Nonprofit Law Update

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RECENT DEVELOPMENTS IN THE LAW

NONPROFIT LAW UPDATE

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

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NONPROFIT LAW UPDATE

This outline consists of nine parts: summaries of (1) the Internal Revenue Service's Exempt Organizations Division's Report on FY 2016 Priorities; (2) the Treasury Department-IRS 2014-2015 Priority Guidance Plan; (3) current developments in the law pertaining to tax-exempt organizations in general; (4) current developments in the federal law of particular pertinence to public charities and private foundations; (5) current developments pertaining to unrelated business activities of exempt organizations; (6) current developments relating to the tax law of charitable giving; (7) current developments relating to the law of fundraising; (8) recent legislation; and (9) miscellaneous other current developments in the law concerning nonprofit organizations.

I. TE/GE REPORT ON FY 2016 PRIORITIES

A. IRS's Exempt Organizations Division, on October 1, 2015, issued its report on fiscal year 2016 priorities. Key areas of focus:

1. Continuous improvement.

2. Knowledge management (including launching of K-Nets).

3. Risk management.

4. Data-driven decisionmaking.

5. Employee engagement.

B. Examinations:

1. Compliance strategy to be implemented through data-driven decisions with goal of identifying and addressing existing and emerging high-risk areas of noncompliance with optimal use of available resources.

2. EO will use most appropriate, cost-effective, and least intrusive compliance treatment (e.g., educational efforts, compliance reviews, compliance checks, and correspondence and field examinations).

3. IRS will balance coverage across subsections and asset classes while optimizing resources on the highest-risk returns.

4. EO will focus resources on non-exempt activities and private inurement; self-dealing, excess benefit transactions, and loans to disqualified persons; unrelated business income and employment tax liability; funds expended outside U.S. and exempt organizations operating as foreign conduits; and hospitals and nonexempt trusts.

C. Determinations:

1. In FY 2016, EO Rulings and Agreements anticipates having 00 determination specialists to review Forms 1023 and 1024, and participate in predetermination reviews of sampled Forms 1023-EZ.

2. Twenty-five tax examiners will review Forms 1023-EZ.

3. IRS projects about 3 percent increase in application receipts, assuming that increase in Form 1023-EZ adoption rate will continue at conservative pace.

4. IRS anticipates receipts outpacing disclosures and an increased open application inventory at fiscal year's end.

5. Thirty determination specialists will be realigned to EO Examinations.

6. Division will continue to study data analyzed from Form 1023-EZ predetermination reviews and will consider future adjustments to percentage of these applications selected for predetermination

II. TREASURY-IRS 2015-2016 PRIORITY GUIDANCE PLAN (JULY 31, 2015) PROJECTS

A. Tax-Exempt Organizations Law Projects

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

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

3. Issuance of update to Rev. Proc. 2011-33 for EO Select Check.

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

5. Guidance relating to exempt organizations' reporting of contributions (IRC § 6033).

6. Promulgation of final regulations and additional guidance on supporting organizations (IRC § 509(a)(3)).

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

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

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

10. Proposed regulations regarding excise taxes on donor-advised funds and fund management in reflection of 2006 statutory law (IRC § 4966).

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

12. Final regulations on qualified ABLE programs (IRC § 529A); proposed regulations were published in June.

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

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

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

16. Guidance providing criteria for treating entity as integral part of state, local, or tribal government (IRC § 7701).

B. Charitable Giving Law Projects

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

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

3. Guidance regarding contributions of inventory (IRC § 170(e)(3)).

4. Regulations concerning uniform basis of charitable remainder trusts (IRC § 1014); proposed regulations promulgated on January 17, 2014.

5. Guidance on qualified contingencies of charitable remainder annuity trusts (IRC § 664).

III. LAW PERTAINING TO TAX-EXEMPT ORGANIZATIONS IN GENERAL

A. Tax-Exempt Status in General

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

1. Qualification for tax exemption in IRC § 501(c)(3) setting:

a. IRS rulings favorable to organizations, in general [no recent developments]

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

(1) Operation in substantially commercial manner (PLR 201609006).

(2) Failure to operate primarily for exempt purposes (violation of operational test) (PLRs 201603039, 201615017).

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

(4) Inactivity (PLRs 201603038, 201603040, 201609007, 201611019, 201615015).

(5) Failure to file annual information returns [no recent developments].

(6) Failure to maintain adequate records (PLRs 201603041, 201603042).

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

(8) Operation as credit counseling organization (PLR 201541012).

(9) Operation of down payment assistance programs [no recent developments].

(10) Failure to serve a charitable class (PLRs 201533014, 201534020).

(11) Failure to show lessening of burden of government by operating financing program benefiting fuel tank owners and contractors (PLR 201531022).

(12) Operation of housing rehabilitation program, where charitable class not being served and homes to be sold at market rates (PLR 201534020).

(13) Operation in manner enabling founder to engage in criminal tax evasion (PLR 201544028).

(14) Operation of website without charge (PLR 201550043).

(15) Operation of a farmers' market (PLR 201601014).

(16) Promotion of stock car racing (PLR 201604018).

(17) Failure to meet organizational test (PLR 201615016).

(18) Illegal distribution of federally controlled substance (marijuana for medical use) (PLR 201615018).

(19) Conduct of accountable care activities without participation in the Medicare Shared Services Program; activities held to not be lessening burdens of government (PLR 201615022).

(20) Failure to timely file a protest (PLRs 201617011, 201617012).

(21) Violation of private inurement doctrine (see III B).

(22) Violation of private benefit doctrine (see III C).

Other types of tax-exempt organizations have been the subject of many IRS rulings and court opinions.

2. Qualification for tax exemption in other settings:

a. Developments concerning single-parent title-holding companies (IRC § 501(c)(2) entities):

(1) IRS retroactively revoked exempt status of organization for engaging in activities inappropriate for an exempt title-holding entity and (incorrectly) for violating organizational test (PLR 201552033).

b. Developments concerning tax-exempt social welfare organizations (IRC § 501(c)(4) entities):

(1) Organizations held to not qualify for exemption where their primary activities constitute participation in political campaigns [no recent rulings].

(2) Organization that maintains common areas associated with condominium properties, and enforces covenants, held to not qualify as social welfare entity (PLRs 201548025, 201604019).

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

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

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

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

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

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

(1) Reporting exception amount for associations with nondeductible lobbying expenses (IRC § 6033(e)(3)) is no more than $112 for 2016 (IRS Revenue Procedure (Rev. Proc.) 2015-53).

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

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

(4) Rural electric power cooperative is becoming member of regional transmission organization (an IRC § 501(c)(6) entity); IRS ruled that organization will retain sufficient control and risk of loss with respect to its facilities pursuant to membership agreement with RTO to enable agreement to be considered management contract, rather than lease or other disqualifying arrangement (PLR 201525007).

(5) Membership organization formed to provide members with business leads, and with membership restricted to noncompeting classes, held to not be promoting line of business and providing particular services to members (PLR 201529010).

(6) Organization ruled not qualified for exemption because services are performed on behalf of owners of franchise business, rather than to improve business conditions for a line of business in its entirety (PLR 201540017).

(7) Organization's exemption revoked because its principal activities now constitute performance of particular services for its membership, including advertising, inspection and reinspection of properties, ACH and credit card processing, and sale of gift certificates; private benefit and commerciality also found (PLR 201617010).

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

(1) Clubs lost exemption due to excessive nonmember income (PLRs 201544026, 201612014).

(2) Organization subletting restaurant and selling beer and wine to public ruled not exempt social club; anyone who drinks there is automatically a member; IRS found lack of requisite mingling (PLR 201515035); likewise (PLR 201529011).

(3) Organization with "limited requirements" for membership, which issues "unlimited" memberships, and (ostensibly) engaged in private inurement denied recognition of exemption (PLR 201551010).

(4) Motorcycle club failed to qualify for exemption because it is sponsored and controlled by for-profit corporation and more than two-thirds of its income is derived from nonmembers (PLR 201615019).

(5) Organization formed to promote hunting, fishing, boating, shooting, etc. failed to qualify for exemption because majority of its income is derived from oil and gas leases (PLR 201615021).

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

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

(1) VEBA ruled able to dissolve and distribute assets without penalty (PLR 201528038).

(2) Amendment of VEBA trust to allow use of funds reserved for retiree benefits to pay for health benefits for active employees approved; IRS ruled no reversion to sponsor to create disqualified benefit and thus no excise tax on sponsor (IRC § 4976) (PLR 201530022).

(3) VEBA, with no remaining participants and no benefits remaining to be paid, ruled able to distribute its remaining assets to charitable organizations without creating disqualified benefit or unrelated business income taxation (PLR 201545026).

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

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

j. Rules concerning cooperatives (IRC § 501(c)(12) entities) [no recent developments].

k. Rulings, etc., concerning cemetery companies (IRC § 501(c)(13) entities) [no recent developments].

l. Developments concerning credit unions (IRC § 501(c)(14) entities) [no recent developments]

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

(1) Organization did not qualify for exemption because it is not an insurance company (PLRs 201609008, 201613016).

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

o. Rulings, etc., concerning supplemental unemployment benefit trusts (IRC § 501(c)(17) entities) [no recent developments].

p. Rulings, etc., concerning veterans' organizations (IRC § 501(c)(19) entities) [no recent developments].

q. Rulings, etc., concerning black lung benefits trusts (IRC § 501(c)(21) entities) [no recent developments].

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

s. Rulings, etc., concerning qualified health insurance issuers (IRC § 501(c)(29) entities:

(1) Joint Committee on Taxation, on January 19, 2016, released report on this category of tax-exempt organization (JCX-2-16).

t. Rulings, etc., concerning farmers' cooperatives (IRC § 521 entities) [no recent developments].

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

v. Rulings, etc., concerning homeowners' associations (IRC § 528 entities) [no recent developments].

w. Developments concerning qualified tuition plans (IRC § 529 entities):

(1) PATH Act repealed aggregation requirement, effective for distributions after December 31, 2014 (§ 302(b)).

(2) Programs unable to adjust their systems to retroactively accommodate new method of calculating earnings portion of distributions before due date of reporting form (Form 1099-Q for 2015); IRS notified these programs that it will not impose penalties (IRC § 6693) solely because of reported earnings computation in 2016 that does not reflect foregoing repeal (Notice 2016-13).

x. Developments concerning qualified ABLE programs/accounts (IRC § 529A entities):

(1) IRS held hearing on proposed regulations on October 14, 2015.

(2) On November 20, 2015, IRS released notice (2015-81) stating that final regulations will be modified in three respects to simplify reporting requirements.

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

(1) By reason of exclusion rule of IRC § 115: trust used by public employers to fund post-employment health and welfare benefits (PLRs 201516031, 201537019, 201550026, 201607025); clinically integrated faculty group practice of hospital and medical school (PLR 201528019); organization of members that are special districts and public bodies in state providing essential governmental functions (PLR 201551001); also PLR 201606004.

(2) IRS, on February 23, 2016, issued proposed regulation defining term *political subdivision* in tax-exempt bond context (REG-129067-15).

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

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

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

3. Court found lack of *organization*, in face of argument that entity was exempt social welfare organization, because there were no organizing documents or bylaws, no employer identification number, no financial records, no minutes, and control of funds by one individual who deposited them in his personal bank accounts (*George* v. *Commissioner* (Tax Ct. 2015)).

4. Court found that married couple, promoting an abusive tax shelter involving use of corporations sole, were liable for penalties (IRC § 6700), even if purchasers did not rely on plan or arrangement or did not underreport federal income tax (*Gardner* v. *Commissioner* (Tax Ct., 2015).

5. IRS ruled that arranger-type health plan that formerly qualified as Medicaid-only HMO should have IRC § 501(c)(3) status revoked, because plan merged with another plan that had commercial enrollment; entity reclassified as exempt entity by reason of IRC § 501(c)(4) (PLR 201538027).

6. Senate Finance Committee, in late November 2015, launched an investigation of small museums to determine extent of public benefit provided by them and existence of unwarranted tax advantages.

7. Import of inquiries in connection with Treasury, IRS proposed regulations concerning political activities of social welfare organizations:

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

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

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

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

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

f. Breadth of proposal.

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

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

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

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

k. IRS ruled, as to organization that has been operational for at least three years, that it does not qualify for exempt status as a social welfare organization because 100 percent of its expenditures were for political campaign activities in one year, even though it expended 100 percent of its volunteer time on exempt functions in the ensuing two years, because this organization did not make any exempt function expenditures in those two years (PLR 201615014).

B. Private Inurement

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

1. Private inurement led to revocation of exemption (PLR 201603042).

2. Private inurement led to denial of recognition of exemption (PLRs 201538026, 201545028, 201545029, 201552034, 201615016).

3. Organization that confined its scholarship grants to members of one family ruled ineligible for tax exemption on grounds of private inurement (*Educational Assistance Foundation for the Descendants of Hungarian Immigrants in the Performing Arts* v. *United States* (D.D.C., July 1, 2015; on appeal)).

4. Religious organization had its exemption retroactively revoked because its funds were used to pay for its president's clothing, jewelry, medical and dental expenses, credit card expenses, car payments, loan payments, and personal home expenses, along with no-interest loan to president's for-profit company (PLR 201533022).

5. Organization had tax-exempt status revoked because it was being used by its founder to conceal business receipts from his accounting practice to avoid payment of federal income taxes; founder convicted of subscribing to false income tax returns (PLR 201544028).

6. Private inurement was found, leading to revocation of exemption, because of purchasing arrangement of fundraising product between exempt organization and for-profit company owned by organization's founder, although there is no discussion of what terms and conditions of arrangement are unreasonable (PLR 201548021).

7. Private inurement was found, in fact that two of four authors of educational program materials, who are insiders with respect to organization, are paid royalties for their services, although there is no discussion of what aspect of the royalty arrangement the IRS considered unreasonable (PLR 201548025).

8. Private inurement held present where nonprofit organization is providing scholarships to students at for-profit school, where founder of both entities is same individual (PLR 201615016).

C. Private Benefit

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

1. Organizations held to not qualify for recognition of tax exemption by reason of private benefit doctrine (PLR 201601014, 201610025, 201610026).

2. Exemption revoked where organization was operating as conduit for payment of tuition to foreign educational institutions, resulting in private benefit to students' families (PLR 201539032).

3. Exemption revoked because of close operational ties with a telemarketing company; both entities were under common control (PLR 201541013).

4. Organization was established to further children's education, with emphasis on entrepreneurship; products created by children will be licensed for sale by this organization; organization held to be operating for private benefit of children (PLR 201545029).

5. Organization had exemption revoked because it participated in scheme of repeatedly accepting contributions of real estate with ostensibly high value then selling property for small amount (PLR 201610026).

6. IRS is in error in finding violation of private benefit doctrine where it is of the view that organization's operations "may" or "might" benefit private interests (e.g., PLR 201534020).

D. Intermediate Sanctions

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

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

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

E. Influencing Legislation

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

1. Annual per-person, -family, or -entity dues limitation to qualify for reporting exception regarding certain exempt organizations with nondeductible lobbying expenditures is $112 or less for 2016 (Rev. Proc. 2015-53).

2. Court found communications to be propaganda rather than educational, and held that nonpartisan analysis exception was not available (*Parks* v. *Commissioner*, Tax Ct., Nov. 17, 2015)).

3. It took Florida Commission on Ethics 16 months to conclude that lawyer did not violate rules by communicating with state's attorney general on behalf of clients, based on advice from independent counsel that distinction between lobbying and legal services is "delicate area" (*New York Times*, April 21, 2016).

F. Political Campaign Activity

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

1. Organization denied exemption as charitable and educational entity because its symposium's speakers were members of same political party and event occurred in midst of political campaign (PLR 201523021).

4. On July 17, 2015, IRS announced use of one or more political activities referral committees, which will consist of GS grade 14 managers, who will receive "appropriate training" and serve on a PARC for two years; a PARC will review and recommend referrals for audit in "impartial and unbiased manner"; the "inventory volume of political activities referrals" will determine number of PARCs established and time commitment required of PARC members (memorandum from Director, Exempt Organization Division (TEGE-04-0715-0018)).

5. IRS revoked exempt status of entity classified as charity, in part because its chief financial officer used entity's funds for his political campaign (PLR 201603036).

6. Organization failed to qualify for exemption by reason of IRC § 501(c)(4) because all of its expenditures have been for advertising in support of candidates in advance of city election (PLR 201615014).

7. Corporation ruled to not be able to deduct as business expenses its contributions to charitable organizations under matching program designed to incentivize employee contributions to political action committee; its PAC gifts and matching charitable gifts were held "inextricably linked," with latter types of gifts made in connection with political campaigns (PLR 201616002).

G. Structural Issues

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

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

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

Public charities and other tax-exempt organizations may, within limitations, utilize taxable

subsidiaries. Tax-exempt organizations may be involved in mergers. There are special rules concerning conversions of for-profit entities to exempt organizations.

3. Charitable organizations held able to utilize taxable subsidiaries without endangering their tax-exempt status [no recent developments].

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

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

6. Rulings as to mergers [no recent developments].

7. Pension Protection Act revised law concerning taxation of certain payments from controlled organizations to controlling organizations; no taxation in instances of arm's-length payments for preexisting arrangements (IRC §§ 512(b)(13), 482); provision made permanent by PATH Act (see VIII C 3).

8. Developments concerning use of limited liability companies [no recent developments].

9. Organizations denied recognition of exemption where they are successors to for-profit enterprises; IRS charged private inurement and commerciality (PLRs 201540016, 201540019).

H. Exemption Recognition Application Process and Notice Requirements

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

1. IRS, on July 1, 2014, released its streamlined application for eligible organizations to use in applying for recognition of tax-exempt status as charitable entity (Form 1023-EZ) (T. D. 9674, REG-110948-14, Rev. Proc. 2014-40, IR-2014-77).

2. National Taxpayer Advocate Mid-Year Report to Congress on Fiscal Year 2016 Objectives states that IRS "has gone too far" in designing and implementing Form 1023-EZ; projects IRS is wrongfully issuing determination letters in over 21 percent of cases; criticism continued in her annual report to Congress, dated January 6, 2016 (IR-2016-01).

3. Organization that is seeking recognition of exemption as charitable entity prevailed in litigation where court ruled it has jurisdiction over issue as to whether IRS acted improperly in its processing of application; organization is alleging viewpoint discrimination in violation of First Amendment (*Z Street, Inc.* v. *Koskinen* (D.D.C. 2014), *aff'd*, D.C. Cir., June 19, 2015)).

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

5. Court ordered IRS to produce list of putative class member organizations to plaintiff organizations seeking to certify class, for class action lawsuit, of aggrieved applicants for recognition of exemption (*NorCal Tea Party Patriots* v. *IRS* (S.D. Ohio, April 1, 2015); class action certified on January 12, 2016) (see no. 12, below).

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

7. Director, Rulings and Agreements, on September 8, 2015, issued memorandum updating agency's procedures for requesting additional information from applicant organizations (TEGE-07-0915-0022).

8. IRS, on December 2, 2015, issued a positive first-year report on use of Form 1023-EZ, concluding that the streamlined application is "reducing taxpayer burden and increasing cost effectiveness of the EO operations."

9. Senate Committee on Finance, on August 5, 2015, released its report on the Committee's bipartisan investigation of the IRS's handling of applications for recognition of tax exemption submitted by political advocacy organizations (S. Rep. No. 114-119). This inquiry was undertaken following allegations that the IRS discriminated against some of these organizations on the basis of their political views.

a. This investigation found that, from 2010 to 2013, IRS management was "delinquent" in its "responsibility to provide effective control, guidance, and direction over the processing of applications for [recognition of] tax-exempt status filed by Tea Party and other political advocacy organizations." IRS managers were said to fail in their responsibility to "keep informed about the very existence of the applications" or "recognize the sensitivity of these applications." As to the former, IRS management "forfeited the opportunity to shape the IRS's response to the influx of political advocacy applications by simply failing to read reports informing them of the existence of those applications." As to the latter, IRS managers "did not take appropriate steps to ensure that the applications were processed expeditiously and accurately."

b. References to IRS management largely means those heading the Exempt Organizations Division, the Director of which during 2006-May 2013 was Lois Lerner. This report states that she first became

aware of applications from Tea Party groups in April or May of 2010. The report states that, "[f]or the next two years, Lerner failed to adequately manage the EO employees who processed these applications" and "failed to inform upper-level IRS management of the serious delays in processing applications [for recognition of] tax-exempt status from Tea Party and other politically sensitive groups." It is stated that, under the leadership of Ms. Lerner, the Division undertook a number of initiatives to process these applications, with "[e]ach of these initiatives . . . flawed in design and/or mismanaged."

c. The report discusses the "dysfunctional culture" in the EO Division during this period, stating that it "operated without sufficient regard for the consequences of its actions for the applicant organizations." The brouhaha over the loss of and recovery of some emails is related; this was said to delay issuance of this report for more than a year. The report concludes that "[o]verall, the IRS's less than complete response to these circumstances cast[s] doubt about the thoroughness of their efforts to recover all relevant records related to the investigation, as well as their candor to this and other Congressional committees."

d. This Senate Finance Committee report offered a number of recommendations, including the following:

(1) The IRS should publish in the applications' instructions objective criteria that may trigger additional review and the procedures IRS specialists use to process applications involving political campaign activity.

(2) The IRS should be prohibited from requesting "individual donor identities" at the application stage, although "generalized donor questions should continue to be allowed."

(3) A position within the Taxpayer Advocate Service should be created, dedicated solely to assisting nonprofit organizations in applying for recognition of exemption.

(4) The EO Division should track the age and cycle time of its cases, so that it can detect backlogs early in the process and conduct periodic reviews of over-aged cases to identify the cause of the delays.

(5) The standards in the Internal Revenue Manual for timely processing of cases should be enforced and employees who fail to follow them should be disciplined.

(6) IRS employees should be directed to conclude application cases within 270 days of filing.

(7) The Sensitive Case Report process should be revised or a more effective way to elevate important issues within the IRS should be developed.

(8) There should be "minimum training standards" for all EO Division managers to "ensure that they have adequate technical ability to perform their jobs."

(9) The IRS should fully implement the recommendations of the Government Accountability Office in its July 2015 report.

e. The majority and minority staff were unable to reach agreement as to these topics:

(1) The extent to which, if any, political bias of IRS employees affecting IRS's processing of applications for recognition of tax-exempt status.

(2) Whether the IRS used improper methods to screen and process applications for recognition of exempt status submitted by "progressive and left-leaning organizations."

(3) The involvement, if any, of Treasury Department and White House employees, including the President, in directing or approving the actions of the IRS.

f. Conclusion: Between 2010 and 2013, the IRS failed to fulfill its obligation to administer the tax law with, in the words of its mission statement, "integrity and fairness to all." The Committee's investigation uncovered "serious shortcomings" as to how the IRS exercises its power when processing the applications at issue – "shortcomings that raise public doubt about whether the IRS is a neutral administrator of the tax laws." "Immediate and meaningful changes, including increased accountability to Congress and strengthened internal controls, are necessary if diminished public confidence in the IRS is to be restored."

g. The title of this report is "The Internal Revenue Service's Processing of 501(c)(3) and 501(c)(4) Applications for Tax-Exempt Status Submitted by 'Political Advocacy' Organizations from 2010-2013."

10. IRS extended date for new social welfare organizations, to June 15, 2016, to file IRC § 506 notice (Notice 2016-09).

11. IRS stated that, since PATH Act (see VIII C 3) expanded declaratory judgment rules for benefit of nearly all types of exempt organizations, prior ways of modifying exemption are no longer applicable but rather will be treated as deemed revocations (TEGE-04-0216-0003).

12. Appellate court appeared to agree with those who assert that IRS used "inappropriate" criteria in processing Tea Party and similar groups' applications for recognition of exemption (*United States* v. *NorCal Tea Party Patriots* (6th Cir., Mar. 22, 2016).

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

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

1. IRS revoked (or proposed revocation of) tax-exempt status of organizations for failure to file annual information returns (PLRs 201445011, 201445012, 201449001, 201517013).

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

J. Disclosure Requirements

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

2. Appellate court, on May 1, 2015, upheld regulation promulgated by attorney general in California requiring charitable organizations, to be eligible to solicit contributions in the state, to submit copy of Form 990, including all schedules, with attorney general's office (*Center for Competitive Politics* v. *Harris* (9th Cir.), *cert. den*., Nov. 9, 2015)); same outcome re New York (*Citizens United* v. *Schneiderman* (S.D.N.Y., July 27, 2015)).

3. Appellate court vacated injunction on California attorney general as to collection of unredacted Schedules B, preserved injunction as to disclosure of information to public (*Americans for Prosperity Foundation* v. *Harris*; *Thomas More Law Center* v. *Harris* (9th Cir., Dec. 29, 2015).

4. District court permanently enjoined disclosure of Form 990, Schedule B information to California's attorney general (Americans for Prosperity Foundation v. Harris (C.D. Cal. April 21, 2016)).

5. Tax-exempt organization was subject of two determination letters; its attempt to cause Tax Court to declare that first determination letter was "un-issued" and thus should not be made available for public inspection, or that a portion of examination report accompanying the first letter discussing application of the private inurement doctrine must be redacted, failed (*Anonymous* v. *Commissioner*, Tax Court, Oct. 26, 2015)).

6. Appellate court rejected IRS assertions that applications for recognition of exemption are tax returns and that applicants' names are return information; court upheld lower court order that BOLO lists must be turned over in discovery proceedings and denied IRS's request for writ of mandamus against district court (*United States* v. *NorCal Tea Party Patriots* (6th Cir., Mar. 22, 2016).

7. District court, on April 21, 2016, permanently enjoined Attorney General of California from demanding the Form 990, Schedule B, filed by a public charity with IRS; following trial, court found the Schedule B disclosure requirement unconstitutional (free speech violation) as applied to this charity (Americans for Prosperity Foundation v. Harris (C.D. Cal.)).

K. Governance Developments

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

2. Board composition and federal tax law rules.

3. Sources of nonprofit governance principles:

a. Watchdog agencies.

b. Sarbanes-Oxley Act of 2002.

c. Treasury Department's Voluntary Best Practices (Nov. 2005).

d. Committee for Purchase proposed best practices (Dec. 16, 2005)

e. IRS's draft Model Good Governance Practices for charitable organizations (Feb. 2, 2007); these practices abandoned in Feb. 2008.

f. Senate Finance Committee staff paper (2004).

g. The American National Red Cross Governance Modernization Act of 2007 (H.R. 1681) was signed into law on May 11, 2007.

h. On February 14, 2008, IRS replaced draft of Model Good Governance Practices with paper on governance of charitable organizations.

i. Form 990 for 2008, particularly Part VI (see III).

j. Panel on Nonprofit Sector recommendations ("Principles for Good Governance and Ethical Practice") (2015 ed.).

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

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

m. California Nonprofit Accountability Act.

4. Governance policies, procedures, protocols, practices:

a. Ones that are generally suitable:

(1) Conflict-of-interest.

(2) Document retention and destruction.

(3) Whistleblower.

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

(5) Executive compensation.

(6) Gift acceptance.

(7) Investment.

(8) Form 990 review.

b. Others:

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

(2) Conservation easement.

(3) Joint venture.

(4) Documentation of meetings.

(5) International and domestic grantmaking.

(6) Chapters, affiliates, branches.

(7) Fundraising.

(8) Tax-exempt bond compliance.

5. Governance issues:

a. Governing board size.

b. Governing board composition.

c. Role of governing board.

d. Organization effectiveness and evaluation.

e. Board effectiveness and evaluation.

f. Frequency of board meetings.

g. Term limits.

h. Board member compensation.

i. Audit committee.

j. Other committees.

k. Compliance with law.

l. Categories of expenditures.

m. Disclosures to public.

n. Mission statement.

o. Code of ethics.

p. Fundraising practices.

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

7. Role of IRS in nonprofit governance:

a. IRS use of private benefit doctrine (see III C).

b. IRS: Organization cannot qualify as exempt charitable entity if it has small board:

(1) Organization cannot qualify as tax-exempt, charitable entity inasmuch as it has board of directors consisting of only two individuals, automatic unwarranted private benefit found (PLRs 200736037, 200737044).

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

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

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

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

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

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

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

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

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

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

(12) Health care organization denied recognition of exemption in part because its 28-person board (nearly all physicians) does not represent "broad interests of community" (PLR 201440020).

(13) Organization with one director held to not qualify for tax exemption because, in part, it does not have a community-based board (PLR 201525014).

(14) Individual, as founder of organization, is its president, executive director, sole employee, and one of three board members; she was held to be in "complete control" of entity, resulting in private inurement (PLR 201540019).

(15) As condition of exemption, IRS forced organization to expand its board from one individual to three unrelated individuals (and add another individual as an officer) (PLR 201541013).

c. IRS: Organization cannot qualify as exempt charitable entity if it has board of related individuals:

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

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

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

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

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

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

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

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

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

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

(11) Organization declined to expand three-individual related board; entity denied recognition of exemption for other reasons (PLR 201507026).

(12) Organization expanded three-individual related board; entity denied recognition of exemption for non-governance reasons (PLR 201526020)

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

(1) Private benefit found in part because entity did not have conflict-of-interest policy (PLRs 200830028, 200843032, 201221022).

(2) Organization failed to gain recognition of exemption in part because it lacked executive compensation policy (PLR 200843032).

e. Discrepant (and correct) determinations:

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

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

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

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

f. Lifetime board positions:

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

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

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

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

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

h. Government agency's acts are ultra vires where (1) it has acted outside the bounds of its statutory authority or (2) acts without applicable authority (*City of Arlington, Texas* v. *Federal Communications Commission* (Sup. Ct. 2013)).

i. Does IRS have the authority (jurisdiction) to regulate in field of nonprofit governance? Implications of *Loving* v. *Internal Revenue Service* and *Ridgeley* v. *Lew*, along with *California Independent System Operator Corporation* v. *Federal Energy Regulatory Commission* (D.C. Cir. 2004)).

L. Procedural Rules and Practices

1. IRS issued administrative procedural rules for 2016:

a. Revised procedures for obtaining private letter rulings, information letters, and determination letters on issues under jurisdiction of Associate Chief Counsel for taxpayers generally (Rev. Proc. 2016-1, 2016-1 I.R.B. 1).

b. Revised procedures explaining when and how Associate Chief Counsel offices provide technical advice to Director or Appeals Area Director, and explaining rights that taxpayer has when field office requests TAM (Rev. Proc. 2016-2, 2016-1 I.R.B. 102).

c. Revised inventory of domestic issues on which IRS will not issue letter rulings or determination letters (Rev. Proc. 2016-3, 2016-1 I.R.B. 126).

d. Revised procedures for rulings, information letters, and the like on matters under the jurisdiction of Tax Exempt and Government Entities Division (Rev. Proc. 2016-4, 2016-1 I.R.B. 142).

e. Procedures for issuance of determination letters as to the exempt status of organizations, including those based on the streamlined application (Rev. Proc. 2016-5, 2016-1 I.R.B. 188).

f. User fee schedule for exempt organizations matters (Rev. Proc. 2016-8, 2016-1 I.R.B. 243).

g. Revised procedures for issuing determination letters on foundation status, including operating foundation status (Rev. Proc. 2016-10, 2016-2 I.R.B. 270).

M. IRS Audit Activity

1. IRS audit authority (IRC § 7602).

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

3. Types of IRS audits:

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

   b. Office examination.

   c. Correspondence examination.

   d. Team examination.

4. Compliance check projects:

   a. Organizations maintaining group exemption (questionnaire Form 14414).

   b. IRC § 501(c)(27) entities (Form 14395).

   c. Status of charitable spending initiative.

   d. Self-declarers (questionnaire Form 14449).

   e. College and university final report issued (April 25, 2013).

5. Other areas of inquiry:

   a. International grantmaking activities.

   b. Employee/independent contractor classification.

   c. Employment taxes.

   d. Private foundations.

6. Church audit rules (IRC § 7611):

   a. Church tax inquiries.

   b. Church tax examinations.

   c. Appropriate high-level Treasury official (magistrate judge held, on November 18, 2008, that the Director, Examinations has been improperly designated by IRS as that official (*United States v. Living Word Christian Center*

(D. Minn.)); IRS filed objections on December 3, 2008; church responded to them on December 15, 2008; district court adopted magistrate's report on January 30, 2009; IRS decided to not appeal this decision (appeal deadline expired on March 31, 2009).

d. IRS proposed regulation changes on July 31, 2009 (REG-112756-09); high-level official proposed is Director, Exempt Organizations; hearing held on January 20, 2010.

e. Status of IRS church inquiries/examinations.

f. A press release dated July 17, 2014 in connection with settlement of litigation (*Freedom From Religion Foundation* v. *Koskinen*) states that IRS has developed new policies and procedures concerning its church investigations.

7. IRS revoked tax-exempt status for failure to respond to IRS request for information (PLR 201603035).

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

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

10. Government Accountability Office, in report issued in mid-July, 2015, concluded that there are "several areas" where Exempt Organizations Division's controls to enable it to properly select tax-exempt organizations for examination "were not well designed or implemented" ("IRS Examination Selection: Internal Controls for Exempt Organization Selection Should Be Strengthened" (GAO-15-514)).

11. IRS memorandum, dated December 30, 2015, from Director, EO Examinations, references newly renamed "EO Referrals Group," which is to create "peer review group" that will be responsible for reviewing "high profile referrals"; these referrals include "information items" containing or involving (1) evidence or allegations of financial transactions with, including contributions to, individuals or organizations with known or suspected terrorist connections; (2) evidence or allegations involving a church; (2) high-impact issues (e.g., the decision may result in media attention); (4) sensitive cases (e.g., the information was submitted by an elected official (other than those in the Congressional or Executive branches); (5) items submitted by a member of Congress or congressional staff; and (6) other factors indicating that review by the peer review team would be desirable for reasons of fairness or integrity.

N. Other Federal Tax Law Developments

1. IRS granted organization's request for extension of time within which to file election by tax-exempt controlled entity to not be treated as an exempt entity (IRC § 168(h)(6)(F)(ii)(I)) (PLRs 201606005, 201609002).

2. IRS, on August 28, 2015, announced that it is waiving penalties assessed against any educational institution for tuition statements (Forms 1098-T) that were filed with an incorrect or missing taxpayer identification number, as long as institution certifies that it complied with regulations governing solicitation of payee TINs; this relief provided in Trade Preferences Extension Act, enacted earlier this year.

IV. MATTERS PERTAINING TO PUBLIC CHARITIES AND PRIVATE FOUNDATIONS

A. Public Charity/Private Foundation Classification Rules

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

i. Seven additional regulation projects are embedded in discussion of final regulations or in final regulations themselves, involving clarification of application of responsiveness test, clarification of significant voice test, new rules for supporting organizations with respect to governmental entities, new definition of *parent*, expansion of rules describing expenditures of non-functionally integrated Type III supporting organizations, rules as to whether program-related investments will count toward distribution requirement, and definition of *control* in connection with Type I or III relationship test.

3. Also, on December 22, 2012, Treasury and IRS issued temporary regulations establishing (revised) payout requirement for non-functionally integrated Type III supporting organizations; 85-percent-of-net-income payout; set-aside feature (REG-155929-06); these regulations were issued in final form on December 21, 2015 (T.D. 9746).

4. Additional requirements in connection with requirements for Type III supporting organizations, and prohibition on certain contributions to Type I and Type III supporting organizations were proposed on February 18, 2016 (REG-118867-10).

5. IRS retroactively revoked supporting organization's exempt status where its sole source of funding is nonvoting partnership interest and it is operated for private benefit of one family (PLR 201543019).

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

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

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

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

c. Evidence of *advisory privilege*.

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

e. Donor required to obtain certain contemporaneous written acknowledgement.

f. Excess business holdings rules are applicable.

g. Certain transactions are automatic excess benefit transactions.

h. Certain distributions from donor-advised fund are taxable.

i. Reporting and disclosure rules.

7. Status of proposed regulations.

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

9. Developments as to church status:

a. Organization lost its status as church, even though it satisfied some of IRS's 14-point criteria, because it failed *associational test* (*Foundation of Human Understanding* v. *United States* (U.S. Ct. Fed. Cl. (2009), *aff'd*, (Fed. Cir. 2010)), *cert. den.*, Mar. 21, 2011)).

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

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

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

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

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

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

h. IRS ruled that, to be exempt, church must have "regular worship services conducted at a regular location with a regular congregation" (PLR 201325017); likewise (PLRs 201327018, 201609006).

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

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

11. IRS revised public charity status of entity from IRC § 509(a)(2) status to § 509(a)(1) status (PLR 201418067).

12. Organization held to be IRC § 509(a)(2) publicly supported charity because majority of its support is in form of fees (PLR 201445013).

13. Proposed grant to community foundation held unusual grant in that all criteria for this type of grant (Reg. §§ 1.170A-9(f)(g)(ii), 1.509(a)-3(c)(4)) are satisfied (PLRs 201507024); other favorable unusual grant rulings (201512004, 201608016).

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

B. Self-Dealing Rules

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

1. In the following situations, the IRS ruled that the transaction or transactions did not constitute self-dealing [no recent developments].

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

C. Mandatory Distributions

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

1. Set-asides, and modifications and extensions of set-asides, approved (PLRs 201533015, 201533016, 201606033).

2. Set-aside ruling for “innovative and dynamic educational” website (PLR 201534018).

3. Proposed regulations issued on September 23, 2012, in connection with standards applicable to private foundations for making good faith determination that foreign organization is charitable organization, grants to which may constitute qualifying distributions and not taxable expenditures (REG-134974-12); regulations issued in final form on September 23, 2015 (T.D. 9740).

4. IRS granted extension of time for private foundation to elect over multiple tax years to treat distributions made in prior years as current distributions (Priv. Ltr. Rul. 201527042).

D. Excess Business Holdings

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

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

2. IRS ruled that private foundation involvement in low-income housing project did not entail an excess business holding (and not generate unrelated business income (PLR 201603032).

E. Jeopardy Investments

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

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

2. IRS published guidance on application of these rules in context of mission-related investing (not PRIs) (Notice 2015-62).

3. Treasury and IRS, on April 21, 2016, issued final regulations providing series of examples illustrating investments that qualify as program-related investments (T.D. 9762).

F. Taxable Expenditures

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

1. Awards of scholarships and/or fellowships held to comply with IRC § 4945(g)(1) and thus not constitute taxable expenditures (PLRs 201540018, 201541011, 201543020, 201544032, 201545032, 201548022, 201548023, 201550045-201550048, 201608017-201608020, 201609009, 201610022, 201612015, 201613017, 201614039, 201615020, 201617013).

2. Proposed regulations concerning private foundations' good faith determinations (see IV C 3).

3. Private foundation and its founder/sole manager held liable for initial and additional excise taxes for producing and distributing direct lobbying communications in form of radio messages and newspaper advertisements aimed at influencing state ballot initiative; founder's reliance on legal advice ruled inadequate (*Parks* v. *Commissioner*, Tax Ct., Nov. 17, 2015)).

4. IRS, on Nov. 20, 2015, issued technical advice memorandum holding that excise taxes on taxable expenditures, that arose because trust (classified as private foundation) failed to meet expenditure responsibility requirements, cannot be abated inasmuch as trust did not demonstrate reasonable cause for the failure; reliance on accounting firm's preparation of returns ruled insufficient to show reasonable cause (201547007).

G. Termination of Status

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

1. Transfers of private foundation's assets to other or new private foundations held to qualify under IRC § 507(b)(2) (PLRs 201603033, 201603034, 201606030, 201609001).

H. Tax on Net Investment Income

1. [no recent developments].

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

I. Disqualified Persons

1. [no recent developments].

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

J. Split-Interest Trusts [no recent developments]

V. MATTERS PERTAINING TO UNRELATED BUSINESS

A. Unrelated Business Rules in General

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

1. Interrelationship of commerciality doctrine and unrelated business rules.

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

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

a. Exempt college's issuance of units in its endowment fund to charitable remainder trusts for which it serves as trustee and is remainder interest beneficiary, in return for trust assets, will not generate unrelated business income to college (PLR 201613014).

b. Charitable remainder trust's exchange of assets for endowment fund units, receipt of associated payments, and holding and redemption of units will not generate unrelated business income to trust (PLR 201613015).

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

a. Fundraising event (sales of arts and crafts, farmers' market, entertainment, and refreshment booths) regularly carried on by exempt alumni association for benefit of college determined to be unrelated business (TAM 201544025).

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

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

7. Court held, in context of multiemployer pension termination liability law, that activities of private equity funds are *trades or businesses*, rather than mere investment activity, relying on concept of *investment plus* that was articulated by First Circuit in 2013 (*Sun Capital Partners III, LP* v. *New England Teamsters & Trucking Industry Pension Fund* (D. Mass. 2016)).

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

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

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

c. Deductions totaled $9.8 billion.

d. Gross income was 5.8 percent decrease in relation to amount reported for 2008.

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

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

B. Exceptions to Unrelated Business Taxation

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

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

2. For 2016, limitation regarding exemption of annual dues required to be paid by member to an agricultural or horticultural organization (IRC § 512(d)(1)) is $161 (Rev. Proc. 2015-53).

3. For 2016, exception from unrelated business taxation involving low-cost articles is applicable with respect to articles with a cost of no more than $10.60 (Rev. Proc. 2015-53).

4. Provision introduced by Pension Protection Act eliminating unrelated business income tax on certain payments to controlling tax-exempt organizations was made permanent by enactment of PATH Act (see VIII C 3).

C. Unrelated Debt-Financed Income Rules [no recent developments]

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

D. Enacted and Proposed Legislation [no recent developments]

VI. MATTERS PERTAINING TO CHARITABLE GIVING

A. Contribution Rules in General

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

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

a. Trust's charitable deduction for gift of property may be based on property's fair market value, rather than be confined to amount trust paid for property out of its gross income (*Green* v. *United States* (W.D. Okla. 2015)).

b. Partnership's charitable gifts of $4.75 million held deductible, even though originally erroneously made using corporation's checks; matter was timely corrected and court ruled that public policy favoring charitable giving dictated outcome (*Green* v. *United States* (W.D. Okla. 2016)).

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

a. Estate's charitable deduction was reduced, by reason of post-death intrafamily transactions that caused property of considerably lesser value than that originally bequeathed to pass to charitable foundation established by decedent (*Dieringer* v. *Commissioner*, Tax Ct. 2016).

b. Claimed charitable deductions of pastor held unavailable because burden of proof not met and amounts involved were "implausible" (*Brown* v. *Commissioner*, Tax Ct. 2016).

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

4. IRS issued rules as to inflation-adjusted amounts for 2016 (Rev. Proc. 2015-53): Insubstantial benefit limitations for contributions associated with charitable fundraising campaigns (IRC § 513(h)):

a. Low-cost article ($10.60).

b. Guidelines using $5, $25, and $50 limits ($10.60, $53, and $106).

5. Donors of conservation easement to charity held not entitled to charitable deduction because, at time of gift, easement was subject to unsubordinated mortgage and risk of foreclosure under these facts was not so remote as to be negligible (*Mitchell* v. *Commissioner* (10th Cir.)); likewise, *Minnick v. Commissioner* (9th Cir., August 12, 2015, two opinions).

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

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

8. Gifts of conservation easements did not qualify for charitable contribution deduction because restrictions on use of property were not granted in perpetuity, in that deeds permit modifications to boundaries between homesite parcels and property subject to easements (*Bosque Canyon Ranch, LP* v. *Commissioner* (Tax Ct., 2015)).

9. Appellate court upholds denial of charitable deductions where company, not owner and executive (and ostensible donor) bore economic burden of contributions (*Zavadil* v. *Commissioner* (8th Cir. 2015)).

10. IRS explored situations where charitable contributions are deductible as business expenses (CCAM 201543013).

11. Trust's charitable deduction for gift of property held based on property's fair market value, rather than confined to amount trust paid for the property with its gross income (basis) (*Green* v. *United States* (W.D. Okla., Nov. 4, 2015)).

12. Donors held liable for 40% gross valuation misstatement penalties (IRC § 6662(h)) because requisite initial determination (IRC § 6751(b)) was made, even though it represented government's alternative position (*Legg* v. *Commissioner*, Tax Ct., Dec. 7, 2015)).

13. Donors held ineligible for charitable contribution deductions for gifts of conservation easements on golf course and owe $4.6 million in tax deficiencies; donors held not liable for $1.4 million in penalties (*Atkinson* v. *Commissioner*, Tax Ct., Dec. 9, 2015)).

14. Donor denied charitable deduction for gift of historic easement in year of gift because deed not effective until next year, under state law, when it was recorded (*Mecox Partners LP* v. *United States* (S.D.N.Y., Feb. 1, 2016)).

15. Trust allowed charitable deduction (IRC § 642(c)(1)), in amount equal to income in respect of decedent included in its gross income, if it pays lump sum amounts received from decedent's individual retirement accounts to charity in same year (PLR 201611002).

B. Planned Giving

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

1. The IRS issued the following private letter rulings with respect to charitable remainder trusts (IRC § 664):

a. Reformation of trust to correct scrivener's errors approved [no recent developments].

b. Although valuation statute (IRC § 664(e)) is ambiguous, its legislative history and IRS guidance make it clear that value of remainder interest in a net income makeup charitable remainder unitrust must be calculated using greater of 5 percent or fixed percentage stated in trust instrument (*Estate of Schaefer* v. *Commissioner* (Tax Ct., July 28, 2015)).

2. Successful qualified reformations of remainder trusts [no recent developments].

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

4. IRS, on January 16, 2014, issued proposed regulations for determining basis, in the case of taxable beneficiaries, in charitable remainder trusts term interests on disposition of all interests in trust, where that basis consists of share of adjusted uniform basis (REG-154890-03); proposal result of transaction-of-interest project announced in 2008 (Notice 2008-99); final regulations (unchanged from proposal) issued on August 11, 2015 (T.D. 9729).

5. Developments concerning pooled income funds (IRC § 642(c)(5) entities) [no recent developments].

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

C. Gift Recordkeeping, Substantiation, and Appraisal Rules

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

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

2. Substantiation requirements (IRC § 170(f)(8)):

a. Ostensible donors of $37,315 in noncash property held to fail requirements for all gifts, assessed accuracy-related penalty (*Kunkel* v. *Commissioner* (Tax Ct., 2015)).

b. Donor lost charitable deductions in part because substantiation rules for noncash contributions exceeding $500 and exceeding $250 were not satisfied (*Isaacs* v. *Commissioner* (Tax Ct., 2015)).

c. Form of substantiation:

(1) Usually provided by charitable donee by letter.

(2) Substantiation rules may be satisfied by provision in deed.

(3) Tax Court held that substantiation rules may be satisfied by provision in conservation easement agreement.

(4) Tax Court held that letter signed by mayor of township constituted requisite substantiation of bargain sale.

3. Proposed regulations implementing exception to general gift substantiation requirement (IRC § 170(f)(8)(D)) were issued on September 16, 2015, by which donee organizations may file information returns with IRS that report required information about contributions (REG-138344-13); IRS withdrew proposal on January 7, 2016, amid controversies about identity theft and IRS authority expansion.

4. Donors denied carryover charitable contribution deductions because their conservation deed did not satisfy substantiation requirement (*French* v. *Commissioner*, Tax Ct., Mar. 23, 2016).

5. Appraisal requirements (IRC § 170(f)(11)):

a. Tax Court will be vacating portion of *Rothman*, holding that appraisal did not contain valuation method (and basis for determining property's after value), because of decision in *Scheidelman* but nonetheless held that appraisal was not qualified due to additional significant defects in document (*Rothman* v. *Commissioner*).

b. Tax Court held that appraisal requirement not met where qualified appraiser testified he did not write appraisal donor tried (unsuccessfully) to introduce into evidence (*Isaacs* v. *Commissioner* (2015)).

c. Tax Court held that deduction for gift of easement was lost because donors failed to attach copy of appraisal of property to tax return as required by IRC § 170(h)(4)(B)(iii) (*Gemperle* v. *Commissioner* (2016)).

6. Valuation disputes:

a. Donor of conservation easement, on February 5, 2016, held entitled to pre-easement value of underlying real property of at least $21 million; IRS asserted $7.75 million; on remand, Tax Court has flexibility to value property as high as $25.2 million (*Palmer Ranch Holding Ltd* v. *Commissioner* (11th Cir.)).

7. IRS, on August 6, 2008, issued proposed and temporary regulations concerning charitable deduction substantiation and reporting requirements (REG-140029-07); IRS held hearing on these proposals on January 23, 2009 (Ann. 2008-122); regulations address:

a. Gift recordkeeping requirements.

b. Gift substantiation requirements, principally for noncash gifts.

c. Qualified appraisals.

d. Qualified appraisers.

e. Rules as to gifts of clothing and household items (IRC § 170(f)(16)).

D. Enacted and Proposed Legislation [see VIII C]

VII. FUNDRAISING REGULATION

A. State Regulation

1. State charitable solicitation act developments.

2. Court opinions [no recent developments].

B. Federal Regulation

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

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

3. Ostensible fundraising operations held commercial:

a. Tax Court, on January 28, 2013, held that an organization selling flowers online to public at market prices, where customers can designate charitable organizations to receive sales transactions profits, is operating in commercial manner and thus cannot be exempt, fundraising component notwithstanding (*Zagfly, Inc*. v. *Commissioner* (affirmed by 9th Cir.).

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

c. Organization, operating "automated fundraising online marketplace," enabling purchasers of goods to direct profits on transactions to public charities, ruled engaged in commercial and nonexempt business (PLR 201503016).

d. Organization providing fundraising and marketing services to unrelated charitable entities on fee-for-service basis ruled commercial and thus not tax-exempt (PLR 201507026).

4. Recordkeeping, substantiation, and appraisal rules (VI C).

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

6. Fundraising event conducted by tax-exempt alumni association, held every weekend, for benefit of public college, held to be an unrelated business (TAM 201544025).

VIII. STILL OTHER DEVELOPMENTS

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

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

1. Inflation adjustments for 2016 (Rev. Proc. 2015-53):

a. Tax rate tables, reflecting the marginal tax rate of 39.6 percent (imposed on individuals' income in excess of $415,050 ($466,950 for married couples filing jointly)

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

c. Limitation on allowable itemized deductions applicable to individuals with income of at least $259,400 ($3113900 for married couples filing jointly)

d. Personal exemption amount is $4,050, with phase-out beginning with incomes of $258,250 ($309,900 for married couples filing jointly); phase-out is complete at $381,900 ($433,800 for married couples filing jointly)

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

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

g. Annual exclusion for gifts is $14,000.

B. Court Opinions

1. United States Supreme Court:

a. Court, on June 18, 2015, ruled that town's sign codes provisions are content-based regulations of speech that do not survive strict scrutiny; sign codes restrictions discriminate against church and do not further compelling governmental interest (*Reed* v. *Town of Gilbert, Arizona*).

b. Court, on June 25, 2015, ruled that refundable tax credits made available to individuals who purchase health insurance on state exchanges are also available if insurance is acquired from an exchange established by federal government (*King* v. *Burwell*).

c. Court, on June 26, 2015, ruled that there is a right to same-sex marriage and that right to marry is fundamental right inherent in personal liberty, and under Due Process and Equal Protection Clauses of Fourteenth Amendment (*Obergefell* v. *Hodges*).

d. Court, on June 29, 2015, announced it will be revisiting issue of use of race in admissions policies of public universities, this time looking once again at the practice by University of Texas at Austin (*Fisher* v. *University of Texas*).

e. Court, on June 29, 2015, issued order allowing certain religious organizations to sidestep compliance with federal regulations involving contraceptive mandate (*Zubik* v. *Burwell*).

f. Court, on June 30, 2015, announced it will hear case concerning the constitutionality (free speech) of practice of government-employees unions requiring workers who are not union members to help pay for collective bargaining *(Friedrichs* v. *California Teachers Association).*

g. Petition for review filed on October 26, 2015, in case claiming that Patient Protection and Affordable Care Act is unconstitutional because it was enacted in violation of the origination clause of the Constitution (*Sissel* v. *Department of Health and Human Services*).

h. Court, on November 6, 2015, granted *certiorari* in cases pending before it challenging legality, under Religious Freedom Restoration Act, of participation, pursuant to federal regulations, of religious organizations in rules concerning Patient Protection and Affordable Care Act's contraceptive mandate (*East Texas Baptist University* v. *Burwell*; *Geneva College* v. *Burwell*; *Little Sisters of the Poor Home for Aged, Denver, Colorado* v. *Burwell*; *Priests for Life* v. *Dept. of Health and Human Services*; *Roman Catholic Archbishop of Washington* v. *Burwell*; *South Nazarene University* v. *Burwell*; and *Zubik* v. *Burwell*).

i. Court, on January 11, 2016, denied certiorari in case challenging legality of individual health insurance mandate, of Patient Protection and Affordable Care Act, on ground that generally requiring individuals to purchase health insurance, while exempting individuals with certain religious beliefs, is violation of Establishment Clause (*Cutler* v. *Department of Health and Human Services*).

j. Court, on March 29, 2016, issued 4-4 decision on issue of whether it is constitutional for public-sector unions to levy fees on workers who are not union

members; argument was that fee-charging practice is violation of free speech principles (*Friedrichs* v. *California Teachers Association*).

2. United States Courts of Appeals:

a. Court, on February 11, 2014, held that IRS regulations concerning plan to regulate paid tax-return preparers are invalid because IRS lacks authority (jurisdiction) under pertinent statute; regulations held to fail both prongs of deference standard (*Loving* v. *Internal Revenue Service* (D.C. Cir.)).

b. Contraceptive mandate held not in violation of Religious Freedom Restoration Act (*Catholic Health Care System* v. *Burwell* (2nd Cir., Aug. 7, 2015); *Michigan Catholic Conference* v. *Burwell* (6th Cir., Aug. 21, 2015).

c. Contraceptive mandate regulations may not be enforced against nonprofit organizations that object on religious grounds (*Sharpe Holdings, Inc.* v. *Department of Health and Human Services*; *Dordt College* v. *Burwell* (8th Cir., September 17, 2015)).

d. Tax-exempt teaching hospital failed in its efforts to obtain an overpayment refund of taxes, accompanied by higher rate of interest reserved for non-corporations, with court rejecting assertion that use of word *corporation* does not include nonprofit corporations (*Maimonides Medical College* v. *United States* (2nd Cir.)).

3. United States District Courts:

a. Court, on August 31, 2015, held that contraceptive mandate, as applied to nonreligious nonprofit organizations and its employees with contrary religious views, is unconstitutional as violation of equal protection clause and Religious Freedom Restoration Act (*March for Life* v. *Burwell* (D.D.C.)).

4. United States Tax Court:

a. Promoters of abusive tax shelter, involving religious entity, were held liable, on August 26, 2015, for promotion penalties for marketing shelter (*Gardner* v. *Commissioner*).

5. United States Bankruptcy Courts [no recent developments]

C. Enacted and Proposed Legislation

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

a. Tax exemption law provisions:

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

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

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

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

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

(6) Increase in specific deduction (IRC § 512(b)(12)) in computing taxable unrelated business income, from $1,000 to $10,000 (§ 5006).

(7) Repeal of exclusion from unrelated business income of gain or loss from disposition of real property (IRC § 512(b)(16)) (§ 5007).

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

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

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

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

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

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

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

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

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

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

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

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

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

(21) Imposition of in-state requirement for certain tax-exempt workers' compensation insurance organizations (§ 5303).

(22) Repeal of law authorizing Type II and III supporting organizations (§ 5304).

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

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

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

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

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

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

b. Charitable deduction law provisions:

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

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

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

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

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

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

(7) College athletic event seating rights charitable deduction rule (IRC § 170(l)) would be repealed (*id.*).

(8) Income from intellectual property contributed to charity would no longer be deductible as additional contribution (IRC § 170(m)) (*id.*).

2. On September 28, 2015, House passed Equitable Access to Care and Health Act, which would expand existing religious exemption from individual mandate to include groups with religious objections to certain medical services (H.R. 2061).

3. The Protecting Americans from Tax Hikes Act of 2015 was signed into law on December 18, 2015; the pertinent nonprofit law provisions are the following:

a. Reinstatement of and permanency for the 50 percent charitable contribution deduction and 15-year carryforward for contributions of real property for conservation purposes (Act § 111).

b. Reinstatement of and permanency for the enhanced charitable deduction for gifts if conservation property by qualified individual and corporate farmers and ranchers (*id.*).

c. Reinstatement of and permanency for the law allowing tax-free distributions for charitable purposes from individual retirement plans (§ 112).

d. Reinstatement of, permanency for, and modification of the enhanced deduction for charitable contributions of food inventory and special rules for valuing food inventory (§ 113).

e. Reinstatement of and permanency for modification of the tax treatment of certain payments by controlled entities to tax-exempt organizations (§ 114).

f. Permanent extension of the rule that a shareholder's basis in the stock of an S corporation is reduced by the shareholder's pro rata share of the adjusted basis of property contributed by the S corporation for charitable purposes (§ 115).

g. Various changes in the law pertaining to 529 higher education accounts, including expansion of the definition of qualified higher education expenses to include computer equipment and technology (§ 302).

h. Elimination of the residency requirement for qualified ABLE programs (§ 303).

i. Public support status and contribution deduction eligibility for certain agricultural research organizations (§ 331).

j. Clarification of the valuation method for the early termination of certain charitable remainder unitrusts (§ 344).

k. Requirement that the IRS create procedures pursuant to which an exempt organization facing an adverse determination may request administrative appeal to the IRS's Office of Appeals (§ 404).

l. Provision of a streamlined recognition process (notice of registration) for organizations seeking recognition of exemption as social welfare organizations (IRC § 501(c)(4) entities) (§ 405).

m. Expansion of declaratory judgment procedure (IRC § 7428) to encompass social welfare entities and other exempt organizations (§ 406); as noted, IRS stated that, because of this law change, prior ways of modifying exemption are no longer applicable but rather will be treated as deemed revocations (TEGE-04-0216-0003).

n. Termination of employment of IRS employees for taking official actions for political purposes (§ 407).

o. Expansion of gift tax exclusion to include transfers to exempt social welfare organizations, labor organizations (IRC § 501(c)(5) entities), and business leagues (IRC § 501(c)(6) entities) (§ 408).

p. The omnibus spending bill contains a provision prohibiting the IRS from spending any fiscal year 2016 funds on regulations concerning political campaign activity by exempt social welfare organizations and preserves the standard, as of

January 1, 2010, for determining permissible and impermissible campaign activity by these organizations (§ 127).

4. On April 20, 2016, House approved legislation that would suspend hiring of new employees at IRS until agency certifies that none of its employees are seriously delinquent on their tax obligations (H.R. 1206).

5. On April 20, 2016, House passed legislation to restrict IRS's ability to allocate spending of user fees (H.R. 4885).

6. On April 21, 2016, passed bill to prohibit rehiring of employees previously fired by IRS for misconduct (H.R. 3724).

7. On April 21, 2016, House passed bill to bar bonuses for IRS employees until new customer service strategy is implemented (H.R. 4890).

8. Charities Helping Americans Regularly Throughout the Year [CHARITY] Act (S. 2750) introduced in Senate on April 6, 2016; proposal would make donor-advised funds eligible for purposes of IRA rollover law, simplify private foundations tax on net investment income, conform mileage rate for use of personal vehicles for charitable purposes to rate used for medical and moving deduction purposes, promote electronic filing of exempt organizations' returns, and create exception to private foundation excess business holdings rules for philanthropic enterprises wishing to contribute profits to charity.

D. Other Developments

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

2. IRS proposes regulations to implement Supreme Court's same-sex marriage decision (*Obergefell* v. *Hodges*) (REG-148998-13).

IX. LOOKING AHEAD: IRS INITIATIVES AND OTHER COMING DEVELOPMENTS

A. IRS Initiatives:

1. Involvement in nonprofit governance.

2. Charitable spending initiative.

3. Import of college and university compliance check.

4. Aftermath of Form 990 revision.

5. Supporting organizations regulations.

6. Donor-advised fund regulations.

7. Gift substantiation and recordkeeping regulations.

8. Other compliance checks.

9. Compensation issues.

10. Non-filers initiative.

11. Websites examination.

B. Other Coming Developments:

1. Consequences of brouhaha concerning IRS processing of applications for recognition of tax exemption.

2. Consequences of hearings held by House Subcommittee on Oversight on tax exemption and charitable deductions; initial hearing occurred on May 16, 2012.

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

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

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

6. Campaign finance law challenges on constitutional law grounds.

7. Implications of pending tax reform.

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