

Prof. Evelyn Brody  
Mon. & Wed., 10:10 – 11:35 a.m.

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**NONPROFIT LAW**  
**255-01**  
**COURSE SYLLABUS: FALL 2014**

**Course Coverage:**

This is a course in the legal issues raised in governing a nonprofit organization, primarily a charity. (As used in the law, the term “charity” is much broader than social service entities, including such institutions as hospitals, colleges, museums, environmental advocacy groups, and churches.) We will focus on the appropriate considerations of State corporate and trust law and Federal tax law, as well as some State tax issues and Federal election law issues if we have time. We will also study First Amendment protections relating to association and charitable solicitation. In our coverage of the governing board’s fiduciary duties, you will learn how to read nonprofit financial statements. More general legal issues implicated in running a nonprofit, such as employment law and torts, are generally beyond the scope of this course.

**Class Assignments:**

Because the law in this area is so rapidly evolving, both in prescription and practice, we will rely heavily on works-in-progress and materials available on the Web. (This Syllabus is current as of July 30, 2014.) Initially, you need:

1. My photocopied set of **SUPPLEMENTAL MATERIAL** (authorities, forms, commentary, and news stories), numbered by Assignment.

Note: You can access the assigned **Internal Revenue Code** sections either by reading the Supplementary Material, which begins with excerpts (“**Code & Regs**”), or by clicking the following link from the IRS, for a searchable Title 26, Internal Revenue Code (on the Cornell website): <http://www.irs.gov/taxpros/article/0,,id=98137,00.html>.

From that IRS link, you can also get **Treasury Regulations and other authorities**.

2. **ALI Nonprofit Principles Draft:** We will read selections from drafts I prepared as Reporter for the American Law Institute’s project on Principles of the Law of Charitable Nonprofit Organizations. Current versions of all the draft chapters will be on library Reserve; the four Tentative Drafts are also on Westlaw and LEXIS.

3. **Course Website:** This Syllabus is current as of June \_\_, 2014. I might post additional material at <http://www.kentlaw.iit.edu/current-students/online-course-materials>. The Course

Webpage also has this Syllabus, with its hot links. Major sources are:

<http://www.irs.gov/Charities-&-Non-Profits> (for all types of tax-exempt organizations)

<http://www.charitygovernance.com> (for events through mid-2011; maintained by Jack Siegel)

[http://www.cyberdriveillinois.com/departments/business\\_services/business\\_not-for-profit/home.html](http://www.cyberdriveillinois.com/departments/business_services/business_not-for-profit/home.html) (Illinois Secretary of State; click on “Business Organization Acts” to get to “Nonprofit Corporations” – really!)

<http://illinoisattorneygeneral.gov/charities/index.html> (Ill. Attorney General, Charities Division)

[http://www.law.columbia.edu/center\\_program/ag/policy/CharitiesProj](http://www.law.columbia.edu/center_program/ag/policy/CharitiesProj) (Columbia Law School)

<http://philanthropy.com/section/Todays-News/284/> (links to news stories on nonprofits)

<http://www.guidestar.org> (recently filed IRS Form 990s for charities) – visit frequently!  
Forms 990 back to 2003 are available from Economic Research Institute at:

<http://www.eri-nonprofit-salaries.com/index.cfm?FuseAction=NPO.Search&trkid=292-49>

<http://lawprofessors.typepad.com/nonprofit/> (academics’ commentary on current developments)

<http://www.charitygovernance.com> (Jack Siegel’s blog; active through mid-2011)

<http://ncpl.law.nyu.edu/ncplsearch> (National Center on Philanthropy and the Law, NYU School of Law – excellent searchable bibliography)

### **Buddy System and Assignments, Attendance, Preparation, Exam, and Grade:**

To make preparing for class more effective, you must form into groups of two or three. Let me know who your co-counsel are (if you wish, see me and I’ll pair you off). Your group should meet regularly to discuss the material. **Starting with our second class, your group must SUBMIT 2 or 3 BRIEF COMMENTS OR QUESTIONS (no answers required!) about the assignment, no later than one hour before EACH CLASS** – these will help the class discussion.

**The grade will be based primarily on your exam.** (The 3-hour exam will be completely open-book; for more info, see the end of this Syllabus.) **I reserve the right to bump up your grade one notch for consistently good questions and to bump down your grade if you consistently neglect to send in questions. Separately, I reserve the right to increase your grade one notch for productive class participation. You may take this course pass/fail.**

Get organized; *keep up*; and contact me with questions (preferably with your co-counsel). If you’re unprepared, at least come to class, but please let me know.

## **LEGAL LANDSCAPE FOR NONPROFIT ORGANIZATIONS**

### **1. Overview of the Legal Landscape for Nonprofit Organizations**

As you try to get your hands around “the nonprofit sector,” think about whether the concept of three sectors (government, business, and nonprofit) makes sense. Who has done and does more “good” – the Gates Foundation or Microsoft? (Steve Jobs never saw the social need to focus his efforts on organized philanthropy as opposed to Apple.)

Supp.: For an idea of what we can readily learn about a charity, skim the excerpts from the Feed the Children’s 2009 Form 990 (the Core Form and relevant portions of Schedule O (explanations)). Note that Feed the Children has since cleaned up these governance issues that we will examine later!

Web: Table III from the Joint Committee report describing federal law on tax-exempt organization (JCX-53-07, July 19, 2007), at pp. 33-34 of <http://www.jct.gov/publications.html?func=startdown&id=1411>).

For statistical information drawn from federal tax filings, see <http://www.urban.org/UploadedPDF/412674-The-Nonprofit-Sector-in-Brief.pdf>. For data on Illinois charities, go to: <http://nccsdataweb.urban.org/PubApps/profileDrillDown.php?state=IL&rpt=RPC>

When you hear “charity,” do you think “redistribution”? See <http://www.washingtonpost.com/blogs/wonkblog/wp/2013/05/30/only-a-third-of-charitable-contributions-go-the-poor/>.

See the chart of 50 largest charities (by revenue), at <http://www.csmonitor.com/Business/Guide-to-Giving/America-s-Top-50-charities-How-well-do-they-rate>.

Read Put Barber, “Five Tips and a Warning” – particularly the warning – at <http://nccsdataweb.urban.org/PubApps/nonprofitfaq.php?i=520&c=21>. Much other advice is available from a long list at <http://nccsdataweb.urban.org/PubApps/nonprofitfaq.php>.

Does the world needs a new charity to respond to every problem (think Superstorm Sandy, the Newtown shootings, the Boston Marathon bombings)? See <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Disaster-Relief-Resources-for-Charities-and-Contributors>.

## 2. Nonprofit Associations as Expressive Activity: Constitutional and Policy Issues

Supp.: *State ex Rel. Grant v. Brown*, 313 N.E.2d 847 (Ohio 1974), and *Association for the Preservation of Freedom of Choice v. Shapiro*, 174 N.E.2d 487 (N.Y. 1961); excerpts from *Boy Scouts of America v. Dale*, 530 U.S. 640 (2000), and April 2014 news stories.

Web: For info on the Boy Scouts of America, see: May 2013 changes to membership requirements, distinguishing between gay members (OK) and gay adult leaders (not [yet?] OK), at <http://www.scouting.org/sitecore/content/MembershipStandards/Resolution/FAQ.aspx>; news story on corporate versus religious sponsors at [http://www.washingtonpost.com/local/boy-scouts-shift-on-gay-youth-ban/2013/06/01/c99d6312-c87b-11e2-9f1a-1a7cdee20287\\_story.html?hpid=z1](http://www.washingtonpost.com/local/boy-scouts-shift-on-gay-youth-ban/2013/06/01/c99d6312-c87b-11e2-9f1a-1a7cdee20287_story.html?hpid=z1); letter expelling Seattle troop at end of posting at <http://www.glaad.org/blog/boy-scouts-toss-out-church-over-gay-scoutmaster#letter>.

For fallout from Susan B. Komen Foundation's (subsequently reversed) decision to stop funding Planned Parenthood, see <http://www.npr.org/blogs/health/2012/06/01/154135526/planned-parenthood-controversy-hangs-over-komens-fundraising-races>; and [http://www.washingtonpost.com/national/health-science/komen-cancels-3-day-walk-in-dc-six-other-cities-in-2014/2013/06/04/df9b50dc-cd4b-11e2-9f1a-1a7cdee20287\\_story.html?hpid=z3](http://www.washingtonpost.com/national/health-science/komen-cancels-3-day-walk-in-dc-six-other-cities-in-2014/2013/06/04/df9b50dc-cd4b-11e2-9f1a-1a7cdee20287_story.html?hpid=z3). For recommendations on how charity leaders can avoid "getting Komened," see Michael Peregrine's piece at <http://www.mwe.com/files/Publication/36e00978-7eea-411f-9a09-3f76dc7a53f8/Presentation/PublicationAttachment/80853d9d-04b0-4704-8948-438a8ef115d5/Steps-Charity-Leaders-Can-Take.pdf>

As the Boy Scouts case illustrates, "federated" charities suffer particular associational issues, such as when a church schisms and a dispute arises over property ownership.

If you're interested, see the application of state franchise law in *Girl Scouts of Manitou Council, Inc. v. Girl Scouts of America*, 646 F.3d 983 (7th Cir. 2011), and commentary at [http://www.nixonpeabody.com/linked\\_media/publications/Nonprofit\\_Alert\\_06\\_08\\_2011.pdf](http://www.nixonpeabody.com/linked_media/publications/Nonprofit_Alert_06_08_2011.pdf). Judge Posner asked "what's the difference between the Girl Scouts and Dunkin' Donuts?!"

### **3. Charitable and Nonprofit Purposes**

Web: Read Article 3 (Purposes and Powers) in the Illinois Not-for-Profit Corporation Act, available on the Secretary of State's website (go to [http://www.cyberdriveillinois.com/departments/business\\_services/incorporation/nfp\\_instructions.html](http://www.cyberdriveillinois.com/departments/business_services/incorporation/nfp_instructions.html) and click "list of the purposes" for 805 ILCS 105 / General Not-for-Profit Corporation Act of 1986).

For a preview of many issues, see <http://nypost.com/2014/06/02/nycs-top-nonprofit-hospitals-spend-little-on-care-for-uninsured/>.

Supp.: *Marsh v. Frost National Bank*, 129 S.W.3d 174 (Tex. App. 2004).

*Illegal purposes and purposes against public policy:*

*Jackson v. Phillips* (Mass. 1867), construing the bequests of a testator who died in 1861, upheld as charitable a trust to advocate for emancipation and to support fugitive slaves. The court acknowledged: "Gifts for purposes prohibited by or opposed to the existing laws cannot be upheld as charitable, even if for objects which would otherwise be deemed such." The court then famously declared:

"A charity, in the legal sense, may be more fully defined as a gift, to be applied consistently with existing laws, for the benefit of an indefinite number of persons, either by bringing their minds or hearts under the influence of education or religion, by relieving their bodies from disease, suffering or constraint, by assisting them to establish themselves in life, or by erecting or maintaining public buildings or works or otherwise lessening the burdens of government."

Here: "The manner stated of putting an end to slavery is not by legislation or political action, but by creating a public sentiment, which rather points to moral influence and voluntary manumission. . . . Giving to the bequest that favorable construction to which all charitable gifts are entitled, the just inference is that lawful means only are to be selected, and that they are to be used in a lawful manner." The court also saved the purpose of aiding fugitive slaves: "To supply sick or destitute fugitive slaves with food and clothing, medicine and shelter, or to extinguish by purchase the claims of those asserting a right to their service and labor, would in no wise have tended to impair the claim of the latter or the operation of the Constitution and laws of the United States; and would clearly have been within the terms of this bequest." However, the court also ruled: "It is quite clear that the bequest in trust to be expended 'to secure the passage of laws granting women, whether married or unmarried, the right to vote, to hold office, to hold, manage and devise property, and all other civil rights enjoyed by men,' cannot be sustained as a charity."

Web.: Denial letters for pro-polygamy organizations:  
IRS Determination Letter 2013-23-025, at <http://www.irs.gov/pub/irs-wd/1323025.pdf>; and Determination

Letter 2013-25-015 at <http://www.irs.gov/pub/irs-wd/1325015.pdf>.

Note: We also consider the definition of charity for purposes of federal tax-exemption in **Assignment 4**, and focus on other aspects of tax exemption throughout the semester.

Case Law: Skim *Bob Jones University v. U.S.*, 461 U.S. 574 (1983), and especially Powell's famous concurrence.

Note: Bob Jones III apologized for and announced a change in Bob Jones University's racial policy in 2000 (see <http://www.bju.edu/communities/ministries-schools/position-statements/race-statement.php>), but the university still has not obtained (sought?) federal tax exemption. It does, though, have charitable affiliates, notably a museum and scholarship funds, to which deductible contributions may be made (see <http://bjugiving.giftlegacy.com/?pageID=1003>).

Web: [We examine the federal tax requirements for charity more thoroughly in **Assignment 4** (see particularly the ruling on Project Veritas).]

As to terrorism, Treasury regulations (at 31 CFR § 594.409) explain: "Unless specifically authorized by the Office of Foreign Assets Control pursuant to this part, no charitable contribution or donation of funds, goods, services, or technology, including contributions or donations to relieve human suffering, such as food, clothing, or medicine, may be made by, to, or for the benefit of, or received from, any person whose property and interests in property are blocked. . . ." See the Ford Foundation's grant-making policy, at <http://www.fordfoundation.org/pdfs/grants/grant-application-guide.pdf>. If you're interested in an unusual criminal conviction, based on a false tax-exemption application and Forms 990, see *U.S. v. Mubayyid*, 658 F.3d 35 (1st Cir. 2011).

See Determination Letter 2010-33-039 (school lacking an adequate racial nondiscrimination policy), at <http://www.irs.gov/pub/irs-wd/1033039.pdf>.

Read the IRS's denial of § 501(c)(3) status to a social networking site, Determination Letter 201125045 (March 30, 2011, released June 24, 2011), at <http://www.irs.gov/pub/irs-wd/1125045.pdf>.

Read the IRS's denial of (c)(3) status to a synagogue, Determination Letter 201325017 (March 28, 2014, released June 24, 2013), available at <http://www.irs.gov/pub/irs-wd/1325017.pdf>.

#### 4. Federal Tax Exemption: Basic I.R.C. § 501(c)(3) Requirements

Code&Regs: Internal Revenue Code § 501(c), particularly subsection (3); and Treas. Reg. § 1.501(c)(3)-1(a), (b), (c) & (d).

Web: On the IRS's website, explore <http://www.irs.gov/Charities-&-Non-Profits/Charitable-Organizations/Life-Cycle-of-a-Public-Charity>. Here you will find links to the application form, Form 1023 and the new 1023-EZ (covered in **Assignment 24**); annual information returns (Forms 990, 990-EZ, and 990-PF). Also take a look at Forms 990-T (Unrelated Business Income Tax) (which we cover in **Assignment 23**) and 1120-POL (we cover political activity in **Assignment 22**), as well as Form 8283 (covered in **Assignment 18**). See also **Assignment 14**, where we'll focus on the governance questions on the Form 990 redesigned in 2008.

Go to <http://www.irs.gov/pub/irs-pdf/p4220.pdf> for the IRS's July 2014 publication "Applying for 501(c)(3) Tax-Exempt Status." A flowchart is at: [http://www.irs.gov/pub/irs-tege/eo\\_determ\\_process080409.pdf](http://www.irs.gov/pub/irs-tege/eo_determ_process080409.pdf). Skim the compliance guide that the IRS sends to successful charities (a separate one is prepared for private foundations), at <http://www.irs.gov/pub/irs-pdf/p4221pc.pdf>; the guide for exempt orgs other than charities is at <http://www.irs.gov/pub/irs-pdf/p4221nc.pdf>.

**Much more interesting, though – and the way we'll proceed in class – is to explore an actual exemption application.** Reportedly because of a FOIA request, the IRS released the documents relating to the successful application of Project Veritas (self-described muckraking journalist James O'Keefe's group); go to <https://www.documentcloud.org/documents/96774-project-veritas.html> (a PDF is at <https://s3.amazonaws.com/s3.documentcloud.org/documents/96774/project-veritas.pdf>).

For information on hundreds of thousands of automatic revocations (starting in 2011) for failure to file a Form 990-N (the "e-Postcard"), as required by 2006 legislation, go to <http://www.irs.gov/Charities-&-Non-Profits/Automatic-Revocation-of-Exemption>.

Supp.: Does the IRS too readily grant (c)(3) exemption? (But see complaints about delayed exemption determinations, covered in **Assignment 22**, at <http://www.reuters.com/article/2013/06/03/us-usa-irs-applications-insight-idUSBRE95210L20130603>.) And I'll explain what's happening in *Z Street v. Koskinen*, available at [https://ecf.dcd.uscourts.gov/cgi-bin/show\\_public\\_doc?2012cv0401-49](https://ecf.dcd.uscourts.gov/cgi-bin/show_public_doc?2012cv0401-49).

For criticism of the exemption process, see Streckfus in the Supplement. **Assignment 24** looks at the new Form 1023-EZ for small charities.

**5. The Corporate Form: Registration and Reporting.**

Supp.: For an overview, skim the ABA-Tax EO Committee checklist for small charities (also available at <http://meetings.abanet.org/meeting/tax/MID14/media/eo-small-carter-supp.pdf>) -- and return to this as we go through the semester.

Note: We look at sample organizational documents in Assignment 6.

Web: Go to the Charities Bureau on the Illinois Attorney General's website, at <http://illinoisattorneygeneral.gov/charities/index.html>.

Read: (1) FAQs;  
(2) Filing Requirements;  
(3) Registration and Annual Report Forms;  
(4) Rules and Statutes (just skim the Charitable Trust Act; recall from **Assignment 3** that the Not-for-Profit Corporation Act is on the Secretary of State's website);  
(5) Forming a Charitable Organization;  
(6) Volunteer Board Members of Illinois Not-for-Profit Orgs.

Go to the Secretary of State's website at [http://www.cyberdriveillinois.com/departments/business\\_services/business\\_not-for-profit/home.html](http://www.cyberdriveillinois.com/departments/business_services/business_not-for-profit/home.html), and click "Business Organizations Acts" – Nonprofit Corporations are the second category. Click on General Not-for-Profit Corporation Act and read the Illinois requirements for the articles of incorporation. For publications, go to [www.cyberdriveillinois.com/publications/business\\_services/nfp.html](http://www.cyberdriveillinois.com/publications/business_services/nfp.html), and read "Articles of Incorporation," "A Guide for Organizing Not-for-Profit Corporations, and "Not-for-Profit Annual Report."

For Massachusetts' database of regulated charities (with a homepage sidebar of links for One Fund Boston, created after the Boston Marathon bombings), go to <http://www.mass.gov/ago/doing-business-in-massachusetts/public-charities-or-not-for-profits/public-charities-annual-filings/public-charities-annual-filings.html>.

**6. Organizational Form: Comparing Charitable Trusts and Nonprofit Corporations**

- Statute: Read Article 8 (Directors and Officers) in the Illinois Not-for-Profit Corporation Act, available at <http://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=2280&ChapterID=65>
- Case Law: *Oberly v. Kirby*, 592 A.2d 445 (1991).
- Supp: For analysis of the ALI project and the Model Nonprofit Corporation Act, Third Edition (2008), see excerpts from Brody, “The Ambitions And Limitations of U.S. Nonprofit Law Reform Projects” (2012), at 537-48. Note that we will spend time in future classes addressing in detail many of the issues raised in my article.
- Web: Take advantage of the Ford Foundation’s laudable amount of disclosure (at <http://www.fordfoundation.org/about-us/governance>), and explore the links to the Foundation’s Charter/Articles of Incorporation, Bylaws, Committee Charters and Membership, and procedures for the receipt, retention and treatment of complaints regarding accounting, internal accounting controls, and auditing matters.

## GOVERNANCE: STATE FIDUCIARY LAW AND FEDERAL TAX RULES

### 7. Fiduciary Duties in General

Statute: Look again (from Assignment 7) at Article 8 (Directors and Officers) in the Illinois Not-for-Profit Corporation Act, available at <http://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=2280&ChapterID=65> -- nothing on fiduciary duties generally!

Case Law: *Stern v. Lucy Webb Hayes National Training School*, 381 F. Supp. 1003 (D.D.C. 1974) (known popularly as the “Sibley Hospital Case”).

Supp.: ALI, excerpts from draft §§ 300, 315, and 320.

Web: Read the recommendations of a governance review conducted for the Clinton Foundation:  
[http://www.clintonfoundation.org/assets/images/blog/2013/08\\_Aug/Publiched%20Results%20from%20Corporate%20Review.pdf](http://www.clintonfoundation.org/assets/images/blog/2013/08_Aug/Publiched%20Results%20from%20Corporate%20Review.pdf). Note that we will return to the issues raised here in later classes.

See Michael Wyland’s criticisms of the governance portion of the Freeh report on Penn State (regarding the Sandusky scandal) at <http://www.nonprofitquarterly.org/governancevoice/20779-freeh-report-on-penn-state-provides-little-guidance-on-nonprofit-governance.html>. (The Freeh report and other material are also available at <http://progress.psu.edu/the-freeh-report>.) For an uncomfortable story about Penn State’s general counsel, see [http://articles.philly.com/2012-07-26/news/32849268\\_1\\_grand-jury-jerry-sandusky-sandusky-investigation](http://articles.philly.com/2012-07-26/news/32849268_1_grand-jury-jerry-sandusky-sandusky-investigation). If you’re interested in the latest, in June the Pennsylvania attorney general released a 339-page report how Penn State hindered its work by withholding requested records for a year:  
[http://filesource.abacast.com/commonwealthofpa/mp4\\_podcast/2014\\_06\\_23\\_REPORT\\_to\\_AG\\_ON\\_THE\\_SANDUSKY\\_INVESTIGATION.pdf](http://filesource.abacast.com/commonwealthofpa/mp4_podcast/2014_06_23_REPORT_to_AG_ON_THE_SANDUSKY_INVESTIGATION.pdf).

## **8. Exploring the Duty of Loyalty: Conflicts of Interest**

- Statute: In Article 8 (Directors and Officers) in the Illinois Not-for-Profit Corporation Act, available at <http://www.ilga.gov/legislation/ilcs/ilcs3.asp?ActID=2280&ChapterID=65>, read § 108.05(c) (compensation), § 10.60 (director conflict of interest), and § 108.80 (prohibited loans).
- Supp.: Rosenthal, *Lessons from the Report to the Board of Regents of the Smithsonian Institution* and materials (also available, with a 2009 GAO report, under “About the Board – Other Reading – Governance” at [www.si.edu/governance](http://www.si.edu/governance)); Donovan, *Heads of Big Nonprofits Won 3% Raises Last Year*.
- Web: Ostrower’s 2007 *Findings on Financial Transactions between Nonprofits and Board Members*, at pages 7-11 of [http://www.urban.org/UploadedPDF/411479\\_Nonprofit\\_Governance.pdf](http://www.urban.org/UploadedPDF/411479_Nonprofit_Governance.pdf). Continue exploring the Ford Foundation’s website – at <http://www.fordfoundation.org/about-us/governance> – specifically, its Standards of Independence, Trustee Code of Ethics, Staff Code of Conduct and Ethics, and Procedures for Approving Affiliated Grants.

For the Massachusetts AG’s lengthy December 2013 nonprofit compensation report, go to <http://www.mass.gov/ago/news-and-updates/press-releases/2013/2013-12-19-nonprofit-ceo-comp.html> (she unsuccessfully has been trying to obtain legislation to disallow or limit board pay). In 2012, New York Governor Andrew Cuomo issued an executive order that, among other things, placed a \$199,000 limit on the amount of state money that can be used to pay executives of nonprofits with state contracts. (Other states, including Illinois, are also considering compensation limits on charities that receive a minimum of state contracts or other funding.) Conflicting New York court decisions put into question the validity of this executive action. See <http://executiveorder38.ny.gov> (headed by the following “Legal Notice”: “Based upon the April 8, 2014 decision in *Agencies for Children’s Therapy Services, Inc. v. New York State Department of Health, et al.* (“ACTS”), covered providers conducting business in Nassau County need not file Executive Order 38 disclosures. . . . Please note that the ACTS decision is under appeal. Those affected by the ACTS’ decision should periodically check the EO 38 website for updates regarding any changes to this notice.”).

If you’re interested, see Boyd, *Lawyers’ Service on Nonprofit Boards: Managing the Risks of an Important Community Activity*, available at: <http://apps.americanbar.org/buslaw/blt/2008-11-12/boyd.shtml>.

## 9. Federal Tax Prohibitions on Private “Inurement”

(Note: This *Assignment 9* could take up to two classes.)

For context:

Supp.: The *Chronicle of Philanthropy*'s 2012 report on executive compensation – see particularly p. 9-5 (“No secrets anymore,” referring to the publication of 990s on GuideStar).

Web: Read [http://www.washingtonpost.com/investigations/inside-the-hidden-world-of-thefts-scams-and-phantom-purchases-at-the-nations-nonprofits/2013/10/26/825a82ca-0c26-11e3-9941-6711ed662e71\\_story.html](http://www.washingtonpost.com/investigations/inside-the-hidden-world-of-thefts-scams-and-phantom-purchases-at-the-nations-nonprofits/2013/10/26/825a82ca-0c26-11e3-9941-6711ed662e71_story.html) and [http://www.washingtonpost.com/investigations/nonprofit-groups-often-seek-restitution-not-prosecution-when-money-goes-missing/2013/11/23/d7b7ba18-51f8-11e3-9e2c-e1d01116fd98\\_story.html](http://www.washingtonpost.com/investigations/nonprofit-groups-often-seek-restitution-not-prosecution-when-money-goes-missing/2013/11/23/d7b7ba18-51f8-11e3-9e2c-e1d01116fd98_story.html). Note: While these diversions violate state law as well as federal tax law, it's the redesigned Form 990 that surfaces the issues.

Supp.: Fred Stokeld, *Lawmakers React to Charities' Disclosure of Asset Diversions*.

### Private Inurement and Private Benefit:

Code&Regs: See Treas. Reg. § 1.501(c)(3)-1(c)(2) and -1(d)(1)(ii) & (iii) (private benefit prohibition); compare I.R.C. § 4958, which we'll focus on next.

Web: *Rameses School v. Commissioner* (just skim the burden of proof), at <http://www.ustaxcourt.gov/InOpHistoric/Rameses.TCM.WPD.pdf>.

### Intermediate Sanctions:

Code&Regs: I.R.C. § 4958 and Treas. Reg. § 53.4958-3 (defining disqualified persons), and -6 (rebuttable presumption of reasonableness).

Web: Consulting companies provide compensation studies; also, Economic Research Institute for a fee prepares salary surveys based on comparables, as explained at <http://www.eri-nonprofit-salaries.com/index.cfm>).

The American Academy of Arts and Sciences self-declared an excess benefit: <http://lawprofessors.typepad.com/nonprofit/2014/04/american-academy-of-arts-and-sciences-self-reports-excess-benefit-transaction-after-internal-investi.html> -- see the Academy's letter to its members at <http://s3.documentcloud.org/documents/1099713/letter-to-fellows-1.pdf> and the internal report at <http://s3.documentcloud.org/documents/1099705/academy-report.pdf> (focus on the part about the improper setting of compensation). For the Boston Globe's take, see

<http://www.bostonglobe.com/metro/2014/03/31/american-academy-arts-sciences-releases-critical-report-former-president/GtIvJkEf95aVfk7nU96pdN/story.html>

“Grassley Seeks to End Reasonable Compensation Safe Harbor.” See ASAE’s letter to Senator Grassley, at <http://www.asaecenter.org/files/FileDownloads/PublicPolicy/Comments%20on%20Grassley%20HC%20Amendments%209%2D23%2D09.pdf>.

Interaction Between § 501(c)(3) and § 4958:

Regs:           Treas. Reg. § 1.501(c)(3)-1(f), in Code & Regs in Supp.

Web:            PLR 2011-15-025 (revoking exemption of a scholarship organization on grounds it was a sham and operated for the benefit of its president and wife; also held them liable for both the 25% and 200% excess benefits tax), at <http://www.irs.gov/pub/irs-wd/1115025.pdf>.

## 10. Understanding Nonprofit Financial Statements

(Jack Siegel will guest teach this – I'll let you know if he wants different or additional reading.)

Web: See the Art Institute of Chicago's 2012 audited financial statements at:  
[http://www.artic.edu/sites/default/files/fy12\\_fs\\_0.pdf](http://www.artic.edu/sites/default/files/fy12_fs_0.pdf).

See Jack Siegel's "Ten Financial Controls that Every Charity Should Put in Place":

[www.charitygovernance.com/charity\\_governance/2007/10/ten-financial-c.html](http://www.charitygovernance.com/charity_governance/2007/10/ten-financial-c.html)

For analysis of the *Washington Post* findings on diversions (see Assignment 9), read Venable's March 2014 report "Preventing and Investigating Fraud, Embezzlement, and Charitable Asset Diversion: What's a Nonprofit Board to Do?," available at:

[http://www.venable.com/files/Publication/a69bda9f-8e55-4159-8799-c1284907f747/Preview/PublicationAttachment/8cd05325-15a0-4989-94e8-4136a8f0efb1/Preventing\\_and\\_Investigating\\_Fraud\\_Embezzlement\\_and\\_Charitable\\_Asset\\_Diversion.pdf](http://www.venable.com/files/Publication/a69bda9f-8e55-4159-8799-c1284907f747/Preview/PublicationAttachment/8cd05325-15a0-4989-94e8-4136a8f0efb1/Preventing_and_Investigating_Fraud_Embezzlement_and_Charitable_Asset_Diversion.pdf) and its February 2014 PowerPoint at:  
[http://www.venable.com/files/Publication/42016899-f04d-433b-80e1-079d2758d31a/Presentation/PublicationAttachment/e4918006-664f-4296-9454-0d0ee116c214/Safeguarding\\_Your\\_Nonprofit\\_against\\_Fraud\\_and\\_Embezzlement\\_Best\\_Practices\\_Common\\_Pitf.pdf](http://www.venable.com/files/Publication/42016899-f04d-433b-80e1-079d2758d31a/Presentation/PublicationAttachment/e4918006-664f-4296-9454-0d0ee116c214/Safeguarding_Your_Nonprofit_against_Fraud_and_Embezzlement_Best_Practices_Common_Pitf.pdf).

NOTE: Contracts with funders (governmental or private, such as from foundations) can be the source of additional financial "regulation." Government funding, in particular, can result in an audit of the use of the funds. In 2013 the Justice Department froze over \$19 million in funding to Big Brothers Big Sisters of America. This audit, available at <http://www.justice.gov/oig/reports/2013/g7013006.pdf>, concluded: "BBBSA (1) did not adequately safeguard grant funds; (2) did not adequately monitor subrecipients or require subrecipients to support the grant funds received and expended; (3) charged unsupported and unallowable expenditures to the grant; (4) did not compute indirect costs based on its approved agreement; (5) did not adequately monitor consultants; (6) did not base its drawdown of funds on actual expenditures; (7) did not monitor actual spending against the approved budget; (8) did not properly safeguard accountable property acquired with grant funding; (9) did not prepare Federal Financial Reports based on actual expenditures; and (10) generated program income which was not properly reported."

**11. Exploring the Duty of Care: Delegation vs. Abdication; Investments**

*(Please start on Assignment 12, too.)*

*(Note: This class also provides a preview of the Assignment 13, enforcement and sanctions.)*

Supp.: Endowment values have recently recovered, but it was scary! Read stories from the Chronicle of Philanthropy's 2012 endowment survey; "Harvard Ignored Warnings About Investments."

Web: For info on Harvard's \$32.7 billion (!) endowment for fiscal year ending June 30, 2013, see the Harvard Management Co.'s press release at go to: [http://www.hmc.harvard.edu/docs/Final\\_Annual\\_Report\\_2013.pdf](http://www.hmc.harvard.edu/docs/Final_Annual_Report_2013.pdf). (And what's with Harvard's announcement in September 2013 of a \$6.5 billion capital campaign – besting Stanford's recently completed, and record-setting, \$6.2 billion drive?!)

For the Oregon AG's \$2 million victory for poor trustee investing, see [http://www.doj.state.or.us/releases/pdf/wintercross\\_ruling.pdf](http://www.doj.state.or.us/releases/pdf/wintercross_ruling.pdf).

Siegel on charities that invested with Bernie Madoff:

[http://www.charitygovernance.com/charity\\_governance/madoff](http://www.charitygovernance.com/charity_governance/madoff) -- especially [http://www.charitygovernance.com/charity\\_governance/2009/04/yeshiva-university-get-religion.html](http://www.charitygovernance.com/charity_governance/2009/04/yeshiva-university-get-religion.html) (be sure to click the link at the end to the heavily-redacted draft board minutes). The NY attorney general won a \$410 million civil settlement with the conflicted Yeshiva investment committee chair; go to <http://www.ag.ny.gov/press-release/federal-court-rules-ag-schneidermans-410-million-merkin-settlement-may-proceed> (April 16, 2013).

For Rick Cohen's take on the *Washington Post* reporting (see Assignments 9 and 10) – that the real scandal is nonprofits' propensity to fall for investment scams – go to <http://www.nonprofitquarterly.org/policysocial-context/23209-the-wapo-diversions-story-part-ii-preying-on-nonprofits.html>.

**12. Limitations on Fiduciary Monetary Liability;  
Board or Board Member Enforcement of Fiduciary Duties**

*(This Assignment 12 will take less than one class, and also provides a preview of the Assignment 13, enforcement and sanctions.)*

Supp.: ALI draft Intro Note to Chap. 3, Topic 2; § 370 (Limitations on Monetary Liability for Breach).

News story on Schlinger Foundation; news story on Metropolitan Council on Jewish Poverty.

Web: Compare the whistleblower policies of the American Cancer Society (go to <http://www.cancer.org/AboutUs/WhoWeAre/Governance/report-fraud-or-abuse>) and (particularly the last paragraph!) of Beth Israel Deaconess Medical Center (go to <http://www.bidmc.org/Centers-and-Departments/Departments/Patient-And-Family-Care-Services/Office-of-Business-Conduct.aspx>).

Case Law: *John v. John*, 450 N.W.2d 795 (Wis. App. 1989).

### 13. State Enforcement of Fiduciary Duties and Sanctions for Breach

(See also *Assignments 11 and 12.*)

Web: Former Independence Seaport Museum president, John Carter, was sentenced to 15 years for looting the museum (see <http://www.justice.gov/usao/pae/News/2007/nov/cartersentencing.pdf>) – and, in particular, read his amazing pre-sentencing letter, at <http://media.philly.com/documents/CARTER21.pdf>. Former state senate leader Fumo was convicted for defrauding the museum; if interested, see *U.S. v. Fumo*, 2009 U.S. Dist. LEXIS 51581 (E.D. Pa. 2009).

Explore news stories on actions by state attorneys general at [http://www.law.columbia.edu/center\\_program/ag/policy/CharitiesProj/resources/charitiespubl/charitiesnews](http://www.law.columbia.edu/center_program/ag/policy/CharitiesProj/resources/charitiespubl/charitiesnews). This project's website also has links to state AG websites and other material. A few recent examples:

A 2012 settlement between the Montana AG and the board of the Montana-based (but Delaware-incorporated) Central Asia Institute and its founder, Greg Mortenson (author of *Three Cups of Tea*) calls for him to pay \$1 million in restitution, and for governance changes including replacing the whole board and expanding their number (from 3 to 7) and hiring a new chief executive. (The AG consulted with the Delaware AG.) Go to [https://files.doj.mt.gov/wp-content/uploads/2012\\_0405\\_FINAL-REPORT-FOR-DISTRIBUTION.pdf](https://files.doj.mt.gov/wp-content/uploads/2012_0405_FINAL-REPORT-FOR-DISTRIBUTION.pdf).

In 2013, the NY AG concluded a large settlement, announced here: <http://www.ag.ny.gov/press-release/ag-schneiderman-secures-77-million-settlement-pearson-charitable-foundation-support>. See the settlement agreement at: [http://www.ag.ny.gov/pdfs/Pearson\\_Executed\\_AOD.pdf](http://www.ag.ny.gov/pdfs/Pearson_Executed_AOD.pdf)

In Illinois, see *Madigan v. Maxwell Manor*, 2013 Ill. App. Unpub. LEXIS 2978 (Ill. App. Dec. 31, 2013) (unreported), available at [http://www.state.il.us/court/R23\\_Orders/AppellateCourt/2013/1stDistrict/1113132\\_R23.pdf](http://www.state.il.us/court/R23_Orders/AppellateCourt/2013/1stDistrict/1113132_R23.pdf).

As described in the court's summary:

The court affirmed summary judgment in favor of the Attorney General and against a charitable nursing home and its officers and directors in an action for violations of the Illinois Charitable Trust Act for failing to maintain registration, failing to file annual reports, and failing to file an accounting for sale of the nursing home, as well as for breach of fiduciary duties for these failures. The court also affirmed a grant of partial summary judgment in the amount of \$2,000,000 and a subsequent full grant of summary judgment against the former director for breach of fiduciary duty under section 15 of the Act, misuse of charitable assets

intentionally and in breach of fiduciary duty with malice under section 16, and intentional breach of fiduciary duty in intentionally disbursing charitable funds to be used for personal benefit with malice and without lawful authority under section 17 – her affidavit stating that the money taken was for repayment of loans she made to the organization was self-serving and conclusory.

Mass. AG investigation: <http://www.mass.gov/ago/news-and-updates/press-releases/2014/2014-04-23-national-graduate-school-of-quality-management.html>.

This press release has links to two documents: the assurance of discontinuance (settlement) with the board at <http://www.mass.gov/ago/docs/press/2014/ngs-aod.pdf> and the complaint against the former president for excessive compensation at <http://www.mass.gov/ago/docs/press/2014/ngs-complaint.pdf>.

\* \* \*

Finally, we'll talk about the Uniform Law Commission's Model Protection of Charitable Assets Act (adopted July 2011; enacted in 2014 in Hawaii and Maryland, but not introduced in any other state), available at <http://www.uniformlaws.org/Committee.aspx?title=Protection%20of%20Charitable%20Assets%20Act>. Skim the 2011 approved text (with comments); if you're interested, see reporter Laura Chisolm's 12/18/09 background memo.

#### 14. Role of IRS in Charity Governance

Supp: Material relating to the IRS's 2008 redesign of the Form 990 – including, for comparison with the final Form 990 that you have in **Assignment 1**, the summary page and the governance page of the 2007 draft. ALI excerpts from draft § 130 (on federalism).

**“Unconstitutional conditions” doctrine:** In **Assignment 22**, we will look at the constitutional limits on political activity that Congress can impose as a condition of tax-exemption. Are there generally limits on the IRS's ability to oversee charities' governance practices? Compare, in a non-tax context, *Agency for International Development v. Alliance for Open Society International, Inc.* (June 20, 2013), at [http://www.supremecourt.gov/opinions/12pdf/12-10\\_21p3.pdf](http://www.supremecourt.gov/opinions/12pdf/12-10_21p3.pdf), dealing with a Bush-era statute on federal funding of a worldwide anti-HIV/AIDS program. The statute stated that no funds may be used (1) “to promote or advocate the legalization or practice of prostitution” (2) by an organization “that does not have a policy explicitly opposing prostitution.” The Supreme Court struck down the latter requirement under the First Amendment because it compelled as a condition of federal funding the affirmation of a belief beyond the scope of the program.

Web: IRS's webpage on governance of charitable organizations is at <http://www.irs.gov/Charities-&-Non-Profits/Governance-of-Charitable-Organizations-and-Related-Topics>, with links to the IRS's guidance on filling out Part VI (Governance) of the Form 990; and to the materials to be followed by IRS examiners. Read Jack Siegel's comment on these at [http://www.charitygovernance.com/charity\\_governance/2009/12/pulling-back-the-curtain-irs-audit-check-sheet.html#more](http://www.charitygovernance.com/charity_governance/2009/12/pulling-back-the-curtain-irs-audit-check-sheet.html#more). For later IRS analysis, see then-EO Director Lois Lerner's April 2012 speech, at pp. 3-7 of [http://www.irs.gov/pub/irs-tege/georgetown\\_04192011.pdf](http://www.irs.gov/pub/irs-tege/georgetown_04192011.pdf).

Bruce Hopkins keeps a running tab of denial and revocation letters at [http://www.nonprofitlawcenter.com/resDetails.php?item\\_ref=78](http://www.nonprofitlawcenter.com/resDetails.php?item_ref=78).

The public version of the 990 (but not the 990-PF) redacts the identities of donors, leading to concerns that we will explore further in **Assignment 22**. For now see the following example:

<http://www.bostonglobe.com/news/politics/2013/05/18/corporations-anonymously-fund-attacks-and-influence-washington-policy-through-nonprofit-groups/qyaJIFcv7yYOsQvya6ykAK/story.html>.

## CHARITABLE CONTRIBUTIONS

### 15. Exploring Fiduciary Duties: Endowment Spending and Accounting (UPMIFA)

To help you grasp this topic, think about a \$100 million gift to endowment. How much should be permanently restricted – i.e., not currently spendable by the charity! – if the gift value: (a) increases to \$120 million (appreciates) or (b) falls to \$80 million (is “underwater”)? For fun and context, explore Yale’s endowment policies, at <http://giving.yale.edu/gift-policies>.

Supp.: Skim Brody, NVSQ article in the Supplement for **Assignment 6**, at 548-553.

Web: Uniform Prudent Investment of Institutional Funds Act (UPMIFA) (2006): <http://www.uniformlaws.org/Act.aspx?title=Prudent%20Management%20of%20Institutional%20Funds%20Act>.

Note: Illinois’s version of UPMIFA: (1) omits the optional rebuttable presumption that spending 7% of the fair market value of an endowment fund is imprudent; and (2) defines “small” as a fund with a total value of less than \$50,000 (instead of \$25,000) for purposes self-help *cy pres* for a small charity (see generally **Assignment 17**).

See pages 17-20 (“Endowment Funds”) of the Art Institute of Chicago’s 2012 audited financial statements, at [http://www.artic.edu/sites/default/files/fy12\\_fs\\_0.pdf](http://www.artic.edu/sites/default/files/fy12_fs_0.pdf).

For the estate-tax deductibility of a restricted charitable gift, see Private Letter Ruling 2002-02-032, available at <http://www.irs.gov/pub/irs-wd/0202032.pdf>.

**16. Board's Responsibilities to Donors;  
Consequences of Breach of Restrictions and Who Can Enforce**

Supp.: Pretend you're the charity that received the donor letter in the Supplement, what do you do?! (For the reconciliation, see <http://today.uconn.edu/blog/2011/02/university-and-donor-put-differences-aside/> -- UConn bought out the AD in July 2011.)

Web: Can you find where the American Red Cross's donation webpage (<https://www.redcross.org/quickdonate/index.jsp>) allows you to make gifts restricted beyond their three specified purposes? Hint: Look in very bottom right corner. . . . See how the donate-by-mail form (available at [http://www.redcross.org/images/MEDIA\\_CustomProductCatalog/m24095016\\_redcross\\_donate\\_by\\_mail.pdf](http://www.redcross.org/images/MEDIA_CustomProductCatalog/m24095016_redcross_donate_by_mail.pdf)) addresses the issue of change of purpose!

Web: See the Form 990 requirement, with links to info on gift acceptance policies, at <http://www.nonprofitlawblog.com/home/2009/01/gift-acceptance-policies.html>).

Supp.: Excerpts from ALI Draft, Introductory Note to Chapter 5, Topic 2 (private enforcement), at pages 42-48.

Case Law: *Smithers v. St. Luke's-Roosevelt Hosp. Center*, 723 N.Y.S.2d 426 (App. Div. 2001); and *United Daughters of the Confederacy v. Vanderbilt*, 174 S.W.3d 98 (Tenn. App. 2005).

Web: "University Gains Control over Robertson Endowment in Settlement," at <http://dailyprincetonian.com/news/2008/12/university-gains-control-over-robertson-endowment-in-settlement/>. If you're interested in more on *Robertson v. Princeton*, including the settlement agreement itself, see [www.princeton.edu/robertson](http://www.princeton.edu/robertson).

And what is "donor intent"? Was the view of organized philanthropy as a mere financial conduit behind the debate at <http://www.bostonglobe.com/metro/2013/07/03/methodology-marathon-victim-payout-faulted-lawyer-group/sqxc7kjTz2OFpdxOTLT5VP/story.html>? Would society be better off if the One Fund spent *more* on administrative expenses?

**17. Change of Purpose: *Cy Pres* and Equitable Deviation Charitable-Trust Doctrines; “Duty of Obedience”; Nonprofit “Conversions” to For-Profit Form**

*(This Assignment 17 will take more than one class.)*

Supp.: From the ALI draft, read the excerpts from Tentative Draft No. 2, § 460.

Web: Read Section 6 of UPMIFA, on pp. 31-36 (with comments) at [http://www.uniformlaws.org/shared/docs/prudent%20mgt%20of%20institutional%20funds/upmifa\\_final\\_06.pdf](http://www.uniformlaws.org/shared/docs/prudent%20mgt%20of%20institutional%20funds/upmifa_final_06.pdf). While UPMIFA applies only to endowments and other investment assets, its articulation of deviation and *cy pres* are classic, and its provision for donor release is bound to be influential on the use of programmatic assets as well.

Note that *cy pres* is not available for conditional (as distinct from restricted) gifts – where the donor provides that the gifts comes back (or is otherwise transferred) if it cannot be carried out. See, e.g., *Adler v. SAVE*, 74 A.3d 41 (NJ Super. 2013):

“Absent the donor’s consent, the recipient of the gift is not at liberty to ignore or materially modify the expressed purpose underlying the donor’s decision to give, even if the conditions that existed at the time of the gift may have materially changed, making the fulfillment of the donor’s condition either impossible or highly impractical.” The *Adler* court declined the charity defendant’s request for *cy pres*, characterizing as “a perversion of these equitable principles” permitting “a modern charity like SAVE to aggressively solicit funds from plaintiffs, accept plaintiffs’ unequivocally expressed conditional gift, and thereafter disregard those conditions and rededicate the gift to a purpose materially unrelated to plaintiffs’ original purpose, without even attempting to ascertain from plaintiffs what, in their view, would be ‘a charitable purpose as nearly possible’ to their particular original purpose.” The court ended by commenting: “We believe that responsible charities will welcome this decision because it will assure prospective donors that the expressed conditions of their gift will be legally enforceable. Thus, the trust relationship necessary to promote generous gift giving has been strengthened by the tenacious efforts of two people who love large dogs and older cats.”

\* \* \*

Supp: As for the ALI project’s treatment of corporate change of charitable purpose, compare Preliminary Draft No. 6 (2013)’s alternative draft versions of § 270 (and my companion § 290).

## 18. Regulation of Charitable Solicitations

(This Assignment 18 could take less than one class.)

Case Law: *People v. World Church of the Creator*, 760 N.E.2d 953 (Ill. 2001).  
*Madigan v. Telemarketing Associates, Inc*, 538 U.S. 600 (2003).

Web: On the Illinois AG's website, at <http://illinoisattorneygeneral.gov/charities/index.html>, click on Rules and Statutes, and skim the Solicitations for Charity Act.

Explore the website of the National Association of Attorneys General/  
National Association of State Charity Officials, at [www.nasconet.org](http://www.nasconet.org).

See the Massachusetts attorney general's warnings about charitable solicitations in response to the Boston Marathon bombings at <http://www.mass.gov/ago/news-and-updates/press-releases/2013/2013-04-17-tips-to-giving-wisely.html>. See the results of a survey posted by the Connecticut attorney general about charities that solicited donations after the Newtown elementary school shootings, at <http://www.ct.gov/ag/cwp/view.asp?a=4424&Q=522546>.

For info on New Jersey's free mobile app on specific charities (rolled out in May 2012), go to <http://itunes.apple.com/us/app/new-jersey-charity-search/id503535534?ls=1&mt=8>.

For a (discouraging) overview, explore the *Tampa Bay Times* June 2013 special report at <http://www.tampabay.com/topics/specials/worst-charities.page> -- especially Part 2 (A Failure of Regulation), which will frame our discussion. In response to this reporting, in May 2014 the Florida legislature almost unanimously approved tighter regulation. See <http://www.tampabay.com/news/politics/gubernatorial/lawmakers-agree-on-legislation-to-crack-down-on-fraud-by-florida-charities/2177482> and <http://www.tampabay.com/blogs/the-buzz-florida-politics/bill-to-rewrite-charities-laws-headed-to-governor/2177873>.

Note the limit on federal oversight: The FTC can regulate paid (professional) fundraisers, but not charities soliciting for themselves. Compare Senator Coburn's request that GAO do a study on the IRS's enforcement activities: <http://www.coburn.senate.gov/public/index.cfm/2013/7/dr-coburn-asks> (this permalink takes a while to load, but the link to the letter is fast).

But is Oregon's new statute denying state tax deductions for contributions to charities with high levels of reported expenses the right answer? See <http://www.nonprofitquarterly.org/philanthropy/22475-oregon-sets-30-program-spending-benchmark-for-charities.html>. Note the Nonprofit Association of Oregon supported this bill; see FAQs at <http://www.nonprofitoregon.org/node/1320>; the AG's press release is at <http://www.doj.state.or.us/releases/Pages/2013/rel061113.aspx>. On almost the same day, GuideStar, the BBB Wise Giving Alliance, and Charity Navigator issued a call to resist focusing on the "overhead myth"! [http://overheadmyth.com/?hq\\_e=el&hq\\_m=2137243&hq\\_l=4&hq\\_v=a4247839a5](http://overheadmyth.com/?hq_e=el&hq_m=2137243&hq_l=4&hq_v=a4247839a5)

See the New York attorney general's February 2014 "Pennies for Charity" annual report, at [http://www.charitiesnys.com/pdfs/2013\\_Pennies.pdf](http://www.charitiesnys.com/pdfs/2013_Pennies.pdf): "of the nearly \$249.3 million in contributions, 62.1% was used for telemarketers' fees and the cost of telemarketing campaigns. . . . Further, in nearly 8 out every 10 fundraising campaigns conducted in 2012, charities lost money or retained less than 50% of the contributions raised." Michigan's December 31, 2013 report, available at [http://www.michigan.gov/documents/ag/Charitable\\_Solicitation\\_Campaigns\\_Final\\_449946\\_7.pdf](http://www.michigan.gov/documents/ag/Charitable_Solicitation_Campaigns_Final_449946_7.pdf), emphasizes the limits of its study: "The costs of a professional fundraiser's campaign may not resemble the charity's overall fundraising costs. For example, a charity may fundraise internally with its own employees and volunteers; this internal fundraising is not included in this report. Also, fundraising campaigns are often used to generate new donors. This can be costly. But once a new donor is obtained, future donations are less expensive to acquire."

For a story on California legislation to increase the AG's budget for charity enforcement, go to <http://www.ocregister.com/articles/charities-616481-percent-charity.html>. For a recent *local* ordinance, see <http://www.delmarvanow.com/story/news/local/delaware/2014/05/31/beth-any-watches-charity-proceeds/9811091/>.

For a story with a happy ending, with links to the opinions requiring the fraudulent fundraiser to make \$3.1 million in restitution, go to <http://www.ag.ny.gov/press-release/ag-schneiderman-obtains-court-decision-ordering-major-long-island-fundraiser-pay-31>.

Supp: Perry, *Worst Charities' Report Prompts Calls for Charities to Respond*.

**19. Pledges**

*(This will take about half an hour.)*

Case Law: *Woodmere Academy v. Steinberg*, 363 N.E.2d 1169 (N.Y. 1977), and skim *Maryland National Bank v. United Jewish Appeal Federation*, 407 A.2d 1130 (Md. 1979).

Web: Doherty, *Record Pledge Remains Unsettled*, at <http://www.dukechronicle.com/articles/2010/09/21/record-pledge-remains-unsettled>.

## OTHER TAX RULES FOR CHARITIES AND OTHER NONPROFITS

### 20. Tax Treatment of Charitable Contributions

Supp.: Skim I.R.C. § 170(a)(1), (c), (e)(1), and (f)(8), (f)(16) & (f)(17), at beginning of Supp. at Code & Regs 1-3; and § 6115 excerpts at end of statutory excerpts.

Lest you think these rules aren't serious, see *Cohan v. Commissioner*, No. 19849-05, T.C. Memo. 2012-8 (2012), where the U.S. Tax Court upheld the IRS's disallowance – because of the charity's failure to provide a contemporaneous acknowledgement that no goods or services were provided in return for the contribution – of a \$4.5 million charitable-contribution deduction for the grant to the Nature Conservancy of rights related to a Martha's Vineyard farm.

Web: The IRS's *Charitable Contributions—Substantiation and Disclosure Requirements* (Pub. 1771, 2013), at <http://www.irs.gov/pub/irs-pdf/p1771.pdf>. If you're interested, see the extensive witness testimony for the House Ways & Means Committee's Feb. 14, 2013 hearing, at <http://waysandmeans.house.gov/calendar/eventsingle.aspx?EventID=319000>.

Supp.: NY Times editorial, "Charity Begins in Washington."

Web: For data in one page on **non-cash gifts**, go to <http://www.taxpolicycenter.org/UploadedPDF/1001577-composition-charitable-contributions.pdf>; if you're interested in more detail, see the latest IRS data on noncash gifts, at <http://www.irs.gov/pub/irs-soi/14insprbulnoncash.pdf>. Read IRS Chief Counsel Advice 2006-23-063, on **quid-pro-quo penalty**, at <http://www.irs.gov/pub/irs-wd/0623063.pdf>.

Further reading if you're interested:

For detailed discussion of the rules on deducting charitable contributions, see JCX-55-11 (October 14, 2011) Present Law and Background Relating to the Federal Tax Treatment of Charitable Contributions, at <https://www.jct.gov/publications.html?func=startdown&id=4371>. This was prepared for a Senate Finance Committee hearing – at <http://www.finance.senate.gov/hearings/hearing/?id=915d5477-5056-a032-524b-feac6e9e3321> you can find witness statements from economist Gene Steuerle and

law professor Roger Colinvaux.

For Obama's **proposal to cap the value of itemized deductions** (including charitable contributions) at 28%, see pp. 154-55 of <http://www.treasury.gov/resource-center/tax-policy/Documents/General-Explanations-FY2015.pdf>. In 2012, the Joint Committee staff provided the following example of a similar proposal (full discussion at pp. 528-36 of <http://www.jct.gov/publications.html?func=startdown&id=3796>):

“Assume that a taxpayer in the 35-percent income tax bracket for 2012 makes a \$10,000 charitable contribution. Under present law, the \$10,000 contribution will result in a \$3,500 tax savings, or 35 percent of \$10,000 (disregarding any other limitations that may apply to reduce the taxpayer's itemized deductions). Under the proposal, the same \$10,000 contribution by the same 35-percent bracket taxpayer would result in a tax savings of only \$2,800 (28 percent of \$10,000), thus raising his tax liability by \$700 (or seven percent (35 percent minus 28 percent) of his \$10,000 contribution).”

If you're interested in how **donor-advised funds** work, see the latest annual report of the Fidelity Charitable Gift Fund, a 501(c)(3) established by Fidelity Investments, at <http://www.fidelitycharitable.org/docs/giving-report-2013.pdf>.

If you're interested in **reform proposals**, see the staff of the Senate Finance Committee's June 13, 2013 discussion draft of options, with links, at <http://www.finance.senate.gov/imo/media/doc/06132013%20Tax-Exempt%20Organizations%20and%20Charitable%20Giving.pdf>. Note that, if we have time, we will look at the Ways & Means reform proposal in **Assignment 24**.

## **21. Private Foundations**

*(I'll just walk you through this regime – you will NOT be responsible for the details. Start **Assignment 22.**)*

Note: All 501(c)(3)'s are presumed to be private foundations unless excluded under the rules of I.R.C. § 509. The full ramifications of private foundation status are beyond the scope of this course; just appreciate that being a “private foundation” carries more restrictions than do the “public charity” alternatives.

Important types of entities resembling private foundations – notably community foundations, donor advised funds, and supporting organizations – are excluded from this regime (although sometimes with similar limitations of their own).

The rules create several major differences between public charities and private foundations:

- (i) lower percentage-of-income annual limits on contributions;
- (ii) filing and disclosure requirements (Form 990 vs. Form 990-PF);
- (iii) intermediate sanctions (for PCs) versus per se prohibitions (for PFs) for self-dealing;
- (iv) minimum annual payout requirement;
- (v) prohibitions on “jeopardizing investments” and “excess business holdings,” and requirements to exercise “expenditure responsibility” for grants to non-public charities; and
- (vi) a (low-level) private foundation investment income tax.

Web: *NBA Player Charities Often a Losing Game*, at [http://www.sltrib.com/ci\\_11314692](http://www.sltrib.com/ci_11314692).

**22. Advocacy, Lobbying, and Political Activities;  
501(c)(3)/(c)(4)/PACs (§ 527) Affiliations**

*(This Assignment 22 will take more than one class.)*

How do you organize these tax rules? Distinguish among three categories of activities:

Advocacy: not a term used in the Code, and **advocacy** is a main purpose of many educational organizations and other charities (including churches!).

Activity to influence legislation: limited **lobbying** is allowed to (c)(3)'s; too much lobbying is the reason some state-law charities must settle for (c)(4) exemption.

Electioneering: participating in **political campaigns** is verboten to (c)(3)'s; and cannot be the "primary activity" of other exempt organizations ((c)(4)'s, (c)(5)'s and (c)(6)'s)). See <http://www.propublica.org/article/six-facts-lost-in-irs-scandal>.

Note that the 2010 decision in *Citizens United* (which we will not have time to read) is a First Amendment (constitutional) case, not a tax law case. (Once the courts rejected Citizens United's assertion that it was merely making a documentary about Hillary Clinton, rather than making an electioneering communication, the issue became the legality under campaign finance law of having corporate donors and disclosure of funders for movie ads.) *Citizens United* has more implications for (c)(4)'s than for (c)(3)'s.

Code&Regs: I.R.C. § 501(h). Note: The dollar limits are in I.R.C. § 4911 (not in your Code & Regs) – see Schedule C to the Form 990.

Note: An organization seeking recognition of tax exemption under a subsection other than (c)(3) files on Form 1024 (rather than Form 1023). However, only (c)(3) status requires an advance ruling; a "self-declarer" can just start filing the appropriate Form 990. Read the IRS questionnaire sent to "self-declarers" and see the links to Form 1024 and other material at <http://www.irs.gov/Charities-&-Non-Profits/Other-Non-Profits/Self-declarers-questionnaire-for-section-501-c-4-5-and-6-organizations>.

Case Law: *Regan v. Taxation With Representation*, 461 U.S. 540 (1983). See also the IRS's revocation of Patrick Henry Center for Individual Liberty (as identified in the *USA Today* April 21, 2014 story at <http://onpolitics.usatoday.com/2014/04/21/hillary-clinton-tax-exemption-revoked/>): <http://www.irs.gov/pub/irs-wd/1416011.pdf>

Web: For limits on political activity by (c)(3)'s, see the 2008 letter from the IRS to all of the political parties, at <http://www.irs.gov/pub/irs->

[tege/2008\\_paci\\_party\\_letter.pdf](#). (Note that the IRS terminated its Political Activities Compliance Initiative after five years, without explanation.) If you're interested, lots of examples are set out in *Revenue Ruling 2007-41*, at [http://www.irs.gov/irb/2007-25\\_IRB/ar09.html](http://www.irs.gov/irb/2007-25_IRB/ar09.html). For IIT's policy on political activity on campus, go to <http://www.iit.edu/news/iittoday/?p=25875> (Jan. 24, 2014).

If you're interested, *Revenue Ruling 2004-6* addresses advocacy activities by (c)(4)'s, (c)(5)'s, and (c)(6)'s; go to [http://www.irs.gov/irb/2004-04\\_IRB/ar10.html](http://www.irs.gov/irb/2004-04_IRB/ar10.html).

For a private ruling approving a (c)(3), (c)(4), PAC chain, see <http://www.irs.gov/pub/irs-wd/1127013.pdf> (April 15, 2011).

The IRS erroneously released Crossroads GPS's pending (c)(4) application; *Pro Publica* has it at <http://s3.documentcloud.org/documents/537045/crossroads-gps-application-to-irs.pdf> (see Part II, Q.15, re political activities). Crossroads' 2011 and 2012 Forms 990 are online. See generally <http://www.propublica.org/article/what-newly-released-docs-tell-us-about-the-irs-and-how-it-handles-dark-mone>.

For the distinction between § 527 and § 501(c)(4) in terms of disclosure, see these segments of the September 29, 2011 episode of the Colbert Report – it's surprisingly accurate but typically profane (send the kids out of the room!): <http://www.colbertnation.com/the-colbert-report-videos/398530/september-29-2011/colbert-super-pac---ham-rove-s-comeback> and <http://www.colbertnation.com/the-colbert-report-videos/398531/september-29-2011/colbert-super-pac---trevor-potter---stephen-s-shell-corporation>. Don't worry if you're not following the plot – I'll explain in class. Colbert – whose material on this topic (including his SuperPAC's 10-page ruling from the Federal Elections Commission) is available at <http://www.colbertsuperpac.com/home.php> – won a Peabody award for his campaign-law work, and a study found that his viewers were better informed on the (c)(4) issue during the 2012 election cycle than watchers of network news (<http://www.annenbergpublicpolicycenter.org/stephen-colberts-civics-lesson-or-how-a-tv-humorist-taught-america-about-campaign-finance/>). I've heard that the FEC staff are huge Colbert fans!

Supp.: “Pastors’ Web Electioneering Attracts U.S. Reviews of Tax Exemptions” and “Former EO Director: Penalize Promoters of Church Campaign.” On July 17, 2014, the Freedom From Religion Foundation announced a settlement of its suit against the IRS for failure to enforce the prohibition on church politicking – go to <http://ffrf.org/news/news-releases/item/20968-ffrf-irs-settle-suit-over-church-politicking>.

**The IRS's (c)(4) Controversy:**

Supp.: Brody, "Can the IRS Regulate Charities Engaged in Advocacy and Politics After the 501(c)(4) Controversy?"; Edsall, *Scandals Republicans Like*.

Web: For coverage of the IRS's May 2013 denial of exemption to a liberal group, see <http://www.publicintegrity.org/2014/06/19/14974/irs-says-liberal-group-too-political-social-welfare-status>.

In November 2013 the IRS proposed (c)(4) that were universally panned: [http://taxprof.typepad.com/taxprof\\_blog/2013/11/treasury-irs-announce.html](http://taxprof.typepad.com/taxprof_blog/2013/11/treasury-irs-announce.html). In May, the IRS withdrew the proposed regs: [http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501\(c\)\(4\)-Organizations](http://www.irs.gov/uac/Newsroom/IRS-Update-on-the-Proposed-New-Regulation-on-501(c)(4)-Organizations).

Stephen Colbert had asked to testify at the hearing on the proposal (go to <http://www.regulations.gov/#!documentDetail;D=IRS-2013-0038-122965>). Adler & Colvin's Top 25 comments on the proposed (c)(4) regs, (<http://www.nonprofitlawmatters.com/tax-treatment-of-lobbying-political-activities/>) start with Colbert's at #25: "... Stephen Colbert's comments [are not the most] informative, but ... they are perhaps the shortest and the most entertaining of the bunch. And they succinctly illustrate why the IRS rulemaking must continue: we wouldn't want to miss his testimony at the public hearing." I guess we'll have to wait for new proposed regs!

See the Tax Policy Center's pithy assessment (June 24, 2014): [http://taxvox.taxpolicycenter.org/2014/06/24/real-irs-flap-dark-money-emails/?utm\\_source=iContact&utm\\_medium=email&utm\\_campaign=Daily%20Deduction&utm\\_content=Daily+Deduction+-+6%2F25](http://taxvox.taxpolicycenter.org/2014/06/24/real-irs-flap-dark-money-emails/?utm_source=iContact&utm_medium=email&utm_campaign=Daily%20Deduction&utm_content=Daily+Deduction+-+6%2F25).

For Public Integrity's July 2014 report, six months in the making, go to: <http://www.publicintegrity.org/2014/07/15/15035/hobbled-irs-cant-stem-dark-money-flow>.

**State Clean Government Laws:** California and New York recently adopted laws requiring (c)(4)'s and (c)(6) trade associations spending above certain thresholds in state elections to disclose their top large donors.

**23. Commercial Activities and the “Unrelated Business Income Tax”**

*(This Assignment 23 will take about two full hours.)*

Supp.: In Code & Regs, read I.R.C. § 511(a) & (b); § 512(a)(1) & (3), and (b)(1) through (12); § 513(a), (c), & (i); Treas. Reg. § 1.501(c)(3)-1(e).

Brody, excerpts from “Business Activities of Nonprofit Organizations” (2008); Mullen & Glanton, *Chicago Museums Increasingly Rely on Private, Nighttime Parties for Funding*. Note that Sen. Coburn proposed repealing (c)(6) exemption for professional sports leagues (like the NFL).

Web: Skim the Boy Scouts of America’s 2012 Form 990-T, available at [http://scoutingnewsroom.org/wp-content/uploads/2014/01/2012\\_990T.pdf](http://scoutingnewsroom.org/wp-content/uploads/2014/01/2012_990T.pdf) (how do you lose \$3 million selling advertising? – and report losses every year from unrelated business activities!).  
Read Private Letter Ruling 200722028 (no UBIT from sale of breast cancer items), at <http://www.irs.gov/pub/irs-wd/0722028.pdf>.  
For the Metropolitan Museum of Art’s international store locations, go to: <http://store.metmuseum.org/The-Met-Store-Locations/page/internationalstorelocator>. See also the rental opportunities, described at <http://www.metmuseum.org/about-the-museum/entertaining-at-the-met>. Explore Colonial Williamsburg’s online shop at <http://www.williamsburgmarketplace.com>.

For IRS’s 1-pager of data, see <http://www.irs.gov/pub/irs-soi/09ubisnaphot.pdf>. If interested in details, read the Summary of the report at <http://www.irs.gov/pub/irs-soi/13eosumbulunrelateintax.pdf>. As you’ll see, the amount of UBIT we collect is miniscule. Why keep it? See Brody & Cordes, “The Unrelated Business Income Tax: All Bark and No Bite?,” at [http://www.urban.org/UploadedPDF/philanthropy\\_3.pdf](http://www.urban.org/UploadedPDF/philanthropy_3.pdf).

For the House Ways & Means Oversight Subcommittee’s hearing on the colleges and universities compliance study (available at [http://www.irs.gov/pub/irs-tege/CUCP\\_FinalRpt\\_042513.pdf](http://www.irs.gov/pub/irs-tege/CUCP_FinalRpt_042513.pdf)), with the statement by then-EO Director Lois Lerner, go <http://waysandmeans.house.gov/calendar/eventsingle.aspx?EventID=332314>. For advice, see <http://www.capdale.com/lessons-learned-from-the-irs-colleges-universities-compliance-project>. If you’re interested, see the June 2014 ACT report on UBIT Compliance by Colleges and Universities, starting on page 75 of [http://www.irs.gov/pub/irs-tege/tege\\_act\\_rpt13.pdf](http://www.irs.gov/pub/irs-tege/tege_act_rpt13.pdf).

Compare Steuerle, *When Nonprofits Conduct Exempt Activities as Taxable Enterprises*, at [http://www.urban.org/UploadedPDF/philanthropy\\_4.pdf](http://www.urban.org/UploadedPDF/philanthropy_4.pdf).

## 24. Administrative and Legislative Change: Form 1023-EZ and Tax Reform Proposals

Web: To see the new Form 1023-EZ (“fast-track” exemption application for small orgs), which can be filed only electronically, go to: <http://www.irs.gov/pub/irs-pdf/f1023ez.pdf>; for the July 1, 2014 press release, go to: <http://www.irs.gov/uac/Newsroom/New-1023-EZ-Form-Makes-Applying-for-501c3Tax-Exempt-Status-Easier-Most-Charities-Qualify>; and for detailed explanation of the requirements (particularly pp. 4-5, describing the ineligible organizations), go to <http://www.irs.gov/pub/irs-drop/rp-14-40.pdf>.

Paul Streckfus reported (July 3, 2014): “The big change from [the proposed version] is that applicants must have assets of \$250,000 or less and annual gross receipts of \$50,000 or less. The IRS had initially said assets of \$500,000 or less and annual gross receipts of \$200,000 or less. Initial reaction to these changes has been favorable.”

Supp.: *Chronicle of Philanthropy* story on the proposed Form 1023-EZ.

Web: For *Time* magazine’s summary, *IRS to Rubber-Stamp Tax-Exempt Status for Most Charities After Scandal* (subtitled *IRS head touts “efficiencies,” but some groups fear fraud*) go to <http://time.com/2979612/irs-scandal-tax-exempt-tea-party-political-groups-john-koskinen/>

Read the National Council of Nonprofits (April 30, 2014) on the proposed form: <http://www.councilofnonprofits.org/files/downloads/1023%20EZ%20Comments%20--%20National%20Council%20of%20Nonprofits.pdf>; and from NAAG-NASCO (April 30, 2014): <http://www.nasconet.org/wp-content/uploads/2014/05/FINAL-NASCO-comments-re-Form-1023-EZ1.pdf>.

Commented Paul Streckfus (Email Update 2014-92, May 7, 2014):

Who knew the IRS would be such a unifying force in these troubled times? Just about everybody now hates the proposed (c)(4) regs – Democrats, Republicans, Independents or, if you prefer, blues, reds, purples. And now it appears just about everybody opposes the new Form 1023-EZ.

One has to wonder who is in charge of EO operations these days. Commissioner John Koskinen needs to right what is now his sinking ship. I realize the EO Division and the IRS have gone through a slew of managers in the last year, and I don’t mean to kick folks when they are down, but a little tough love is called for here. Somehow Koskinen has to develop a strong EO team that will make smart decisions instead of keep coming up with dumb ideas. In a recent letter, reprinted below, the National Council of Nonprofits clearly outlines what is wrong with the

1023-EZ. As I see it, the IRS cannot just walk away from its regulatory responsibilities by installing a registration system for anyone who wants to run an exempt organization, especially a (c)(3) that gets section 170 deductibility of contributions. I see a day when most Americans will file a 1040 and a 990, with half their income contributed to their own (c)(3), and the IRS will need a 100% audit rate to keep the government going. While we won't miss Congress, we will still need an Army and a Navy and some other crucial services only the federal government can provide.

See also <http://tsne.org/ill-advised-solution-serious-problem> (Third Sector New England's criticism of the "cross my heart and hope to die" approach).

Combining elimination of up to 70% of annual exemption applications with the IRS's announced shift of the EO guidance function from the EO Division to Chief Counsel, what will become of the IRS's advance ruling policy? More generally, aren't we all better off when the IRS performs its gate-keeper rule to nip in the bud such organizations as the one in Determination Letter 201430014 (April 30, 2014), available at <http://www.irs.gov/pub/irs-wd/201430014.pdf> (denying exemption to an organization whose stated purpose is the "protection of the human rights of defenseless victims from involuntary microwave and M attack, organized stalking, or direct mind control attack of its various forms, and to compensate such targets from (SIC) the associated damage or death resulting from such sightings")?!

Compare Letter 201429027 (released July 18, 2013), available at <http://www.irs.gov/pub/irs-wd/201429027.pdf>, denying exemption to an organization whose "purpose, as described in more detail in your Form 1023 . . . , is to facilitate the distribution of contributions made by wireless mobile telephone customers to charities sponsoring fundraising projects." The IRS's approach (although not the conclusion) in that ruling prompted Paul Streckfus to write (*EO Tax Journal* 2014-147 (July 25, 2014)):

Denial 201429027, reprinted below, appears correct but, as has been the case in recent denials, there are rationale statements that seem overly broad. Or maybe the IRS is becoming more assertive in attacking arrangements that seem to benefit insiders. In any event, the denial raises a number of issues that appear to have been reviewed in some depth by Tax Law Specialists in the National Office, and perhaps with review by the Office of Chief Counsel. As an aside, let me note both the proposed denial letter and the final denial letter are dated December 12, 2012. I assume the proposed denial was issued on December 12, 2012, and that the final denial letter came out earlier this year. Here are some rationale statements from Denial 201429027 that I believe may be overly broad:

- "First, you lack the public support and public control that are characteristic of a charitable organization seeking to serve the public." If this is a requirement, a large number of recognized (c)(3)s are in trouble.
- "You are similar to the organization described in *B.S.W. Group*, 70 T.C. 352

(1978), in which the court cited lack of solicitation and sole support from fees as factors disfavoring exemption.” Same comment as above: If this is a requirement, a large number of recognized (c)(3)s are in trouble.

- “In addition to your lack of public financial support, your organization shows none of the public involvement that characterizes organizations serving a public interest.” Same comment as above: If this is a requirement, a large number of recognized (c)(3)s are in trouble.
- “You are unlike the organization described in Rev. Rul. 69-441, *supra*, in which the organization’s Board of Directors is comprised of representatives from religious organizations, civic groups, labor unions, business groups, and educational institutions.” I’ve argued for independent boards for years. Is the IRS finally coming around to my point of view?
- “Like the organization in *Church by Mail*, T.C. Memo 1984-349, *aff’d* 765 F.2d 1387 (9th Cir. 1985), you have chosen without any competition one for-profit entity to manage every aspect of your business.” This seems to be a common practice, with the IRS only asking for a veneer of arm’s-length dealing at fair market value. I’d have no problem with the IRS cracking down on a lot of these insider deals that are very common in the nonprofit world.
- “When private individuals or for-profit entities have either formal or effective control of a nonprofit organization, it raises questions concerning whether the organization furthers the profit-seeking motivations of those private individuals or entities.” Same comment as above: This seems to be a common practice, with the IRS only asking for a veneer of arm’s-length dealing at fair market value.
- “Although you do not have the long-term management agreement that the court objected to in *Redlands*, 113 T.C. 47 (1999), the effect of ceding all control to LLC effectively keeps you from being independent. As the court pointed out in *Redlands*, you have no ability to oversee your activities because you have no independent employees or resources.” Same comment as above: This seems to be a common practice, with the IRS only asking for a veneer of arm’s-length dealing at fair market value.
- “Absent appropriate control of the funds, you operate as a conduit to direct charitable donations, an activity that has not been recognized as charitable within the meaning of I.R.C § 501(c)(3).” I’m not sure what the IRS is stating here. What is meant by “appropriate control of the funds”? Do donor-advised funds have “appropriate control of the funds”? If not, are they mere conduits and hence not exempt?

And see the (anonymous) reaction from someone inside the IRS, writing to Streckfus

(EOTJ Email Update 2014-90 (Monday, May 5, 2014)):

Oh Paul, Paul, Paul. For so long I've resisted the urge to write you (call it IRS paranoia), but Dorothy has finally surrendered.

With respect to the . . . new Form 1023-EZ, while I think those lawyers have a vested interest in killing the 1023-EZ, I completely agree with them.

I understand the resource constraints and other pressures that have led to the 1023-EZ. However, I consider Determ Agents and Specialists to be gatekeepers of the public trust (laugh all you want, Mr. Issa). The "full development" cases we get are called that for a reason. They require heightened scrutiny, and often with a little education we provide the applicants (a core part of our mission), we can set them on the right path from the start.

An ounce of prevention is worth a pound of cure.

Now, unfortunately, I fear those efforts will be undercut, and dispersing us to the field for subsequent audits and compliance checks will be sorely inadequate to address the flood of abuse that may ensue.

This is on top of having us now work highly complex cases that were previously reserved for EO Technical. I won't go into the training we're getting for this, but you can guess (I, too, miss the old days of CPE, with greats like Bill Brockner, Debbie Kawecki, and Charlie Anderson at the helm ... sigh).

If you think EO is dysfunctional now, better fasten your seatbelt. I hope I'm wrong.

-- Name Withheld on Request

Compare the comments (June 2, 2014) of the late (and former EO'er) Bill Brockner:

A registration system is necessary. Applicants make representations. But so do 1040 [individual] and 1120 [corporate] filers. There is no evidence that untrue statements are more prevalent with these filers than with 1023 or 1024 applicants. The applicants are subject to penalties of perjury. If the applicants are (or were) not what was represented, throw the book at them and the people who prepared the application. Maybe make it clear that the years of unlawful exemption will include a payback of the value of the years of exemption, with interest and penalties, by the perps who prepared, assisted, and signed the forms if the organization is financially challenged. The SEC has a registration system. So do the state and local governments that regulate nonprofits. Go to a registration system and place most of the present Determinations personnel or their positions on the EO Exam side.

## 25. Peer Group Role in Charity Governance

(This will be brief, if we don't omit it altogether for lack of time.)

- Web:
- \* BBB Wise Giving Alliance Charity Standards, at <http://www.bbb.org/us/Standards-Charity/> – also, search, e.g., for “Feed the Children”
  - \* Association of Fundraising Professionals Ethics Guides, at <http://www.afpnet.org/ethics>
  - \* Charity Navigator, at [www.charitynavigator.org](http://www.charitynavigator.org) and read “How Do We Rate Charities?” under Methodology – also, search, e.g., for “American Red Cross,” and read the rating and comments.
  - \* Wall Watchers, at [www.ministrywatch.com](http://www.ministrywatch.com), and read a couple of “Donor Alert Ministries.”
  - \* American Institute of Philanthropy, at [www.charitywatch.org](http://www.charitywatch.org).

See also the *Tampa Bay Times*' online tool – at [www.charitychecker.com](http://www.charitychecker.com) -- that graphically aggregates the ratings and reviews offered by the BBB Wise Giving Alliance, CharityNavigator, GreatNonprofits and GuideStar.

The 2007 Report of the Panel on the Nonprofit Sector, convened by Independent Sector at the request of then-Senate Finance Committee chair Chuck Grassley: <http://www.nonprofitpanel.org/Report/index.html>.

Grassley also asked the Evangelical Council for Financial Accountability ([www.ecfa.org](http://www.ecfa.org)) to look into certain ministries. See “Grassley Releases Review of Tax Issues Raised by Media-based Ministries,” at [http://grassley.senate.gov/news/Article.cfm?customel\\_dataPageID\\_1502=30359](http://grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=30359). The Commission's December 2012 report is at <http://religiouspolicycommission.org>.

For a public/private partnership between a state AG and a state nonprofit association, go to [www.ag.state.il.us/charities/charitable\\_advisory.html](http://www.ag.state.il.us/charities/charitable_advisory.html), and click on the link to the Donor's Forum for best practices. The Illinois AG also has links to other charity watchdogs and “peer regulators.”

Compare <http://www.nytimes.com/roomfordebate/2014/05/27/should-the-government-grade-colleges?hp&rref=opinion>.

Supp.: Bialik, *Charity Rankings*.

## 26. State Property-Tax Exemption for Charities

*(We'll abbreviate or omit this topic if we're running out of time.)*

Web: Brody, Marquez & Toran, <http://www.urban.org/UploadedPDF/412640-The-Charitable-Property-Tax-Exemption-and-PILOTs.pdf>.

See Brody bibliography on property-tax exemption and PILOTs at <http://www.urban.org/taxandcharities/upload/prop-tax-brody-biblio-July-2012.pdf> -- focus on Illinois, but skim the rest.

Note: As for Pennsylvania, in June 2013, the legislature approved an amendment to the state constitution “providing that the General Assembly may, by law, establish uniform standards and qualifications which shall be the criteria to determine qualification as institutions of purely public charity under Article VIII, Section 2(a)(v) of the Pennsylvania Constitution.

“In order to amend the Constitution, legislation proposing the Constitutional amendment must be passed by the General Assembly in two consecutive legislative sessions and be advertised in newspapers upon each passage before being submitted to the electorate for approval.” See –

<http://www.legis.state.pa.us/WU01/LI/BI/FN/2013/0/SB0004P0347.pdf>.

Read the Illinois Supreme Court’s opinion in Provena Covenant Medical Center, upholding denial of exemption for 2002, available at <http://www.state.il.us/court/opinions/supremecourt/2010/march/107328.pdf>, and Provena’s reaction, posted at: <http://www.provena.org/covenant/body.cfm?xyzpdqabc=0&id=6&action=detail&ref=2675>.

On a related note, see <http://www.nytimes.com/2014/05/26/us/hospitals-look-to-health-law-cutting-charity.html>

**27 and 28. Exam Practice**

Near the end of the semester, I'll distribute a couple of old exams (from 2005 and 2011). I'll divide up the class into groups, for you to prepare and present the questions for all of us to discuss. We'll spend our last two classes (the Wednesday before Thanksgiving and Monday, December 1) on this practice.

**EXAM**

The exam will be on Wednesday, December 17, at 8:30 a.m. This will be a 3-hour, open-book exam.

Take into the exam all of your written course material and your notes, and any other written material you wish. Some of you might be living out of your notebook computers. You **may** bring your computer (and smart phone and other devices) into the exam, including your notes and outlines, but you **may not** bring any CD-ROMs or go online. Anyone who prepares for class, attends regularly, and studies the material should be able to do well on the exam; by contrast, anyone who does not keep up should not be able to do well on the exam simply by having an electronic outline.