

Potholes To Avoid In Road-Tripping With 501(c)(3) Organizations



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ALL LAWYERS need to be careful when providing counsel to “c3” organizations (this article will refer to those with 501(c)(3) exemption as “charities” or “charitable organizations”). It is common for smaller charities to expect that an attorney working with them will be knowledgeable about every aspect of tax law (and even all state nonprofit and charitable trust laws) to which the organization is subject. Today’s climate increasingly requires that charities *demonstrate* obedience to the laws that apply to them. Indeed, adherence to both tax-exemption mandates *and* good-to-best practices in board governance are being demanded not only by a more robust IRS, but also by state regulators and the public. Practitioners need to “do no harm” in working with charities. Being aware of red flags that may indicate noncompliance and/or evidence that additional counsel may be necessary is key in helping the charitable sector “do good.”

The aspiration (and need) that lawyers will provide assistance to the 501(c)(3) sector (again, commonly referred to as “charitable” organizations) is expressed in the ABA’s Model Rules of Professional Conduct. The Model Rules’ section on public service states the following:

RULE 6.1 VOLUNTARY PRO BONO PUBLICO SERVICE

Every lawyer has a professional responsibility to provide legal services to those unable to pay. A lawyer should aspire to render at least (50) hours of pro bono publico legal services per year. In fulfilling this responsibility, the lawyer should:

(a) provide a substantial majority of the (50) hours of legal services without fee or expectation of fee to:

(1) persons of limited means or

(2) charitable, religious, civic, community, governmental and educational organizations in matters that are designed primarily to address the needs of persons of limited means; and

(b) provide any additional services through:

(1) delivery of legal services at no fee or substantially reduced fee to individuals, *groups or organizations seeking to secure or protect civil rights, civil liberties or public rights, or charitable, religious, civic, community, governmental and educational organizations in matters in furtherance of their organizational purposes, where the payment of standard legal fees would significantly deplete the organization's economic resources or would be otherwise inappropriate;*

(2) delivery of legal services at a substantially reduced fee to persons of limited means; or

(3) participation in activities for improving the law, the legal system or the legal profession.

In addition, a lawyer should voluntarily contribute financial support to organizations that provide legal services to persons of limited means.

Model Rules of Professional Conduct (2004 Edition). Available at: www.abanet.org/cpr/mrpc/mrpc/rule_6_1.html (emphasis added).

The ABA Section of Taxation's *Pro Bono* Committee aims to encourage and assist lawyers to provide effective and laudable *pro bono* service. Its charitable organizations subcommittee, in conjunction with the Section's Exempt Organizations Committee, works to support lawyers who provide services without fee to 501(c)(3) organizations "in matters that are designed primarily to address the needs of persons of limited means" or who provide reduced fee (or free) services to 501(c)(3) organizations whose resources are not sufficient to pay for same, thereby performing a public service within the mandates of Rule 6.1(a)(2) or 6.1(b)(1), respectively.

Charitable, religious, and educational organizations often seek and qualify for exemption under Internal Revenue Code ("Code") section 501(c)(3). (All section references are to the Code unless otherwise noted.) Civic and community groups, as well as organizations that work to secure or protect civil rights, civil liberties, or public rights, if they limit their operations appropriately, may also qualify.

So when you do your *pro bono* service in helping these organizations, what are the potholes you need to avoid?

POTHOLE #1: FAILING TO NOTE THAT PUBLIC BENEFIT (OR OTHER) ACTIVITIES THAT ARE OUTSIDE OF 501(c)(3)'S NARROW DEFINITIONS ARE BEING CONDUCTED • Section 501(c)(3) requires that organizations exempt under that section be both *organized* and *operated* exclusively for one or more of eight "exempt purposes":

- Religious;
- Charitable;
- Scientific;
- Testing for public safety (This one category, however, is not eligible to receive income tax-deductible contributions; same is omitted from section 170(c)(2), providing for such deductibility);
- Literary;
- Educational;
- Fostering national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment) (but section 501(j) effectively removes the effect of this parenthetical); or
- Preventing cruelty to children or animals.

The regulations provide some broad guidance on three of those specific exempt purposes (charitable, educational, and scientific). For example, they provide a list of *charitable* purposes that are considered beneficial to the public interest:

- Relief of the poor, the distressed, or the underprivileged;
- Advancement of religion;
- Advancement of education or science;
- Erection or maintenance of public buildings, monuments, or works;
- Lessening the burdens of government;
- Lessening of neighborhood tensions;
- Elimination of prejudice and discrimination;
- Defense of human and civil rights secured by law; and
- Combating community deterioration and juvenile delinquency.

The regulations also explicate that *educational* purposes include both the instruction of individuals to improve their abilities and the instruction of the public on subjects useful to the individual and beneficial to the community.

Such general definitions do little to guide organizations. In every case, individual operations are judged on a “facts and circumstances” basis. Thus, one issue that arises for 501(c)(3) organizations is that certain activities that are of benefit to the community may not actually fit within the specific exempt purposes embraced by the Code section. In the most general terms, for an organization to be 501(c)(3)-qualified, its efforts must either serve a charitable class (e.g., the ill, the poor, those suffering discriminatory actions) and/or be conducted to accomplish an overarching 501(c)(3) purpose (e.g., defending civil rights secured by law—one of the activities that fits within “charitable” as noted above; or conducting religious ceremonies—an activity comporting with a religious purpose; or operating a school—an educational purpose). The fact that certain activities improve the society because they are civic in nature, or can be cast as “social welfare” activities, does NOT mean those activities comprise 501(c)(3) purposes.

Red Flags/Common Problems

- Services provided are to small subset of public (e.g., eight people being served by dog obedience school);
- Efforts perceived as educational go only to those who are already educated in that arena (e.g., the organization exists to sponsor house meetings addressing “how to get the city council to pay more attention to the neighborhood council’s opinion”);
- Social activities are often conducted, but not all participants are from a charitable class;
- Fundraising activities independent of other charities are what the organization exists to conduct;
- Economic development activities are conducted in a neighborhood or region that is not economically blighted.

POTHOLE #2: EFFECTIVE GOVERNANCE (AS BRAKE AGAINST TRANSACTIONS THAT MIGHT UNDULY BENEFIT INSIDERS) IS NOT EVIDENCED

• The governors (board of directors, trustees, officers, and those to whom they delegate authority) of charities are legally entrusted with the responsibility of ensuring that two key precepts of 501(c)(3) qualification are “operationalized” —no private inurement to insiders *nor* operations for private, rather than public, purposes.

The last two years have seen a marked increase in regulatory and “court of public opinion” attention to scandals and errors in the charitable sector. Headlines (and Congressional hearings) have chiefly focused on situations in which excessive compensation to insiders and/or “asleep at the switch” boards have been evidenced. Appropriate *capacity* of boards to meet their responsibilities (which under state statute and common law are understood to comprise duties of care, loyalty, and obedience) needs to be demonstrated by all charities. Failure to manage against insider benefit can expose board members of “public charities” to personal tax consequences under the “intermediate sanctions” excise tax scheme found in Code section 4958. (This article assumes that the charities being advised are public charities, rather than private foundations. The dividing line between these two subsets of the c3 universe is noted at Pothole #5.)

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IRS Publication 1828, *Tax Guide for Churches and Religious Organizations* (9/03) (hereinafter, “Pub. 1828, *Tax Guide*”) at page 5 provides an excellent narration of the mandates against both private inurement (including the application of “intermediate sanctions” to “excess benefit transactions”) and operation for private rather than public purposes:

Inurement and Private Benefit

Inurement to Insiders

[A]ll exempt organizations under IRC section 501(c)(3) are prohibited from engaging in activities that result in inurement of the...organization’s income or assets to insiders.... Insiders could include the...board members, officers, and in certain circumstances, employees. Examples of prohibited inurement include the payment of dividends, the payment of unreasonable compensation to insiders, and transferring property to insiders for less than fair market value. The prohibition against inurement to insiders is absolute; therefore, any amount of inurement is, potentially, grounds for loss of tax-exempt status. In addition, the insider involved may be subject to excise tax. See the following section on Excess benefit transactions. Note that prohibited inurement does not include reasonable payments for services rendered, payments that further tax-exempt purposes, or payments made for the fair market value of real or personal property.

Excess benefit transactions. In cases where an IRC section 501(c)(3) organization provides an excess economic benefit to an insider, both the organization and the insider have engaged in an excess benefit transaction. The IRS may impose an excise tax on any insider who improperly benefits from an excess benefit transaction, as well as on organization managers who participate in such a transaction knowing that it is improper. An insider who benefits from an excess benefit transaction is also required to return the excess benefits to the organization. Detailed rules on excess benefit transactions are contained in the Code of Federal Regulations, Title 26, sections 53.4958-0 through 53.4958-8.

Private Benefit

An IRC section 501(c)(3) organization’s activities must be directed exclusively toward charitable, educational, religious, or

other exempt purposes. Such an organization’s activities may not serve the private interests of any individual or organization. Rather, beneficiaries of an organization’s activities must be recognized objects of charity (such as the poor or the distressed) or the community at large (for example, through the conduct of religious services or the promotion of religion). Private benefit is different from inurement to insiders. Private benefit may occur even if the persons benefited are not insiders. Also, private benefit must be substantial in order to jeopardize tax-exempt status.

The IRS website links to many helpful articles on intermediate sanctions. See those listed under the “More information” header at: <http://www.irs.gov/charities/charitable/article/0,,id=123298,00.html>.

Red Flags

- Boards not meeting or meeting infrequently (e.g., only annually);
- Minutes of Board meetings evidence few actions by Board;
- Board or officers/key employees populated with those who have family or business relationships to each other;
- Significant transaction(s) contemplated or consummated without employment of basic conflict of interest policies/procedures;
- Organization is employing contractors, officers, or employees who have family or business relationships with members of board or officers without appropriate safeguards or reviews;
- No or poor evidence that officers’/key employees’ compensation or terms of significant transactions are subject of Board review.

POTHOLE #3: ORGANIZATION FAILS TO APPRECIATE THE “NO SUBSTANTIAL LOBBYING LIMIT” OR THE SO-CALLED ELECTIONEERING PROSCRIPTION

• Charities need take care to properly understand (and then follow) each of the two disparate rules

that apply to their work on public policy and with public-policy makers. The genesis of these rules is the language of section 501(c)(3) which sets out the following activity limits: “no substantial part of the activities...is the carrying on of propaganda, or otherwise attempting to influence legislation (except as otherwise provided in subsection (h)), and which [the organization] does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of (or in opposition to) any candidate for public office.”

Lobbying Limits

Although 501(c)(3) organizations are entitled to influence public policy to promote outcomes furthering their mission by engaging in a wide variety of “lobbying” activities (501(c)(3) organizations classified as private foundations have that entitlement further limited, but that is not the topic here!), tax law does limit the magnitude of a charity’s activities that may be directed to the passage of legislation. In essence, these limits are expressed by two alternative tests.

The “[No] Substantial Part” Test

Pub. 1828, *Tax Guide* at page 5 first sets out the rule imposing the overall lobbying limit, and then at page 6 provides the relevant measurement parameters:

Substantial Lobbying Activity

In general, no organization, including a church, may qualify for IRC section 501(c)(3) status if a substantial part of its activities is attempting to influence legislation (commonly known as lobbying). An IRC section 501(c)(3) organization may engage in some lobbying, but too much lobbying activity risks loss of tax-exempt status.

Legislation includes action by Congress, any state legislature, any local council, or similar governing body, with respect to acts, bills, resolutions, or similar items (such as legislative con-

firmation of appointive offices), or by the public in a referendum, ballot initiative, constitutional amendment, or similar procedure. It does not include actions by executive, judicial, or administrative bodies.

Measuring Lobbying Activity

Substantial Part Test. Whether [an] organization’s attempts to influence legislation constitute a substantial part of its overall activities is determined on the basis of all the pertinent facts and circumstances in each case. The IRS considers a variety of factors, including the time devoted (by both compensated and volunteer workers) and the expenditures devoted by the organization to the activity, when determining whether the lobbying activity is substantial.

The Code Section 501(h) Expenditure Test

Given the imprecision and subjective nature of the preceding test, Congress was moved in 1976 to establish clearer limits (and definitions) by which a charity may measure its permitted maximum amount of propaganda/ attempts to influence legislation. Under section 501(h), which may be *elected* by certain charities, there is a ‘bright line’ limit that is established in relationship to an organization’s total

expenditures each year. From a reporting and compliance perspective, it is often advantageous for eligible charities to make the “501(h) election.”_Pub. 1828, *Tax Guide*, at page 6 addresses the measurement parameters used under this test:

Expenditure Test. Although churches are not eligible, [others including] religious organizations may elect the expenditure test under IRC section 501(h) as an alternative method for measuring lobbying activity. Under the expenditure test, the extent of an organization’s lobbying activity will not jeopardize its tax-exempt status, provided its expenditures, related to such activity, do not normally exceed an amount specified in IRC section 4911. This limit is generally based upon the size of the organization and may not exceed \$1,000,000.

Consequences Of Excessive Lobbying Activity. Under the expendi-

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ture test, a[n] . . . organization that engages in excessive lobbying activity over a four-year period may lose its tax-exempt status, making all of its income for that period subject to tax. Should the organization exceed its lobbying expenditure dollar limit in a particular year, it must pay an excise tax equal to 25 percent of the excess.

Electioneering Proscription

Pub. 1828, *Tax Guide*, at page 7 sets out the rule here:

Under the Internal Revenue Code, all IRC section 501(c)(3) organizations . . . are absolutely prohibited from directly or indirectly participating in, or intervening in, any political campaign on behalf of (or in opposition to) any candidate for elective public office. Contributions to political campaign funds or public statements of position (verbal or written) made by or on behalf of the organization in favor of or in opposition to any candidate for public office clearly violate the prohibition against political campaign activity. Violation of this prohibition may result in denial or revocation of tax-exempt status and the imposition of certain excise tax.

The text there goes on to note that “certain activities or expenditures may not be prohibited, depending on the facts and circumstances. For example, certain voter education activities (including the presentation of public forums and the publication of voter education guides) conducted in a non-partisan manner do not constitute prohibited political campaign activity.”

This notion of requisite “non-partisan”-ship engenders much confusion, particularly because the boundary line for impermissible activity that favors a candidate or group of candidates for 501(c)(3)s is *not* the same line that 501(c)(4)-exempt organizations face. As an example of this dichotomy, 501(c)(4) organizations not only may compile legislative scorecards but may disseminate them to their membership during election cycles as well. They may also tell their members which candidates have pledged to back the organization’s legislative proposals. *Such activities are impermissible for a 501(c)(3) organization.* In fact, a 501(c)(4) organization’s only tax law

limit is that its election advocacy activities may not be its *primary* ones. (However, the Federal Election Campaign Act does generally prohibit corporations from engaging in “express advocacy” with respect to federal candidates. “Express advocacy” not only includes contributing to a candidate, but also comprises the making of communications that are unmistakably electoral, such as “vote fair trade” while including a list of names of candidates who are in favor of the organization’s fair trade proposals.)

A recap of the IRS’s position and enunciation of the 501(c)(3) rules in this arena has recently been released. *See* Fact Sheet 2006-17 (2/06), *Election Year Activities and the Prohibition on Political Campaign Intervention for Section 501(c)(3) Organizations*, available at: www.irs.gov/newsroom/article/0,,id=154712,00.html.

State Law “PAC” Rules

Given the electioneering proscription set out in federal tax law, charities are right to perceive themselves as not being allowed to have political action funds or committees (“PACs”) that work with candidates. However, charities may be subject to individual states’ campaign finance/sunshine statutes and regulation when the charity acts to influence the electorate on the passage of legislation by the public (e.g., in initiatives or referenda). In defining who must so report, many jurisdictions use language employing “PAC” terminology. In such instances, what the states are describing is activity that is permissible to charities because it is *lobbying*. Charities need take note of these rules, particularly because they may expose an organization’s entire base of contributors to disclosure if a separate fund is not employed.

POTHOLE #4: FAILING TO HONOR REPORTING MANDATES TRIGGERED BY FUNDRAISING OR OTHER NON-EXEMPT PURPOSE ACTIVITIES • Although Pothole #1 emphasized that a charity’s operations

need further the narrow set of exempt purposes set out in section 501(c)(3), it is actually *not* the case that the statute’s language (“operated exclusively for exempt purposes”) is absolute. Indeed, the Regulations provide that a charity may qualify if it is operated *primarily* for exempt purposes; they state that an “insubstantial part” of a charity’s activities may be devoted to nonexempt purposes.

Lawyers will find a plethora of “unrelated” activities conducted in the charitable sector. Many of these are fund-raising activities (which do little to threaten exemption, because it is clear that they are undertaken to generate contributions so that the organization may continue to conduct its primary exempt purposes). Others may have been undertaken by the organization for income production overall.

Three compliance/exposure issues are raised when such activities are conducted by the 501(c)(3) organization:

- *Application Of Income Tax:* To the extent that any activities are “regularly” carried on, constitute a trade or business, and do *not* fit an exception to what comprises an “unrelated trade or business” in section 513, the gross revenues so generated will be subject to section 511’s level-the-playing-field-with-the-commercial-sector tax (this tax is referred to as the Unrelated Business Income Tax).
- *Appropriate Representation Of What Is (And Is Not) A Tax-Deductible Contribution:* Fund-raising activities come with federal tax requirements (and often state regulation) designed to ensure that the public is not misled as to what comprises a gift payment that is deductible as a charitable contribution.

- *Transparency In Presenting Revenues And Expenses:* Accounting for funds raised at special events and through sales of goods needs to be transparent and accurate. The reporting of “net” proceeds after expenses are withheld by agents of the organization or third parties involved in the income-production creates distortions that the IRS does not countenance. Full transparency of such arrangements is also often mandated by state statutes, particular with respect to the use of “professional fund-raisers”.

Practitioners should be mindful that 501(c)(3) organizations have to meet the following reporting requirements that such activities implicate:

Charitable Contributions—Substantiation And Disclosure

Organizations that are tax exempt must meet certain requirements for documenting charitable contributions. The federal tax law imposes two general disclosure rules: (1) a donor must obtain a *written acknowledgment* from a charity for any single contribution of \$250 or more before the donor can claim a charitable contribution on the donor’s (personal or corporate) federal income tax return; and (2) a charitable organization must provide a *written disclosure* to a donor who makes a payment in excess of \$75 partly as a contribution and partly for goods and services provided by the organization. IRS Publication 1771, *Charitable Contributions—Substantiation and Disclosure Requirements* (7/05) provides information on both of these requirements.

Contributions earmarked for lobbying or specifically designated for an individual (and not otherwise within the control of the recipient organization) are not deductible contributions.

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Property donation/auction programs (e.g., car donation programs) and analogous programs whereby property is donated to or for the benefit of the charity and then sold, so that it is the *net* of the sale after associated costs that is retained by the charity, raise additional issues:

- Congress has acted to deter potential abuses in this area, enacting specific rules in the American Jobs Creation Act of 2004 that limit the amount of charitable donations attributable to donations of vehicles. The IRS's website has a page on those rules: www.irs.gov/charities/article/0,,id=139579,00.html.
- Regardless of the type of property donated/sold, charities must take care to properly report the donation as a contribution (at line 1 of the Form 990/990-EZ) and separately report the amount garnered from the sale of that property, along with the cost of such sale, on the special event/activity line(s) of those Forms (line 9, Form 990). Costs of solicitations of the property or for those to attend events are considered fundraising expenses, not costs of the sale.

State Regulation Of Charitable Solicitation, Registration Requirements For Entities Holding Charitable Assets, Registration/Filing/Bonding Of Professional Fundraisers

More than 35 states require organizations that solicit charitable contributions or hold assets subject to charitable trust regulation to register and, then as necessary, report. In addition, states typically regulate "professional fundraisers" and require their registration, which may implicate ancillary (for the organization) reporting requirements. *See* the website of the National Association of State Charity Officials for more information on each state: www.nasconet.org/agencies/document_view.

Appropriate Reporting Of Income (And Expenditures) On Unrelated Business Income Tax Return (Form 990-T)

An exempt organization must file Form 990-T if it has \$1,000 or more of gross receipts from an unrelated trade or business. For more information on the application of the unrelated business income tax, see IRS Publication 598, *Tax on Unrelated Business Income for Exempt Organizations* (3/05).

For some organizations, the primary distinction between a classification as a public charity or a private foundation is the organization's source of financial support.

Exempt organizations that file Form 990 are required to specifically note whether or not revenues from non-contribution activities are either "exempt function,"

excepted from the application of the unrelated business income tax, or are subject to that tax (at Part VII).

POTHOLE #5—CONFUSION OVER THE "PUBLIC SUPPORT TEST"

• Every exempt charitable organization is classified as either a *public charity* or a *private foundation*. Generally, organizations that are classified as public charities are those that:

- Are churches, hospitals, qualified medical research organizations affiliated with hospitals, schools, colleges, and universities;
- Have an active program of fundraising and receive contributions from many sources, including the general public, governmental agencies, corporations, private foundations, or other public charities;
- Receive income from the conduct of activities in furtherance of the organization's exempt purposes; or
- Actively function in a supporting relationship to one or more existing public charities.

Private foundations, in contrast, typically have a single major source of funding (usually gifts from one family or corporation rather than funding from many sources) and most have as their primary activity the making of grants to other charitable orga-

nizations and to individuals, rather than the direct operation of charitable programs. (The preceding is taken verbatim from the IRS’s two resources, *Life Cycle of a Public Charity* and *Life Cycle of a Private Foundation*. See IRS’ website charities page—www.irs.gov/charities; “Life Cycle” link is available at the left side of the charities page.)

IRS Publication 4220, *Applying for 501(c)(3) Tax-Exempt Status* (9/03) explains:

For some organizations, the primary distinction between a classification as a public charity or a private foundation is the organization’s source of financial support. Generally, a public charity has a broad base of support while a private foundation has very limited sources of support. This classification is important because different tax rules apply to the operations of each. Deductibility of contributions to a private foundation is more limited than deductibility of contributions to a public charity. See Publication 526, *Charitable Contributions*, for more information on deductibility of contributions. In addition, private foundations are subject to excise taxes that are not imposed on public charities.

. . . .

If the organization requests public charity classification based on receiving support from the public, it must continue to seek significant and diversified public support in later years. A new organization that cannot show that it has received enough public support may request an *advance ruling* of its status. At the end of its advance ruling period, usually five years, it must file a schedule showing its sources of support. If the schedule indicates sufficient public support, the organization receives a definitive ruling of its public charity status. If the organiza-

tion does not meet the public support requirements in the future, it could be reclassified as a private foundation. Unless the organization is committed to raising funds from the public, it may be more appropriate to consider alternate statutorily-based public charity classifications.

Advance Rulings

As the above description notes, charities that are not automatically classified as public charities (such as schools or hospitals) but that expect to have appropriately diverse contribution or program service revenues are accorded an “advance ruling” covering their first five tax years. Their initial 501(c)(3) determination letter is *not* time-expiring. Rather, the “advance ruling” limits the period in which contributors may view the entity as a public charity, rather than a private foundation. In the “advance ruling period,” *as well as every year thereafter*, organizations that are public charities under one of the two statutory “public support tests” have their revenue streams evaluated for capture of appropriate diverse support. The “test” looks back over prior consecutive years (the first five tax years are covered for those holding an “advance ruling”; thereafter, it is the *four* prior years that are tested in each reporting year). Inadvertent failure of the public support test will jeopardize an organization’s ability to capture donative income and expose the organization (and its managers) to excise tax on a series of activities that may be undertaken by public charities without such consequence.

PRACTICE CHECKLIST FOR Potholes To Avoid In Road-Tripping With 501(c)(3) Organizations

Charitable, religious, and educational organizations often seek and qualify for exemption under Internal Revenue Code (“Code”) section 501(c)(3). Civic and community groups, as well as organizations that work to secure or protect civil rights, civil liberties, or public rights, if they limit their operations appropriately, may also qualify. So when you do your *pro bono* service in helping these organizations, what are the potholes you need to avoid?

- Activities outside 501(c)(3)’s narrow definitions are being conducted.
- ___ Services provided are to small subset of public (e.g., eight people being served by dog obedience school);
- ___ Efforts perceived as educational go only to those who are already educated in that arena (e.g., the organization exists to sponsor house meetings addressing “how to get the city council to pay more attention to the neighborhood council’s opinion”);
- ___ Social activities are often conducted, but not all participants are from charitable class;
- ___ Fundraising activities independent of other charities are what the organization exists to conduct;
- ___ Economic development activities are conducted in a neighborhood or region that is not economically blighted.
- Ineffective governance.
- ___ Boards not meeting or meeting infrequently (e.g., only annually);
- ___ Minutes of Board meetings evidence few actions by Board;
- ___ Board or officers/key employees populated with those who have family or business relationships to each other;
- ___ Significant transaction(s) contemplated or consummated without employment of basic conflict of interest policies-procedures;
- ___ Organization is employing contractors, officers, or employees who have family or business relationships with members of board or officers without appropriate safeguards or review;
- ___ No or poor evidence that officers’/key employees’ compensation or terms of significant transactions are subject of board review.
- Organization fails to appreciate the “no substantial lobbying” limit.
- Organization confused about electioneering proscription and/or definition of “non-partisan” with respect to election cycle activities.
- Failing to honor the multitude of reporting mandates triggered by fundraising or other non-exempt purpose activities.
- Confusion over the public support test.

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Addendum to preceding article, regarding the “public support test” and “five year advance ruling periods” . . .

In September of 2008, Treasury Department Regulations revised the two public support tests (the first found in Code Sections 509(a)(1) & 170(b)(1)(A)(vi); the second in Code Section 509(a)(2)) in order to have the testing period reach a total of five years (the preceding four back years ALONG WITH the most-recent completed tax year). These regulatory changes also ended the “five year advance ruling period”.

New 501(c)(3) organizations who represent that they will be seeking diverse funders (likely to meet the “contributions” test set out in Code Sections 509(a)(1) & 170(b)(1)(A)(vi)) or will likely capture diverse revenue streams (measuring not only contributions received but also exempt function income per the test set out in Code Section 509(a)(2)) are now granted public charity classification for the entirety of their first five tax years [indeed, any organization who *had a five year advance ruling period that was to expire on or after 6/9/08* now is covered by the new Regulations!] Testing of such organization’s revenue streams is first performed on tax years 2-6 (upon the Form 990 reporting on the organization’s sixth tax year), and thereafter continues in all ensuing years. A predicate for these changes was the streamlining and updating of reporting under these tests that occurs on the Redesigned (for tax years begun in 2008) Form 990



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