayer per year made permanent (\$8 billion)
- It failed to gain support from Democrats or the President because the bill included no offsets to the \$11.1 billion revenue loss

Treasury/IRS Developments

Proposed Regulations Under Section 501(c)(4)

- In November 2013, the IRS issued proposed regulations defining what would constitute political campaign intervention in the context of Section 501(c)(4) organizations. The proposal generated more than 150,000 comments
 - Comments from all sides of the political and tax-exempt sector expressed overwhelming opposition to the proposed regulations
 - Key issues were the definition of campaign intervention, including fact that activities considered permissible for 501(c)(3) organizations were defined as campaign intervention for 501(c)(4)s and the lack of any guidance as to how much campaign intervention would be permissible
- Soon after the end of the comment period, the IRS Commissioner announced that the proposed regulations would be scrapped and redone. Recent IRS statements suggest that revised proposed regulations may be issued later in 2015; these would cover more categories of 501(c) organizations and would define campaign intervention as well as address the amount of such activity that would be permissible without jeopardizing exemption

Introduction of New Form 1023-EZ

- In July 2014, the IRS introduced a new Form 1023-EZ that is intended to streamline the exemption process for small organizations (gross receipts of \$50,000 or less and assets of \$250,000 or less) seeking exemption under 501(c)(3)
 - Form 1023-EZ is only three pages long and amounts to a self-certification by asking applicants to check a series of boxes stating that they meet the requirements for exemption.
 - Applicants do not have to provide copies of their governing documents, describe their activities, or provide any financial information
- In Rev. Proc. 2015-9, the IRS clarified that grantors and contributors can rely on exemptions granted to organizations that use Form 1023-EZ applications to the same extent as those filing the regular Form 1023s

TIGTA Report on Exempt Organizations with Delinquent Payroll Taxes

- Majority of tax-exempt organizations pay their Federal taxes, but a small percentage do not
 - 64,200 exempt organizations (3.8%) owed \$875 million of federal tax debt as of June 16, 2012.
 - 56,000 organizations owed less than \$10,000 each
 - 7,000 organizations each owed from \$10,000 to \$100,000
 - 1,200 organizations owed more than \$100,000 each for a total of \$656 million
 - 5 organizations owed more than \$10 million
 - 9 organizations each had federal tax debt spanning 10 or more years that collectively totaled more than \$5.5 million
- The 25 “worst offenders” were 501(c)(3) organizations that received government payments over a three-year period of \$148 million, including Medicare, Medicaid, and government grants; had annual revenue of almost \$167 million; and owned assets of more than \$97 million. They owed payroll and other taxes, including penalties and interest, totaling more than \$25 million
- IRS management response said TIGTA report paints “an incomplete picture,” reaches an “illogical conclusion” that exempt orgs can avoid paying payroll taxes, and defends IRS enforcement efforts. IRS opened collection cases on all 25 organizations that TIGTA reviewed, and 17 have been closed

ACT Report Recommendations on UBIT

- Issue guidance that profits from a substantial commercial activity should not preclude exemption under Section 501(c)(3) as long as an organization's income and its financial resources are used commensurate in scope with its charitable program
- Issue guidance regarding proper methods for allocating indirect costs where facilities and/or personnel are used to carry on exempt activities and to conduct unrelated trade or business
- Issue guidance on a range of UBI issues including categories of activities that will be considered related and unrelated, guidance on preparatory time spent on activities, and scenarios of situations involving the activities frequently reported on the college and university questionnaire, such as facility rentals and dual use properties
- Adopt a new Form 990-T based upon the proposed format enumerated in the ACT report
- Improve communication, education, and training as well as enhance access to IRS materials and information available on its website

IRS EO Realignment

- In March 2014, the IRS of the EO and EP divisions, announced a major realignment, transferring responsibility to IRS Chief Counsel's exempt organization's office in Washington, DC (EO Counsel) for:
 - Review of certain applications for recognition of tax exemption
 - Guidance
 - PLRs
 - TAMs
 - Revenue rulings and procedures
 - Regulations
 - Notices and announcements

IRS EO Realignment: New Procedures for Obtaining Private Letter Rulings

- Under the realignment, the IRS EO National Office no longer issues letter rulings or technical advice memoranda. Jurisdiction over letter rulings, formerly with the Commissioner, Tax Exempt and Government Entities Division, has been delegated to the Office of Associate Chief Counsel (Tax Exempt and Government Entities), except with respect to changes in accounting methods and certain rulings described in Rev. Proc. 2015-4
- “The Office of Chief Counsel generally will respond to requests for letter rulings within 180 days of the date of receipt. Branch personnel must notify the Associate Chief Counsel or Deputy Associate Chief Counsel when the branch determines that a response will not be provided within 180 days of the date of receipt. This notice generally should be provided no later than 165 days from receipt of the request for letter ruling.” IRM § 32.3.2.3
- Fees for smaller organizations have been reduced

Revised User Fees for Ruling Requests

- Rev. Proc. 2015-1 (rulings issued by IRS Counsel)
 - Rulings requested by organizations with gross receipts greater than \$1 million increased to \$28,300
 - Rulings requested by organizations with gross receipts greater than \$250,000 and less than \$1 million reduced to \$6,500
 - Rulings requested by organizations with gross receipts less than \$250,000 reduced to \$2,200

Emerging Issues Identification

- Memo of Sept. 30, 2014 (TEGE-07-0914-0026) establishes Emerging Issues Committee as the central point for referrals of emerging issues and all issues involving potential abusive transactions, fraud, or terrorism as well as large case, complex, or sensitive issues
- Submission form requests Exempt Organizations employees to provide the following information regarding emerging issues:
 - DESCRIPTION of emerging issue identified (Do NOT include taxpayer specific information)
 - IRC Section(s) potentially impacted by the emerging issue identified
 - Describe HOW you identified the potentially emerging issue
 - Describe any DOCUMENTATION you may have and HOW you acquired it
 - Any additional information you may have to offer (size, marketing, etc)

Redomestication Without Having to Reapply for Exempt Status

- Organizations are generally required to reapply to the IRS for recognition of tax-exempt status when they change to their legal form, which generally includes reincorporating in another state. *See American New Covenant Church v. Commissioner*, 74 T.C. 293 (1980); Rev. Rul. 77-469, 1977-2 C.B. 196; Rev. Rul. 67-390, 1967-2 C.B. 179
- In PLR 201426028 (June 27, 2014), the IRS held that an organization that converted from “public nonprofit corporation” status to “nonprofit corporation” status was not required to reapply for exemption
- In PLR 201446025 (Aug. 20, 2014), the IRS held that an exempt organization could redomesticate from state A to state B by filing, a certificate of conversion in state A and articles of domestication in state B without filing a new exemption application. The reason for the redomestication was to take advantage of the favorable corporate law of the destination state.

2014 Form 990 Changes

- Form 990 Schedule A includes significant revisions for supporting organizations
- Form 990 Schedule L definition of “interested person” is expanded to include the founder and his/her family; substantial contributors and their family; 35% controlled entities of the above
- Form 990 Schedule L definition of “interested person” is contracted by removing five highest compensated employees (Part II), non-stock organizations more than 35% controlled by other interested persons (Part IV); an entity of which a current or former officer, director, key employee, or family member was serving as a director, officer or trustee or more than 5% owner of a professional corporation treated as a partnership (Part IV)
- Form 990 Schedule L instructions include new exception in Part IV for transaction with public companies in the ordinary course of business

Judicial Developments

ABA Retirement Funds v. United States, (7th Cir., July 21, 2014)

- Seventh Circuit upheld District Court ruling that ABA Retirement Funds does not qualify as a 501(c)(6) tax-exempt business league because “(1) its activities are not directed to the improvement of business conditions for the legal field generally; and (2) it engages in a business ordinarily conducted for profit”
 - Issue (1): “[W]e do not doubt that retirement planning is good for the legal profession generally (as it is for everyone else), but ABA Retirement furnished that benefit almost exclusively by providing a particular service to particular persons, namely, retirement plans for those who signed up for its Program”
 - Issue (2): “[W]hether ABA Retirement was engaged in business ordinarily done for profit during the relevant period -- the answer is an unequivocal yes. ABA Retirement did not just sponsor the Program; it was the Program fiduciary”

Citizens for Responsibility and Ethics in Washington v. U.S. Dept. of Treasury (D.D.C. Feb. 27, 2014)

- Court dismisses complaint filed by Citizens for Responsibility and Ethics in Washington (CREW) asking court to force the IRS to initiate a rulemaking procedure to revise regulations governing standards for granting tax-exempt status to organizations under Section 501(c)(4)
- Court determines that CREW lacked standing to bring the suit