



Exempt Organizations 2018 Year in Review

Non-Profit and Associations Forum

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Welcome

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- **Developments in Political Law, Disclosure**
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- **Governance Case Study: USA Gymnastics – Lessons Learned**
 - Vernetta Walker
- **Noteworthy State Enforcement Cases**
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EO Developments:

FY 2019 Program Letter

Each year the IRS's Tax Exempt & Government Entities Compliance Governance Board issues a "Program Letter" (formerly known as the EO Work Plan) that prioritizes issues that have been flagged by IRS employees as known priorities or emerging risks.

The priority FY 2019 compliance strategies include:

- Private Benefit and Inurement: Organizations with indications of potential private benefit or inurement, including loans by private foundations to disqualified persons.
- Previously For-Profit: Section 501(c)(3) charities that formerly operated as for-profit entities prior to their conversion to tax-exempt status.
- Misclassified Workers: Incorrectly treating employees as independent contractors.

TE/GE FY 2018 Accomplishments Letter released this week.

EO Developments:

Treasury/IRS Priority Guidance Plan

- The 2018-2019 Priority Guidance Plan indicates projects that are underway, or guidance that has recently been published. Highlights include:
- UBTI for separate trades or businesses under new section 512(a)(6), Notice 2018-67 (8/21/18).
- The excise tax on excess remuneration paid by “applicable tax-exempt organizations” under new section 4960, Notice 2019-09 (1/1/19).
 - Note: Includes compensation of covered employees paid by related for-profit organizations.

EO Developments:

Treasury/IRS Priority Guidance Plan (Cont'd)

- Opportunity Zones under sections 1400Z-1 and 1400Z-2, released as Rev. Proc. 2018-16 (2/18/18) and Notice 2018-48 (6/20/18). See also Rev. Rul. 2018-29; 83 FR 54279.
- Payments made in exchange for state and local tax credits under section 170, released as Notice 2018-38 (4/30/18).
- Calculation of net investment income for purposes of the excise tax on certain colleges and universities under new section 4968, released as Notice 2018-55 (6/8/18).
- Updating of revenue procedures on grantor and contributor reliance under sections 170 and 509, including an update to Rev. Proc. 2011-33 for EO Select Check, released as Rev. Proc. 2018-32 (5/16/18).

Treasury/IRS Priority Guidance Plan (Cont'd)

- Additional highlights in the 2018-2019 Priority Guidance Plan:
 - Final regulations on section 509(a)(3) supporting organizations.
 - Guidance under section 512 regarding methods of allocating expenses relating to dual-use facilities. See Notice 2018-67 (8/21/18).
 - Guidance under section 4941 regarding a private foundation's investment in a partnership in which disqualified persons are also partners.
 - Update to Rev. Proc. 92-94 regarding sections 4942 and 4945, released as Rev. Proc. 2017-53 (9/14/17).
 - Guidance regarding the excise taxes on donor advised funds and fund management, released as Notice 2017-73 (12/4/17).
 - Final regulations designating an appropriate "high-level Treasury official" under section 7611.

Less Noticed, But Still Important EO Developments

- *United States v. Driscoll*:
 - Armed Forces Foundation, a Washington-area charity to benefit veterans
 - Executive Director involved in inurement, related party transactions
 - Concealed related party transactions from Board
 - Convicted of wire fraud, tax fraud
 - In addition, convicted of filing false Form 990 returns
- *United States v. Zak* – lawsuit against defendants involved with 96 conservation easement syndicates resulting in over \$2 billion in federal tax deductions.

Developments in Political Law, Disclosure

- **IRS**

- Treasury Inspector General (TIGTA) Report on Political Activity Referrals
- Changes to Form 990 Schedule B Disclosure (Rev. Proc. 2018-38)

- **FEC**

- CREW case
- Internet rulemaking

- **Federal Laws**

- HR-1

- **State Laws**

- California, Montana, New York, Washington

- **2018/2020 Trends**

Developments in Political Law (IRS)

Treasury Inspector General Report on Political Activity Referrals

- Background
 - In 2015, Senate Finance Committee concluded IRS had not performed any examinations of 501(c)4 groups based on referrals.
 - Complaints made that IRS subjected conservative groups to extra scrutiny.
 - IRS created Political Activities Referral Committee to independently review referrals.
- Audit Findings
 - Examinations not initiated and no revocations or other negative findings.
 - IRS did not adequately document research or explain decisions.
 - Many referrals not forwarded to committee.
- Recommendations
 - Further guidance and training on consistently documenting and forwarding cases.
- Impact
 - Unclear – some call for objective standards.

Developments in Political Law (IRS)

Changes to Form 990 Schedule B Disclosure (Rev. Proc. 2018-38)

- Background
 - Schedule B required 501(c)4s and (c)6s to disclose names and addresses of \$5,000+ donors; filed with IRS but redacted to public.
 - Concerns about unnecessary and inadvertent disclosure.
 - Schedule B filing requirements in some states (NY and CA).
- Change (2018-38)
 - 501(c)4s and (c)6s no longer required to disclose donor names and addresses to IRS.
 - Continue to collect and keep info and make available to IRS upon request
- Impact
 - Doesn't change what public sees.
 - Praised by conservative groups.
 - Criticized by progressive groups as creating more avenues for dark money.
 - May result in new efforts by states to require disclosure.

Developments in Political Law (FEC)

- *CREW v. FEC*: District court struck down FEC regulation that permitted groups making independent expenditures (IEs) to disclose identity of donors who gave over \$200 for purpose of supporting a specific advertisement. Instead, groups must disclose identity of donors who gave over \$200 for purpose of supporting any independent expenditure intended to influence elections. Supreme Court declined review.
 - Background
 - Prior to decision, 501(c)(4)s spent millions on IEs without reporting donors.
 - Impact
 - FEC issued guidance – still ambiguity about how far-reaching disclosures must be.
 - Significant impact on 501(c)(4)s that engage in IEs – dramatically increase disclosure obligations.
 - Some outside groups will stop making IEs or shift activity to electioneering communications or super PACs.
- FEC Internet Rulemaking: Amend regulations on internet political disclaimers.

Developments in Political Law (Federal Legislative)

H.R. 1 (“For the People Act”)

- Background
 - Introduced by House Democrats on first day of session (221 co-sponsors)
 - Mammoth 571-page bill covers voting, campaign finance, ethics and redistricting.
 - Campaign finance proposal is update from DISCLOSE Act.
- What’s In It?
 - Focus on dark money disclosure.
 - Requires 501(c)(4)s disclose donors who contribute more than \$10,000.
 - Shuts down use of transfers between organizations to cloak identity of source contributor.
- Impact
 - Bill language recently released. Further review needed.
 - May pass House, but dead on arrival in Senate.
 - However, could foreshadow framework for future reforms (e.g., 2021).

Developments in Political Law (State Legislative)

- **California:** Social media DISCLOSE ACT requires political advertisers to place additional disclaimers on Facebook, Twitter, Google ads.
- **Montana:** Executive Order requires state contractors to disclose political contributions and contributions to entities that make electioneering communications.
- **New York:** Democracy Protection Act imposes new disclosure requirements for social media ads.
- **Washington State:** DISCLOSE Act requires organizations to register with state and disclose top 10 donors of \$10,000+ contributions if expect to make \$25,000 in contributions or expenditures.

Developments in Political Law (2018/2020 Elections)

501(c)(4)s and “Dark Money”

- CREW case impact
- Expect more issue advocacy / super PAC activity in 2020
- Increased regulation at state level
- House legislation (H.R. 1) – precursor for 2021?
- State enforcement against groups masking donors (e.g., Massachusetts, Washington)

Traps for the Unwary

- Prohibition on 501(c)(3) political campaign intervention
- Electioneering communications (federal and state reporting)
- Social media advertising disclaimers
- Foreign Agents Registration Act (FARA)

USA Gymnastics: Lessons Learned

Exempt Organizations Year in Review



What Do These Organizations
Have in Common?



Many Nonprofit Boards Need Significant Improvement



2015 Survey on
Board of Directors of
Nonprofit Organizations

STANFORD
BUSINESS

ROCK
CENTER
FOR
CORPORATE
GOVERNANCE

In collaboration with BoardSource and GuideStar

Findings:

- Too many directors lack a deep understanding of the organization.
- Many are not engaged, do not understand their obligations.
- Over two thirds (69%) of directors say their organization has faced one or more serious governance-related problems in the past 10 years.

Legal compliance is critical, but there's more to good governance. As guardians of the mission, boards need to ensure the organization operates with the highest level of integrity and is deserving of the public trust!

Finding: Widespread Workplace Culture Issues



- Racial and sexual comments
- Fear of speaking out or reporting issues
- Distrust of HR leadership
- Top-down, command-and-control management style
- Unacceptable behavior inadequately addressed
- Failure to consistently act upon complaints

Finding: The culture made elite gymnastics inherently attractive to child sexual predators and reduced the likelihood that survivors would raise complaints.

- The corporate governance model did not involve athletes in policy-making or provide an effective avenue to raise complaints involving sexual misconduct
- USAG repeatedly declined to respond adequately to concrete reports of specific misconduct, and instead erected procedural obstacles
- At the direction of the CEO, USAG engaged in efforts to protect and preserve their institutional interest and the reputation of Nassar



Recommendations

- Implement clear reporting practices and protocols.
- Address informal reports and “open secrets.”
- Systematize evaluation of exit interviews to identify potential concerns.
- Reset or reaffirm core values and ensure that systems align with those values.
- Build stronger lines of communication between the board and staff.



Overarching Recommendation: Cultural Shift Throughout USA Gymnastics



Board Structure and Duties

- Amend bylaws to clarify priority of athlete well-being
- Revise board selection process
- Ensure that term limitations are consistently enforced
- Ensure each board meeting includes a robust discussion of Safe Sport matters
- Increase the number of in-person board meetings
- Hold an executive session at the conclusion of each board meeting
- Conduct an annual enterprise risk review that routinely includes Safe Sport issues

Reflections

How does the board assess morale and culture?

Do evaluation systems provide staff feedback about the CEO's leadership

How do you ensure established standards are followed by chapters/affiliates?

What are your organizational values and is there accountability across all levels?

Noteworthy State Enforcement Cases: New York

Trump Foundation – NY Attorney General

NY Attorney General lawsuit filed in June 2018 alleging serious civil law violations, including:

- Private benefit – payments of \$100k and \$158k to settle legal disputes involving the Mar-a-Lago Resort and Trump National Golf Club.
- Political activity – charitable contributions and campaign-like fundraising events held in Iowa on eve of Iowa Caucuses coordinated/directed by Trump campaign.
- Political contribution – \$25k contribution to Florida PAC.
- Self-dealing – purchase of \$10k portrait of Trump subsequently displayed at Trump-owned golf course. \$5k to buy ad for Trump hotel in D.C. Preservation League's commemorative program.
- Breach of fiduciary duty, waste – lack of necessary oversight, funds not used for charitable purposes.

In November 2018, NY state judge ruled lawsuit could proceed. Trump Foundation agreed in December 2018 to dissolve under court supervision. Lawsuit continues, seeking \$2.8 million in restitution along with other monetary penalties and barring Trump from serving on nonprofit boards for a decade.

Noteworthy State Enforcement Cases: California

National Cancer Coalition (NCC) – CA Attorney General

In March 2018, the CA Attorney General secured a stipulated judgment against NCC for filing false and misleading financial reports and for deceptive solicitations. California's complaint alleged:

- False and Deceptive Representation: inflated value of pharmaceutical donations, resulting in misleading reports of revenue and program activity.
- Misleading and Deceptive Solicitation: to minimize the appearance of NCC's high administrative and fundraising costs, it stated that over 97% of its resources go directly to program activities when reality was less than 60%.
- False Statements in Solicitation Campaign: raised funds for a "special project" known as "The Breast Cancer Relief Foundation" to provide "life saving" medical treatment to vulnerable women and fund "innovative research programs," none of which ever actually took place.

As part of stipulated judgment, NCC agreed to dissolve and pay a \$500k judgment.

AG Becerra: "Let this serve as a stern warning – charities that intentionally mislead the public at the expense of others will be held accountable."

Q & A

Questions ?

Diara M. Holmes

Diara M. Holmes serves as co-chair of the firm's Tax-Exempt Organizations Practice. She counsels tax-exempt organizations, including large public charities; colleges, universities and other higher education organizations; foreign charities and their U.S. affiliates; associations; government instrumentalities; social welfare organizations; and religious organizations on a broad range of tax compliance and governance issues.

She advises nonprofit and for-profit organizations on structuring a variety of transactions—including joint ventures, corporate sponsorships, merchandising, cause-related marketing, and other revenue generating strategies. In addition, she works with high net worth individuals and families to establish family foundations and donor-advised funds.

Diara has represented numerous organizations before the IRS—navigating complex audits involving an array of issues (e.g., executive compensation, unrelated business tax, and political campaign intervention); seeking private letter rulings regarding proposed transactions, requesting determination letters regarding public charity classification, applying for exempt status, and seeking reinstatement of exempt status following auto-revocation.

Diara is a frequent speaker at national professional conferences on exempt organizations issues and serves on the board of directors of both the Washington Area Women's Foundation and N Street Village.



Marcus S. Owens

Marcus Owens represents a broad range of nonprofit organizations, including private foundations, charities, lobbying/political organizations and trade associations. The context has ranged from tax planning, the process of formation and application for exemption, through IRS and state attorney general investigations, including complex audits by IRS Exempt Organizations Financial Investigative Units. Marcus' focus includes executive compensation, excess benefit and self-dealing excise taxes, as well as the impact of digital and social media on tax exempt organizations. His experience also extends to social impact investing and program-related investments. Particular projects have involved the emerging rules for foreign grant making and organizations interested in public policy but concerned with legislative and political activities. Marcus is also a frequent lecturer, writer and commenter on the complex laws affecting exempt organizations.

Prior to entering private practice, Marcus was employed by the Exempt Organizations Division of the Internal Revenue Service and served as the division's director for ten years. In that capacity, he was the chief decision maker regarding design and implementation of federal tax rulings and enforcement programs for exempt organizations, political organizations and tax-exempt bonds. He also served as the IRS's primary liaison with other federal agencies, Congress, and state regulators on exempt organizations issues.



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Duke University School of Law, J.D., 1974
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Admissions

Florida
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Vernetta Walker, J.D.

§ “Chief Governance Gladiator,” Walker & Associates Consulting, Inc.

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Other Experience:

§ Chief Governance Officer, BoardSource

§ Associate General Counsel, Maryland Association of Nonprofits

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Darrin Hurwitz

Darrin Hurwitz serves as Deputy General Counsel for the Human Rights Campaign. Hurwitz provides advice to the organization on political compliance issues including federal and state campaign finance and lobbying disclosure regulation as well as on other non-profit management matters. Hurwitz also offers legal support to the HRC Foundation, HRC PAC and the organization's affiliated state PACs.

Prior to joining HRC in 2006, Hurwitz was an associate at Covington & Burling LLP, where he specialized in election and political law. In 2004, he served as in-house legal counsel to the campaign organization America Coming Together. Hurwitz was a campaign aide to California State Controller Kathleen Connell in 1997-98.

Hurwitz received his bachelor's degree from UCLA and his law degree from Georgetown University Law Center. After law school Hurwitz clerked for Judge A. Raymond Randolph of the U.S. Court of Appeals for the D.C. Circuit. He is admitted to the bars of the District of Columbia and California.

