

NAAG/NASCO ANNUAL CONFERENCE: STATE REGULATION OF NONPROFIT ORGANIZATIONS

HOT TOPICS: AN EXCHANGE OF VIEWS

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What's New at the Internal Revenue Service?

- 2012 ACT Report on “Form 1023: Updating it for the Future”
 - Recommendations include 1) develop e-1023 for electronic filing; 2) redesign the 1023 for simplicity, effectiveness, consistency and customer education; 3) no 1023-EZ for small organizations; 4) seek precedential guidance on alternatives to creating new 501(c)(3)s; 5) consult with state charity regulators about indicia of noncompliance. http://www.irs.gov/pub/irs-tege/tege_act_rpt11.pdf
- Donations to Single-Member LLCs
 - Charitable donations can be made directly to single-member LLCs. Query whether this will create issues for the states when charitable solicitation activities are conducted in the name of the parent organization. IRS Notice 2012-52 (July 31, 2012).

What's New at the Internal Revenue Service?

(cont'd)

- New PRI Regulations
 - These long-awaited new regulations should expand the use of program-related investments by private foundations.
http://www.irs.gov/irb/2012-21_IRB/ar11.html
- Group Ruling Questionnaire
 - The IRS is designing a questionnaire to seek information to help IRS continue analyzing the group exemption/group return issues raised by the 2011 ACT Report, which recommended retaining group exemptions but eliminating group returns.
See http://www.independentsector.org/irs_eo_2012_workplan

Political Campaign Intervention – Defining a Role for State AGs

- Section 501(c)(3) organizations are prohibited from engaging in campaign intervention. Section 501(c)(4)s may engage in campaign intervention but this cannot be their primary activity. These restrictions are typically reflected in articles of incorporation.
- The question of whether donations to 501(c)(4)s are subject to gift tax is unresolved; the IRS has announced that any decision to apply the gift tax will have prospective application only. See http://www.irs.gov/pub/newsroom/guidance_for_irs_sbse_estate_and_gift_tax_and_tege_exempt_organizations.pdf. See also the recent Congressional Research Service Report on “Political Ads: Issue Advocacy or Campaign Activity Under the Tax Code” (August 29, 2012). <http://www.fas.org/sgp/crs/misc/R42684.pdf>.
- There have been numerous allegations of campaign intervention by 501(c)s during the current election season. Examining these allegations is not listed as a project on the 2012 IRS workplan.

Political Campaign Intervention – Defining a Role for State AGs (cont'd)

- 501(c)(4) campaign intervention is an even bigger issue since it involves massive amounts of money, the sources of which are unknown to the public. There is no IRS guidance on the extent to which 501(c)(4)s can be involved in campaign intervention.
- The NY AG is conducting an investigation of contributions to tax-exempt groups that are heavily involved in political campaigns. Given the reluctance of the IRS to tackle these issues, query whether there is a role for the states to play.
See http://www.nytimes.com/2012/08/09/us/politics/eric-schneiderman-investigating-groups-campaign-spending.html?_r=2

Donor-Advised Funds

- The Pension Protection Act (“PPA”) added tax penalties for the misuse of donor-advised funds. To date the IRS has not issued regulations implementing these penalties, which have been in effect since 2006.
- On December 5, 2011, the Treasury Department issued a “Report to Congress on Supporting Organizations and Donor Advised Funds.”
 - The report examined 2006 data and was generally positive, concluding that the PPA “provided a legal structure to address abusive practices and accommodate innovations in the sector without creating undue additional burden or new opportunities for abuse.” See <http://www.treasury.gov/resource-center/tax-policy/Documents/Supporting-Organizations-and-Donor-Advised-Funds-12-5-11.pdf>

Donor-Advised Funds (cont'd)

- On June 11, 2012, the Congressional Research Service also issued a report which examined 2008 data and was less positive. See <http://www.fas.org/sgp/crs/misc/R42595.pdf>.
 - While finding that on the whole, the payout rate for DAFs was much higher than for private foundations, the report observed that some sponsoring charities have a very small number of DAFs for which the payout rate is much lower.
 - Possible recommendations included imposing minimum distribution requirements on an individual account basis, imposing tighter limits on private foundation gifts to DAFs, limiting the life of DAFs, and enhancing DAF reporting requirements.

Donor-Advised Funds (cont'd)

- One problem with the CRS study is that it relies on IRS Statistics of Income information taken from the Form 990. Using aggregate information in these cases can be misleading.
 - For example, the study makes much of the fact that sponsoring charities with a small number of DAFs have a much lower payout than the national sponsoring charities and community foundations. But the study does not try to determine why that is the case.
 - One hypothesis is that many of these sponsoring charities are operating organizations that receive a substantial portion of DAF distributions for their own charitable programs, but this information is not captured on the Form 990 as currently designed.

Donor-Advised Funds (cont'd)

- Examples: a significant number of colleges and universities have a small number of DAFs. Typically they require that at least half of the DAF funds be applied to support their own programs; however, these distributions are not required to be reported as DAF distributions on the Form 990.
- Improvements to the Form 990 would identify this information more clearly.
- Other DAF Issues
 - What lessons are to be learned from *Styles v. Friends of Fiji*, No. 51642. (Nev. Sup. Ct. unpublished opinion Feb. 8, 2011)?
 - What are the implications of the rise in the DAF model to process small online donations?

Charities and Fundraising Go Viral

- Invisible Children – Kony 2012
 - 86 million views on You Tube
- The Bullied Buss Lady video
 - \$700,000+raised, 32,000 donors (and it's not even a charity.)
- Minnesota North Community YMCA
 - Hot Cheetos & Takis (2+ million You Tube views)

Executive Compensation

- Governor Cuomo has announced proposed regulations to ensure that state-funded providers to not pay excessive executive compensation or administrative costs.
<http://www.governor.ny.gov/press/05162012State-Funded-Providers>
- In May 2012, a budget amendment was approved by the Massachusetts Senate to limit the compensation of directors and officers of public charities. See
<http://www.jdsupra.com/post/documentViewer.aspx?fid=491b73ea-4ccf-4a45-88a5-6a2a37352761>
- Proposed legislation introduced in 2011 in Massachusetts to restrict the pay of nonprofit board members was not enacted. See
<http://philanthropy.com/blogs/state-watch/mass-foundations-consider-proposed-restriction-on-board-member-pay/645>.

Charity Scandal of the Year

Finalists:

U.S. Navy Veterans Association

- <http://www.ohioattorneygeneral.gov/Briefing-Room/News-Releases/May-2012/Attorney-General-DeWine-Announces-U-S-Navy-Vetera>

Three Cups of Tea (Central Asia Institute)

- <http://www.thedailybeast.com/articles/2012/04/05/greg-mortenson-to-repay-charity-1-million-for-three-cups-of-tea-fraud.html>
- <http://philanthropy.com/article/Three-Cups-of-Tea-Scandal/127251/>

Charity Scandal of the Year (cont'd)

Help Hospitalized Veterans

- <http://latimesblogs.latimes.com/lanow/2012/08/state-attorney-general-sues-charity-supposed-helping-wounded-veterans.html>
- <http://abcnews.go.com/Blotter/hospitalized-veterans-csi-actor-cuts-ties-serving-vets/story?id=16996255>

Second Mile

- <http://www.centredaily.com/2012/05/25/3207932/second-mile-to-close-amid-sandusky.html>
- http://espn.go.com/college-football/story/_/id/7970999/jerry-sandusky-founded-charity-second-mile-seeks-ok-shutter-transfer-programs

Charity Scandal of the Year (cont'd)

Fiesta Bowl

- <http://philanthropy.com/article/Fiesta-Bowl-s-Lesson-Boards/127043/>

And the winner is . . .

Complex Structures

- On July 25, 2012, the House Oversight Subcommittee held a hearing on “Public Charity Organizational Issues, Unrelated Business Income Tax, and the Revised Form 990.”
 - <http://waysandmeans.house.gov/calendar/eventsingle.aspx?EventID=303617>
- Witnesses included Steve Miller, IRS Deputy Commissioner for Services and Enforcement; Eve Borenstein (Borenstein and McVeigh Law Office); Thomas Hyatt (SNR Denton); Professor John Colombo (University of Illinois Law School); Professor Donald Tobin, Ohio State Law School.

Complex Structures (cont'd)

- Testimony included a presentation by Hyatt on charitable organizations that have complex corporate structures to explain. The Subcommittee wanted a better understanding about why many charitable organizations have complex corporate structures.
- Principal reasons given included the need to manage risk, to protect endowments from operating risks, to protect tax-exemption, and to achieve better governance for activities conducted through separate entities.

Other Developments

- Report on “Revitalizing Nonprofits Renewing New York” from the Leadership Committee for Nonprofit Revitalization to New York Attorney General Eric T. Schneiderman (February 16, 2012). See <http://www.ag.ny.gov/sites/default/files/press-releases/2012/NP%20Leadership%20Committee%20Report%20%282-16-12%29.pdf>