Non-Profits & Associations Forum:
Exempt Organizations (2017) Year in Review

Association of Corporate Counsel
National Capital Region

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Roadmap

- The Act Formerly Known as The Tax Cuts and Jobs Act
- IRS/Treasury Developments
- State Law Developments
- Employment Law Developments
The Act Formerly Known as The Tax Cuts and Jobs Act
Charitable Giving

- Increases the standard deduction to $24,000 for joint filers (and surviving spouses), $18,000 for head-of-household filers, and $12,000 for individual filers.
  - Amounts adjusted for inflation based on chained consumer price index (C-CPI-U).

- Retains the charitable contribution deduction for taxpayers able to claim itemized deductions.

- Increases the limitation for cash contributions to public charities (and certain private foundations) to 60% of the donor’s adjusted gross income (computed without net operating losses) for taxable years beginning after December 31, 2017 and before January 1, 2026.

- Eliminates the charitable deduction for donations to educational institutions that entitle the donor to the right to purchase tickets for athletic events (section 170(l)), regardless of the value of the seating rights or the amount of the contribution.
Charitable Giving (cont’d)

- Repeals the “Pease” limitation, which sets an overall limit or “haircut” on itemized deductions including charitable contribution deductions for taxable years beginning after December 31, 2017 and before January 1, 2026.

- Doubles the amount eligible for exclusion from estate, gift, and generation-skipping taxes to $10 million, indexed for inflation occurring after 2011. The change applies to taxable years beginning after December 31, 2017 and before January 1, 2026.
Unrelated Business Income Tax: Siloing

- New Section 512(a)(6) requires an organization with more than one unrelated trade or business to compute unrelated business taxable income (UBTI) separately with respect to each trade or business and without regard to the specific deduction allowed under Section 512(b)(12).
  - A net-operating-loss deduction is allowed only with respect to a trade or business from which the loss arose.
  - It is unclear how broadly a line of business will be defined for purposes of UBTI loss siloing.
  - Courts have long held that investing for one’s own account is not a trade or business.
  - Will UBTI arising from debt-financed income be trapped in its own silo? Or will it be able to be used to offset income from any trade or business?
  - What trade or business should UBTI from fringe benefits be allocated to?
Unrelated Business Income Tax: Fringe Benefits

- New Section 512(a)(7) increases UBTI by the amount of certain fringe benefits for which a deduction would be denied under Section 274 if the employer were taxable.
  - The purpose of the rule is to achieve parity between taxable and tax exempt employers.
  - The specific items listed in Section 512(a)(7) include: qualified transportation fringe benefits, any parking facility used in connection with qualified parking, and on-premises athletic facilities to the extent a deduction is disallowed.
  - Section 274, however, does not deny a deduction for the use of on-premises athletic facilities due to a last minute switch between the House and Senate versions of the rule.
  - Doesn’t apply to the extent that the amount is directly connected with a regularly carried-on unrelated trade or business.
Executive Compensation

• Section 4960 imposes a 21% excise tax on an employer with respect to (1) compensation in excess of $1 million as well as (2) excess parachute payments paid by an applicable tax-exempt organization to a covered employee.

• What is an applicable tax-exempt organization?
  – Organizations exempt from tax under Section 501(a) (e.g., 501(c)(3), (c)(4), (c)(6) organizations)
  – Farmer cooperatives described in Section 521(b)(1)
  – Organizations with income excluded from tax under Section 115(1)
  – Political organizations described in Section 527(e)(1)
Executive Compensation (cont’d)

• Who is a covered employee?
  – An employee (including a former employee) who is one of the five highest-paid employees for the taxable year or who was a covered employee of the organization (or a predecessor) for any preceding taxable year beginning after December 31, 2016.

• Special rules apply to compensation paid by related entities.
  – Treasury may refer to Section 1.414(c)-5 of the Treasury Regulations which provides that “control” means a person or entity with power to appoint 80% of the governing body.
Executive Compensation (cont’d)

• How is “compensation” defined?
  – All remuneration paid for services performed as determined for income tax withholding purposes, plus amounts required to be included in gross income under Section 457(f) at the time they are no longer subject to a substantial risk of forfeiture
  – Excludes:
    – Any designated Roth contribution as defined under Section 402A(c)
    – Compensation paid to a licensed medical professional (including veterinarians) for the performance of medical or veterinary services

• When deferred compensation is “compensation” under 4960
  – 457(b) plan – when paid or made available
  – 457(f) plan – upon vesting
    – May inadvertently trigger excise tax
Executive Compensation (cont’d)

• What is an excess parachute payment?
  – The excess of (a) any payment (in the nature of compensation) to or for the benefit of a covered employee that is contingent on the employee’s separation, and the aggregate present value of all payments is at least three times the base amount, over (b) the portion of the base amount allocated to such payment.
  – The base amount is the average annualized compensation includible in gross income for the five taxable years ending before the date of the employee’s separation.
  – Excludes payments under a qualified retirement plan, a simplified employee pension plan, a simple retirement account, a tax-deferred annuity, and an eligible deferred compensation plan of a state or local government employer, as well as payments to licensed medical professionals for the performance of medical or veterinary services and to an individual who is not a highly compensated employee under Section 414(q).
Endowment Excise Tax

- Section 4968 imposes a 1.4% excise tax on the net investment income of each applicable educational institution.
  - Net investment income corresponds to the private foundation definition and generally includes interest, dividends, rents, royalties (and income from similar sources), and capital gain net income, reduced by expenses incurred to earn this income.

- An applicable educational institution is defined as an eligible educational institution within the meaning of Section 25A(f)(2):
  - That had at least 500 students during the previous taxable year, more than 50% of whom are located in the United States;
  - That is not described in the first sentence of Section 511(a)(2)(B) (relating to state colleges and universities); and
  - The aggregate fair market value of the assets of which at the end of the preceding taxable year (other than those used directly in carrying out the institution’s exempt purposes) is at least $500,000 per student.
Endowment Excise Tax (cont’d)

• The number of students of an institution (including for purposes of determining the number of students at a particular location) shall be based on the daily average number of full-time students attending such institution (with part-time students taken into account on a full-time student equivalent basis).

• The excise tax includes the net investment income and assets of related organizations—such as controlling and controlled organizations and supported and supporting organizations.
Other Provisions

• Closes a loophole that some taxpayers had attempted to exploit by amending the donee organization’s Form 990 to claim that a charitable contribution had been substantiated in a prior year.

• Requires taxpayers to include the interest on advance refunding bonds in taxable income.

• Repeals the Section 162(e) exception for amounts paid or incurred related to lobbying local councils or similar governing bodies, including Indian Tribal governments.
What Does this Mean for Nonprofits?

- Review employment contracts to identify possible liability for excise tax on excess compensation and parachute payments.
- Confirm whether the organization offers any fringe benefits that could become subject to the unrelated business income tax.
- Discuss possible impact of UBTI loss siloing with accountants.
- Prepare for possible impact to charitable giving as a result of the increase in the charitable deduction and other related changes.
IRS/Treasury Developments
Changes in IRS Leadership

- David Kautter is both the Acting Commissioner of the IRS and the Assistant Secretary for Tax Policy. Kautter is a tax attorney who previously worked for the accounting firm RSM US and was director of national tax at Ernst & Young. He also worked for Senator Danforth (R-MO) as tax legislative counsel.

- Dana Trier has been appointed Deputy Assistant Secretary for Tax Policy. Trier previously worked as a tax attorney for Davis Polk & Wardwell.

- Margaret Von Lienen has been named exempt organizations director in the IRS Tax-Exempt and Government Entities Division after serving as acting director for seven months.
Notice 2017-73:
Guidance on Donor-Advised Funds

• Three main areas for potential guidance:
  – Bifurcation. A distribution from a DAF made pursuant to the advice of a donor or advisor that enables a donor, advisor, or related person to attend or participate in an event would be considered to provide more than an incidental benefit to the donor, advisor, or related person and, therefore, be subject to the excise tax under Section 4967.
  – Same analysis would apply where a DAF paid the deductible portion of a membership fee charged by a charity.
  – Pledges. A distribution from a DAF to a charity would not be considered to result in more than an incidental benefit to a donor, advisor, or related person merely because the donor, advisor, or related person has made a charitable pledge to the same charity, regardless of whether the charity treats the distribution as satisfying the pledge, if the sponsoring organization makes no reference to the existence of the pledge when making the distribution.
Public support. A distribution from a DAF would be treated as an indirect contribution from the donor (or donors) who funded the DAF rather than as a grant from the sponsoring organization.

- All anonymous grants would be treated as being made by one person (including grants for which the sponsoring organization fails to identify the donor).

- A distribution from a sponsoring organization would be treated as unlimited support if the sponsoring organization specifies that the distribution is not from a DAF or states that no donor or donor advisor advised the distribution.

- Requests comments related to considerations for DAFs with multiple unrelated donors and methods to streamline any required recordkeeping.

Requests comments on how private foundations use DAFs in support of their purposes, and whether a transfer of funds by a private foundation to a DAF should be treated as a “qualifying distribution” for purposes of Sections 4942 and 4940 only if the DAF sponsoring organization agrees to distribute the funds for Section 170(c)(2)(B) purposes within a certain timeframe.

Affected parties should submit comments by March 5, 2018.
Foreign Equivalency Determinations

- Preferred written advice from a qualified tax practitioner and all attachments should be in English
- Grantor and qualified tax practitioner may rely on translations of and public information concerning foreign laws
- Nondiscrimination rules continue to apply to school grantees
- Hospital grantees do not need to comply with 501(r)
- Should verify that the grantee has not been designated a terrorist organization by the U.S. government
- Five-year public support calculation for U.S. charities applies and must attach a public support schedule
- Grants from foreign governments and foreign 509(a)(1) organizations count as public support
Re-Proposed Regulations Implementing New Partnership Audit Rules

• The rules create a centralized regime for partnership audits and adjustments that generally assesses and collects tax at the partnership (as opposed to partner) level.

• Tax-exempt organizations involved in partnerships need to consider how a partnership will take into account their exempt status.

• This can impact a tax assessment under audit and the allocation of tax assessments between tax-exempt and taxable partners.

• The rules are effective for tax years beginning after December 31, 2017, and apply to all existing and new partnerships. A public hearing occurred on September 18th.
Conservation Easement Reporting Update – Notice 2010-10

- Notice 2017-10, which required participants and material advisors to disclose certain transactions to the IRS by May 1, 2017. The IRS extended the due date for participants in the transactions to October 2, 2017.
- As of July 13, the IRS received 200 Form 8886 Reportable Transaction Disclosure Statement, and 5,500 Form 8918, Material Advisor Disclosure Statement.
- Of the 200 Forms 8886 received, 104 have been analyzed. 40 of the 104 show an aggregate contribution deduction claimed of $217,067,598.
• The Office of Appeals hears appeals of more than 100,000 taxpayers attempting to resolve their tax disputes without going to court. Currently, taxpayers involved in the appeals process can meet with an Appeals Officer by phone, in person or virtually through video-conference technology available only at a limited number of IRS offices.

• Appeals’ pilot program will use a secure, web-based screen-sharing platform to connect with taxpayers face-to-face from anywhere they have internet access. Similar to popular screen-sharing programs used on phones and home computers, this technology may also be a way for the IRS to provide greater access, efficiency and flexibility to taxpayers. This web-based model is more convenient and has more features than the existing video-conferencing technology.
Data-Driven Approach to Selecting Exempt Organization Returns for Audit

• The IRS Office of Exempt Organization Examinations is working with the IRS Research, Applied Analytics and Statistics Division (“RAAS”) to develop algorithms to select returns for audit.

• Maria Hooks, Director of Exempt Organization Examinations, has stated publicly that the IRS is selecting returns with a focus on organizations at risk for private benefit and inurement issues. In the area of private foundation returns, the algorithm looks for noncompliance with Chapter 42 excise taxes, unrelated business income, and exempt purposes.

• The IRS has indicated that it is running every single 990 and 990-PF through the process.

• This reiterates the importance of ensuring that the 990 and 990-PF is thorough and complete.
Changes to Form 1023

- In December 2017, the IRS released a revised version of the Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code.
- Part IX, Financial Data, was revised to: require organizations in existence for 5 or more years to include financial information for the most recent 5 tax years, instead of 4 tax years; require organizations in existence for less than 5 years to include financial information and projections for three years if they have not completed one tax year, and four years if they have completed one tax year.
- Part X, Public Charity Status, was revised to: include the option to declare status as an agricultural research organization under 509(a)(1) and 170(b)(1)(A)(ix), delete the Consent Fixing Period of Limitations Upon Assessment of Tax Under Section 4940, and delete the option to request a Definitive Ruling.
Changes to Form 1023 (cont’d)

- Part XI, User Fee Information, was revised to only require organizations to enter the amount of the user fee that is being paid.
- Schedule E, Organizations Not Filing Form 1023 Within 27 Months of Formation, was revised to delete language about determining whether an organization was eligible for exemption as a 501(c)(4).
Form 1024-A

• The IRS recently released the new Form 1024-A for organizations applying to be social welfare organizations under Section 501(c)(4).
  – The Form was initially released in draft in September 2017.

• While organizations seeking 501(c)(4) status are allowed to self-declare, the new form was authorized by the Protecting Americans From Tax Hikes Act of 2015 and can be used by organizations that want an official determination of their exempt status from the IRS.

- Guidestar labeled certain organizations as “hate groups” based on designations by the Southern Poverty Law Center

- Liberty Counsel asserts the “hate group” designation is slanderous, defamatory, false and misleading because it is “based on nothing more than [Liberty Counsel’s] Christian viewpoint on matters of religious liberty, the sanctity of life, human sexuality, marriage, and family values.”

- Liberty Counsel seeks an injunction preventing Guidestar from designating Liberty Counsel as a hate group, as well as reputational damages, costs, and fees.
Parks Foundation v. Commissioner (9th Cir., Dec. 15, 2017)

- The U.S. Tax Court found Parks Foundation liable for tax due to its expenditures for the production and broadcast of 30- and 60-second radio messages regarding Oregon ballot measures on wages for prison labor, criminal sentencing, administrative rules, and other public policy matters.
  - The Foundation was liable for excise taxes on nine of the ten radio messages, including the second tier tax for failure to correct during the taxable period.
- The Tax Court also held a foundation manager liable for excise tax for the knowing and willful agreement to making the expenditures, as well as second tier taxes for refusal to correct them.
- The Tax Court also held that Section 4945 and its regulations are constitutional.
- The Ninth Circuit affirmed the decision of the United States Tax Court, finding that expenditures made by the Foundation for the production and broadcast of nine radio advertisements were subject to tax under Section 4945.
New Financial Reporting Rules for Nonprofit Organizations

• On August 18, 2016, the Financial Accounting Standards Board (FASB) issued new accounting rules which represent the first change to the presentation of nonprofit financial statements since 1993. The new rules apply to annual financial statements issued for fiscal years beginning after December 15, 2017.

• The new rules simplify the treatment of net assets in financial statements by focusing on the existence or absence of donor-imposed restrictions, as opposed to the types of restrictions (i.e., temporarily restricted vs. permanently restricted).

• The new rules require quantitative and qualitative information to explain how an organization manages its liquid resources available to meet cash needs for general expenditures within one year of the balance sheet date.

• The new rules require investment income to be reported net of related internal and external investment expenses (this was previously optional), but eliminate the related requirement to disclose the amount of those netted investment expenses.

• The new rules eliminate the requirement to present or disclose the indirect method in the notes if the direct method is presented on the statement of cash flows.
State Law Developments
NY AG Settles Lawsuit Re: Breach of President’s Fiduciary Duties

- State of New York v. Schulman, Index No. 453119/2017

- President and Attorney in Charge of New York Legal Assistance Group

- Diverted millions from NYLAG to other charities he controlled

- Failed to invest prudently

- Inaccurate filings with NYAG

- Settlement
  - Schulman repaid $150k to NYLAG
  - Schulman banned for 5 years from NY nonprofits
NY AG Report on Professional Fundraisers

- Focuses on cost of external fundraisers
- 987 fundraising campaigns in 2016
  - $41.2 billion 33% retained by fundraisers
  - In 37% charities receive <50% of donations
  - In 13% expenses > revenue
- Mobile and online fundraising increasing
  - GoFundMe - $4b since 2010
  - fees <10%
- Direct mail and telemarketing decreasing
  - Telemarketing fees >50%
NY AG Settlement with Breast Cancer Survivors Foundation

- Shell charity created and run by external fundraiser who
  - Fraudulently solicited through telemarketing and direct mail
  - Kept 92% of donations
  - Ran BCSF financial operations, took minutes at board meetings
  - Filed false reports with NYAG
- President had no experience with charities
- BCSF dissolved, paid ~$350k to legitimate breast cancer charities
- President permanently barred nationally from access to charitable assets
- External fundraiser already barred from NY nonprofits
WA AG Lawsuit against Value Village

- Filed December 20, 2017
- Alleges unfair and deceptive consumer protection practices
  - Deceptive advertising
  - Misrepresentation to consumers, “deceptive net impression”
  - Failure to honor donor intent
  - “Deceptive net impression”
- Alleges violation of Charitable Solicitations Act
  - False and misleading statements in solicitations
  - Failure to include required disclaimers
Employment Law Developments
#MeToo & Sexual Harassment Allegations

- Tech
- News
- Entertainment
- Federal and State Government
- Academia
- Fashion
Biography

Jesse Raben, JD, is the Associate General Counsel in the Office of General Counsel at the APA where he has served for 17 years with a focus on intellectual property, internet privacy, cyber security and technology issues, contracts, corporate governance, compliance, tax and general business and legal risk management. Previously Jesse owned and operated his own internet company in the late 1990’s. In 1994, Jesse clerked for the Supreme Court of Hawaii and worked pro bono for an environmental watchdog group in Israel, before working as an associate at two large DC law firms. Jesse is a board member with the non-profit Kids4Peace.org and a fellow in the ACC/NCR Leadership Academy. He earned his J.D. from Georgetown University in 1993 and his B.A. from Tufts University in 1988 and is admitted to the District of Columbia Bar.
Mary Elizabeth Cisneros is a Vice President and Deputy General Counsel at the American Red Cross where she leads and manages lawyers and paralegals providing legal advice and counsel in labor and employment law, fundraising, tax, trusts and estates, intellectual property, corporate governance, ethics and compliance and international law. Mary Elizabeth joined the American Red Cross in 2001 as a Senior Counsel for labor and employment litigation and counseling. In 2004, in addition to her employment practice, Ms. Cisneros was the legal counsel for the International Services Department, including the Tsunami Recovery Program. From 1995 to 2001, Mary Elizabeth practiced employment law with Epstein Becker & Green in New York and Washington, D.C.

Mary Elizabeth received her B.A. in American Studies, cum laude, from Amherst College in 1989 and her J.D. from Georgetown University Law Center in 1995.
Alexander L. Reid advises tax-exempt organizations in planning, structuring, and transactional matters. He also represents taxpayers under audit, and helps organizations improve their governance and enhance their tax compliance. Alexander counsels taxpayers seeking administrative guidance from the Internal Revenue Service (IRS) and US Department of the Treasury, as well as on legislative matters with the US Congress. His tax-exempt clients include charities, foundations, colleges and universities, museums, and other nonprofit organizations.
Kimberly Eney advises tax-exempt organizations on the tax and corporate laws integral to advancing their missions. Her clients include major private foundations, family foundations, media and sports organizations, museums and cultural associations, community and economic development organizations, colleges and universities, hospitals, scientific and medical research organizations, social welfare organizations, business leagues and trade associations, churches and religious organizations, and many other types of special-purpose organizations.

Ms. Eney earned a B.A. from Brown University and J.D. from New York University School of Law where she was a fellow at the National Center for Philanthropy and the Law.
THANK YOU