TEGE | Exempt Organizations Council

Exempt Organizations Annual Meeting

March 8, 2024

DC Bar Continuing Legal Education

gwscpa learn | connect | lead

Welcome and Administrative Announcements

TEGE | Exempt Organizations Council

8:00 – 8:05 ET	Initial Comments
8:05 – 9:05 ET	UBIT Feels like a Four-Letter Word
9:05 – 9:15 ET	Break
9:15-10:45 ET	IRS Chief Counsel and Treasury Update
10:45-10:55 ET	Break
10:55-11:55 ET	State Regulation of Charitable Organizations
11:55 – 12:25 ET	Lunch Break
12:25 – 1:25 ET	Circular 230: Professional Responsibilities in Today's Tax Practice
1:25 – 1:35 ET	Break
1:35 – 2:35 ET	Donor Advised Funds – Proposed Regulations and Comments
2:35 – 2:45 ET	Wrap Up/Closing Remarks

Question/Comment Submission

Submit questions or comments for future speakers:

https://www.eocouncil.org/question-submission.html

For Council information – admin@eocouncil.org or visit www.eocouncil.org

TEGE | Exempt Organizations Council

TEGE | Exempt Organizations Council

Thanks to Our Producers and Sponsors:

DC Bar Continuing Legal Education

gwscpa learn | connect | lead

TEGE | Exempt Organizations Council

Save the Dates:

June 7, 2024 – Live in DC and Dallas

November 22, 2024 - Virtual

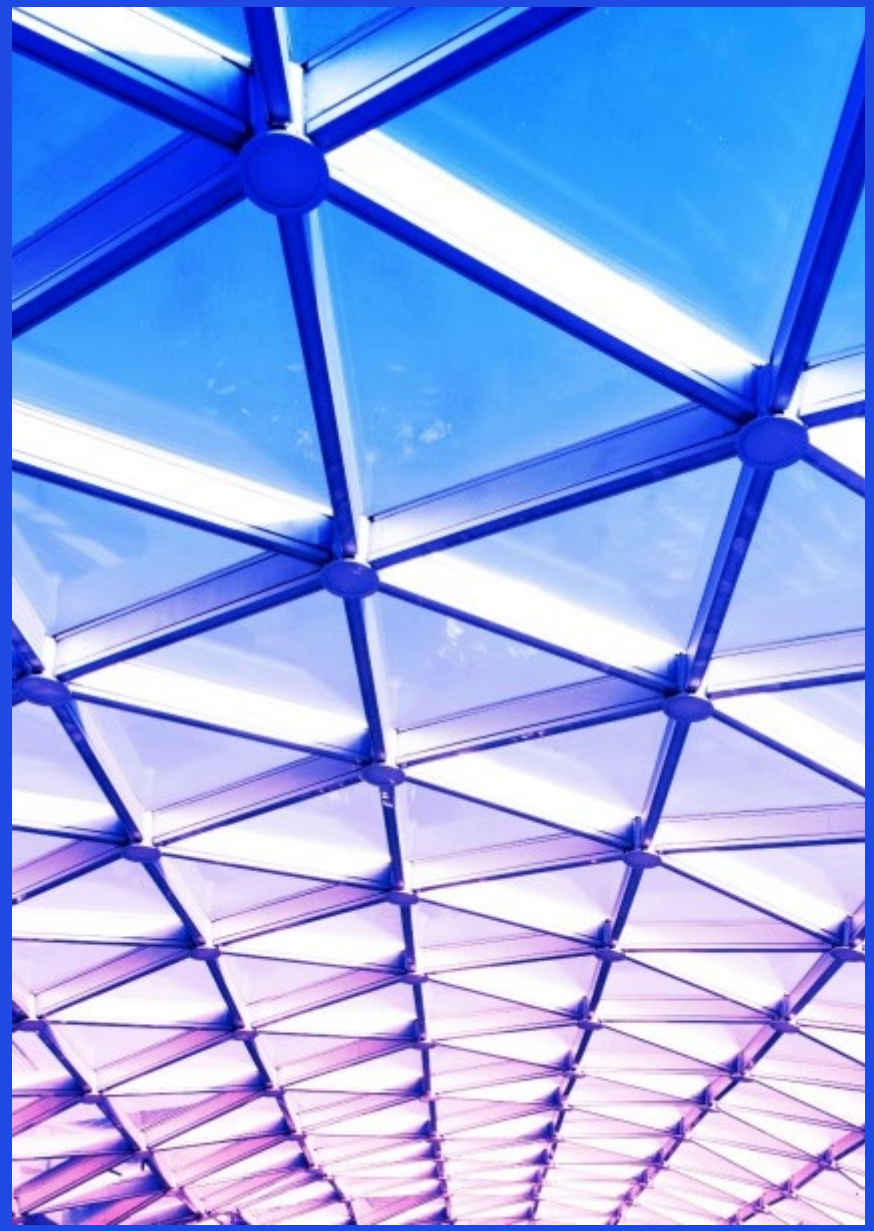
DC BAR Continuing Legal Education

gwscpa learn | connect | lead

UBIT Feels Like a Four-Letter Word

TEGE EO Council Update

March 8, 2024



Notice

The following information is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

Preston Quesenberry

Panelist
KPMG LLP
pquesenberry@kpmg.com

Stephanie Robbins

Panelist
Harmon Curran
srobbins@harmoncurran.com

Laura Kenney

Panelist
CLA
laura.kenney@claconnect.com

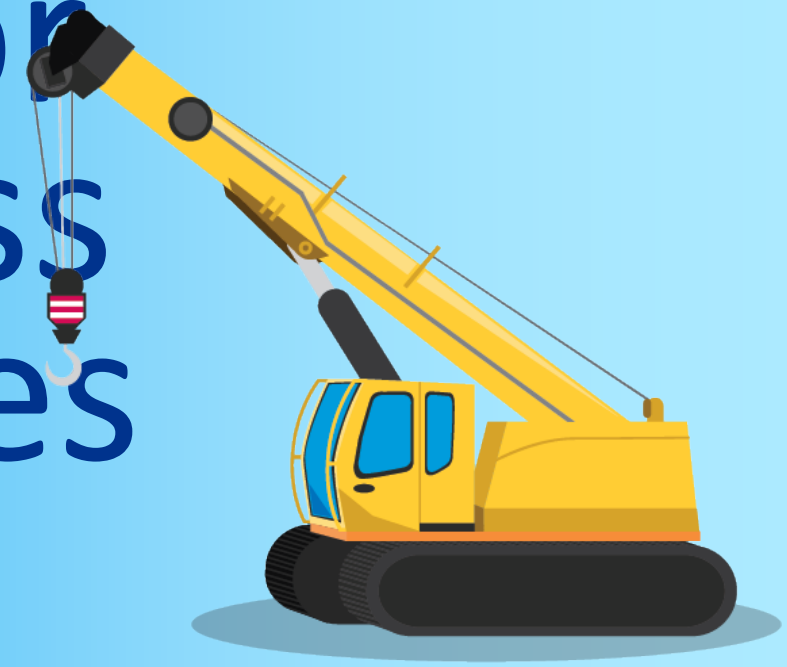
Meghan Biss

Moderator
Caplin & Drysdale
mbiss@capdale.com

Elements of an unrelated trade or business

- Trade or Business
- Regularly Carried On
- Not Substantially Related
- How Much Is Too Much?

Trade or business activities



Is profit motive sufficient for a trade or business?

- *Ohio Farm Bureau Federation, Inc. v. Commissioner*, 106 TC 222 (1996): "While profit motive is an important factor in the trade or business analysis, the Supreme Court made it clear that the level of activity remains an important component of the trade or business standard."
- *American Academy of Family Physicians v. United States*, 91 F.3d 1155 (8th Cir. 1996): "In addition to the profit motive requirement, the income-producing activity of a tax-exempt organization must have the general characteristics of a trade or business," which requires carrying "out extensive business activities over a substantial period of time."
- *San Antonio District Dental Society v. United States*, 340 F. Supp. 11 (W.D. Tex. 1972) finding no trade or business when exempt organization was "only passively involved." *See also Oklahoma Cattlemen's Association, Inc. v. United States*, 310 F. Supp. 320 (W.D. Okla. 1969).

Is profit motive sufficient for a trade or business? (cont.)

Memorandum on Exclusive Provider Arrangements and UBIT from the Acting Director of EO Rulings & Agreements to the Director of EO Examinations (Aug. 15, 2001), available at **https://www.irs.gov/pub/irs-tege/081401.pdf**:

- "Take, for example, a university that enters into a multi-year contract with a soft drink company to be the exclusive provider of soft drinks on campus in return for an annual payment. If the company agrees to provide, stock and maintain on-campus vending machines as needed, leaving little or no obligation on the university's part to perform any services or conduct activities in connection with the enterprise, then based on this contract alone the university may not have the requisite level of activity to constitute a trade or business under I.R.C. 513(a)."

Is profit motive sufficient for a trade or business? (cont.)

- PLR 8951066: “[I]t has been the longstanding position of the Service that profit motive rather than the extent of activity is relevant, for purposes of the unrelated business income tax provisions, in determining whether an activity is a trade or business for a corporation, nonprofit as well as for-profit”
- TAM 8310003: “Where a corporate taxpayer is involved, we think the determinative factor in resolving the trade or business issue is whether the activity was engaged in with the intent to earn a profit. If a profit motive is present, normally no further inquiry into the nature of the activity is required”
- TAM 8230008: “[T]he determinative factor in the trade or business question is the existence of a profit purpose and not whether the activities may be characterized as passive or active. It is under section 512(b) not section 513, that certain passive income, including dividends, interest and royalties, are excluded from taxation”
- GCM 37513 (Apr. 25, 1978): “[T]he amount of ‘activity’ employed by an exempt organization in generating income is not relevant to the question of whether it is engaged in trade or business”

Is profit motive sufficient for a trade or business? (cont.)

Preamble to proposed regulations under section 512(a)(6) (85 FR 23172 (citations omitted)):

> *"Higgins* [*v. Comm'r*, 312 U.S. 212 (1941)] is not relevant under sections 511 through 514 because it applies to individuals, not corporations or trusts. . . . Congress responded to *Higgins* by enacting what is now section 212(1) to allow individuals to deduct all ordinary and necessary expenses incurred in the production or collection of income. Section 212 applies only to individuals. Corporations or trusts may deduct only "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business" under section 162. Thus, no deduction for expenses directly connected with investment activities would be permitted to a corporation or trust unless its investment activities are a part of a trade or business within the meaning of section 162."

Is lack of profits sufficient to find no trade or business?

If unrelated activity consistently shows a loss, IRS could argue that there is no profit motive and hence no "trade or business" and hence no NOL

- Taxpayers can't use fixed costs to generate a loss but then argue for a profit motive based only on variable costs. *Portland Golf v. Comm'r,* 497 U.S. 154 (1990)

Losantiville Country Club v. Comm'r, 906 F.3d 468 (6th Cir. 2018)

- A taxpayer can show a profit motive in the absence of actual profitability
- The nine "hobby loss" factors in Treas. Reg. § 1.183-2(b) may illuminate an intent to profit

Tax Court applied the hobby loss factors to find that a golf course operated with an intent to profit despite generating significant losses throughout its 13-year history. *WP Realty, LP v. Comm'r*, T.C. Memo. 2019-120

- Of the nine factors, the Tax Court found that only four weighed in favor of the taxpayer (one only "slightly")

Relevant factors in determining profit motive

Manner in which the EO carries on the activity

Expertise of the EO and its advisors

Time and effort expended by the EO

Expectations that assets will appreciate in value

Success of the EO in carrying on similar or dissimilar activities

History of income or losses

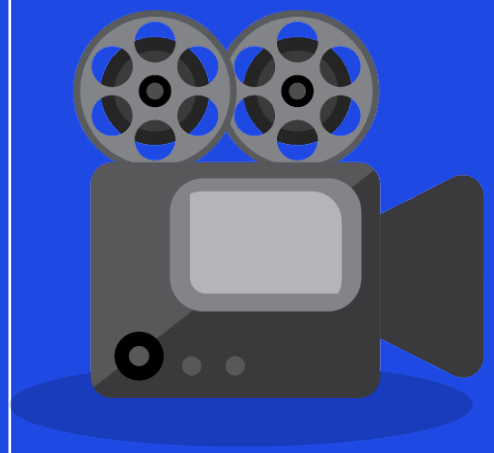
Amount of occasional profits earned

Financial status of the taxpayer

Elements of personal pleasure or recreation

Reg. 1.183-2(b)

Profit motive example



Whether X's rental of studio space, equipment and personnel, to the general public constitutes a “trade or business” within the meaning of §162.

- X's primary activity consists of providing public television broadcasting to a region of the U.S.
- X rents certain of its facilities to the general public. It rents studio space and equipment to unrelated third parties such as production companies. X also rents the time of certain of its professional employees such as engineers.
- X determines its charges by computing the average cost on an hourly basis of the facilities or personnel plus a mark-up. X recently performed a survey and determined that its facilities were priced at the middle of the market.
- On Form 990-T, X reported a large loss from this activity. The loss was due, in significant part, to accelerated depreciation and administrative costs. X maintains that in years subsequent to 1984 its losses have substantially decreased. X maintains that it has always engaged in this activity with the intent to make a profit. Although X had a substantial loss in 1984, it has subsequently shown a history of decreasing losses. The loss it did show in 1984 can be attributed to accelerated depreciation, which will not be a factor in future years.
- X's pricing of it services in the middle of the market, demonstrates that it is endeavoring to be competitive. X conducts this activity in a business-like manner. The rentals are more than incidental and there is repeat business.
- While the existence of a profit is a clear indication that an activity is a trade or business, it is not the only acceptable means of making the determination. On balance, there are a significant number of factors which indicate that X is engaged in a trade or business and can deduct the expenses incurred in this activity. X's rental of studio space, equipment, and personnel is a trade or business within the meaning of §162.

TAM 8846002

No profit motive example

The Medical Association membership consists of physicians that qualifies as a business league exempt under § 501(c)(6).

- As part of its exempt purpose, the Association publishes a monthly medical journal which is circulated to its members. The journal sells advertising space to providers of medical products and services to physicians, but it has not made a net profit on its advertising activities since 1962. Between 1974 and 1986 it incurred annual losses ranging from $18,874 to $63,786.
- The determinative factor then is not whether advertising generally is a trade or business, but whether the advertising business conducted by the Association's journal is the kind of trade or business in which losses are considered deductible under the "for profit" rationale of § 162, i.e., that the activity for which a loss is incurred was entered into primarily for profit.
- The Association had incurred direct advertising costs resulting in substantial losses for twenty-one consecutive years, and has failed to explain why it consistently incurred losses that could have been avoided by simply discontinuing the advertising activity.
- Courts concluded that the Association's long-standing policy of voluntarily incurring losses evidenced a lack of profit objective underlying the loss-generating activity.

West Virginia State Med. Ass'n v. Commissioner, 91 T.C. 651 (1988), *aff'd*, 882 F.2d 123 (4th Cir. 1989)

Allocation methods

When assets and personnel are used in both unrelated and related activities, the regulations permit applicable expenses, depreciation and similar items to be “allocated between the two uses on a reasonable basis”

- § 1.512(a)-1(c)

TD 9933, released in Nov. 2020, states that Treasury and the IRS expect to publish an NPRM on the allocation of expenses between unrelated and related uses

- 2023-2024 Priority Guidance Plan includes “Regulations under §512 regarding the allocation of expenses in computing unrelated business taxable income”

Pending the publication of such further guidance, the preamble states that the IRS will “refrain from litigating the reasonableness” of allocation methods

- One exception: The unadjusted gross-to-gross method where different prices are charged for tax years beginning after December 2, 2020

Regularly carried o

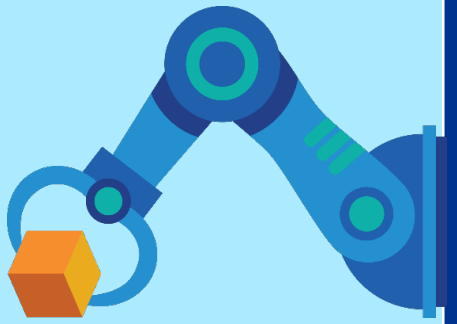
Regularly carried on

- In determining whether a trade or business is “regularly carried on”, consideration must be made to the frequency and continuity of the activities producing the income and the manner in which they are pursued.
- This requirement must be applied considering the purpose of UBIT to place EO business activities upon the same tax basis as the nonexempt business endeavors with which they compete.

Specific business activities of an EO will ordinarily be deemed to be "regularly carried on" if they manifest a frequency and continuity, and are pursued in a manner, generally similar to comparable commercial activities of nonexempt organizations.

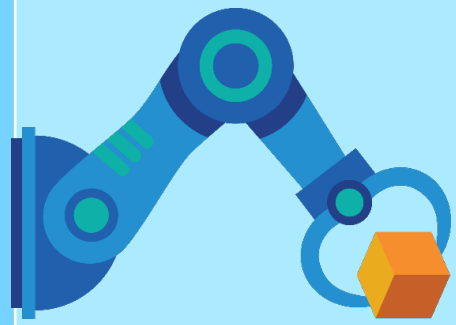
§1.513-1(c)(1)

Frequency and continuity – Normal span of activity



Where income producing activities are of a kind normally conducted by nonexempt commercial organizations regularly, the conduct of such activities by an EO over a comparatively abbreviated period (e.g., few weeks) does not constitute the regular carrying on of trade or business.

If the time span over which an EO operates a business is identical or similar to the normal time span of comparable commercial activities, the activity is regularly carried on for purposes of UBTI. Conversely, a business activity operated for a shorter duration than comparable commercial activities may not be regularly carried on and may escape taxation.



§1.513-1(c)(2)(i)

Manner in which the activity is pursued

- The manner of conduct of the EO activities must be compared with the manner in which commercial activities are normally pursued by nonexempt organizations.
- EO business activities that are engaged in only discontinuously or periodically will not be considered regularly carried on if they are conducted without the competitive and promotional efforts typical of commercial endeavors.

§ § 1.513-1(c)(2)(ii)

Special rule for infrequent conduct

- Certain intermittent income producing activities occur so infrequently that neither their recurrence nor the manner of their conduct will cause them to be regarded as trade or business regularly carried on.
- “For example, income producing or fund raising activities lasting only a short period of time will not ordinarily be treated as regularly carried on if they recur only occasionally or sporadically.”
- “Accordingly, income derived from the conduct of an annual dance or similar fund raising event for charity would not be income from trade or business regularly carried on.”

§ § 1.513-1(c)(2)(iii)

Does “prep time” count when there is an “event”?

- *NCAA v. Comm’r*, 914 F.2d 1417, 1422 (10th Cir. 1990)
  - The court concluded that “preparatory time should not be considered” and that the “length of the tournament is the relevant time period because what the NCAA was selling, and the activity from which it derived the relevant income, was the publication of advertisements in programs distributed over a period of less than three weeks, and largely to spectators.”
- *Suffolk County Patrolmen's Benevolent Ass’n v. Comm’r*, 77 T.C. 1314 (1981).
  - Preparation for the shows and the program, including the solicitation of advertisements, lasted eight to sixteen weeks but the court found that "nowhere in the regulations or the legislative history of the tax on unrelated business income is there any mention of time apart from the duration of the event itself.”
  - The court also found that event and solicitation of advertising for the program guide, constituted a “single inseparable activity.” (But solicitation of advertising in the absence an event could be of “no small variance.”)
- Rev. Rul. 75-201
  - Sale of advertising by volunteers of an exempt organization, which raises funds for an exempt symphony orchestra and publishes an annual concert book distributed at the orchestra's annual charity ball, was not a business regularly carried on.

Does “prep time” count when there is no “event”?

- *Veterans of Foreign Wars, Dep’t of Michigan v. Comm’r*, 89 T.C. 7 (1987).
  - Veterans organization’s distribution of Christmas greeting cards in connection with the solicitation of contributions was regularly carried on trade or business in part because the activity “does not concern ‘an event of some sort (sandwich stand, sports, drama or music event, dance, etc.).”
- Rev. Rul. 73-424
  - Sale of advertising in an exempt organization’s annual yearbook, which was conducted annually over three months was regularly carried on.
  - “[N]ot effected at any fund-raising event and did not tie in with any other organization activity of that general kind.” Rev. Rul. 75-201
  - “Had the year book in Rev. Rul. 73-424 been distributed at an annual fund raising ball, we believe that the result would have been different.” IRS EO CPE Text, “IRC 512 – Regularly Carried On” (1984).

Is a one-time agreement that spans several years regularly carried on?

- The court in *Ohio Farm Bureau, supra*, concluded that three-year non-compete agreement was a “one-time agreement” occurring “as a result of the unique relationship between” the parties that “is clearly not the sort of frequent and continuous activity contemplated by the regulations.”
- In *Museum of Flight Foundation v. U.S.*, 63 F. Supp. 2d 1257 (W.D. Wash 1999), a four-year lease-back of a donated jet was found to be not regularly carried on because it “appears to be a one-time, completely fortuitous lease of unique equipment that was unavailable on the open market.”
- In PLR 9530009 (Apr. 21, 1995), an exempt organization’s guarantee of a line of credit to the organization’s for-profit subsidiary from an independent lender was found to be “a one-time activity connected with the initial funding of” the subsidiary that should not considered regularly carried on.
- *Contrast: Cooper Tire & Rubber Co. Employees' Retirement Fund v. Commissioner*, 306 F.2d 20 (6th Cir. 1962): a trust’s ten-year lease of twenty tire-manufacturing machines to a tire company was found to be regularly carried on.

Not substantially related

Substantially related activities

To determine whether the activity is related, an examination is made of the relationship between:

- Business activities that generate the income (i.e., the activities of distributing the goods or performing the services involved), and
- The accomplishment of the EO's exempt purposes.

§1.513-1(d)(1)

Type of relationship required

- Trade or business is considered related only where the conduct of the business activities has a substantial causal relationship to the achievement of exempt purposes, other than through the production of income.
- Must directly or indirectly contribute importantly to the accomplishment of exempt purposes
- Whether the activities contribute importantly to the accomplishment of an exempt purpose depends upon the facts and circumstances involved
- An EO may engage in multiple business activities, some of which are related and others of which are unrelated.

§1.513-1(d)(2)

Are “commerciality factors” relevant to the substantially related inquiry?

“In many instances, courts have found that, due to the ‘commercial’ manner in which an organization conducts its activities, that organization is operated for nonexempt commercial purposes rather than for exempt purposes.” *Airlie Foundation v. Comm’r*, 283 F Supp 2d 58 (D.D.C. 2003). So-called “commerciality” factors include:

- Competition with for profit commercial entities;
- Extent and degree of below cost services provided;
- Pricing policies;
- Reasonableness of financial reserves
- Whether the organization uses commercial promotional methods (e.g., advertising) and
- The extent to which the organization receives charitable donations.

“Logically, if *** activities do not contribute to *** [an organization's tax-exempt purpose] in the context of determining whether an organization qualifies for exemption, then surely these same activities cannot be said to be related to the organization's exempt purpose in the context of the UBTI provisions.” *Ocean Pines Association v. Comm’r*, 135 T.C. 276 (2010).

Business activities as the basis for exemption v. related to exempt purposes

Example 1: Consulting services

- Providing management and consulting-type services to unrelated tax-exempts in a commercial manner cannot generally be the basis of exemption. See *BSW Group, Inc. v. Comm'r*, 70 T.C. 352 (1978); Rev. Rul. 72-369.
- But providing consulting services for a fee to local businesses relating to securing housing for minority group employees contributes importantly to the accomplishment of the exempt purpose of an organization conducting charitable and educational programs to foster and promote fair housing in a metropolitan area. Rev. Rul. 68-225.

Business activities as the basis for exemption v. related to exempt purposes (cont)

Example 2: Restaurant

- Operating a restaurant in a commercial manner cannot generally be the basis for tax-exemption *Living Faith, Inc. v. Comm'r*, 70 T.C. 352 (1978) (finding that promoting religious beliefs on diet and health were peripheral and incidental to substantial commercial purposes).
- But a museum's operation of a restaurant may contribute importantly to its accomplishment of exempt purposes by attracting and retaining visitors in the museum to devote more time to exhibits and enabling staff and employees to remain on premises. Rev. Rul. 74-399.
  - The restaurant was "not directly accessible from the street" and "patronage of the eating facilities by the general public [wa]s not directly or indirectly solicited." But even when museum advertises its restaurant and charges commercial prices, only patronage by non-visitors is considered UBTI. TAM 9720002

Other examples of commercial activities being substantially related

- Museum's selling of greeting cards with reproductions of art in museum's collection contributes importantly to museum's exempt purposes of "stimulating and enhancing public awareness, interest, and appreciation of art." Rev. Rul. 73-104
  - Sales through catalogues and in retail stores at "significant profit"
- Sale of merchandise bearing universal symbol for breast cancer awareness contributes importantly to exempt purpose. PLR 200722028
- Community foundation's grantmaking services provided to unrelated tax-exempt grantmakers that served the same community contributed importantly to foundation's exempt purposes. PLR 200832027
  - IRS noted that "there are dozens of for-profit companies that provide services similar to those you intend to sell"
  - Nonetheless, "if the provision of a service contributes importantly to benefiting the charitable class served by an organization's activities, the commercial nature of the service should not be controlling" provided the "organization is uniquely qualified to provide a particular service"

Other examples of commercial activities being substantially related (cont.)

Foundation's providing technical assistance to social sector organizations for a fee contributes importantly to its charitable purposes of improving the lives of low income children and their families by collecting, analyzing, interpreting, and sharing of metro region neighborhood data to improve community decision-making. PLR 201701002

- Foundation engages in extensive screening process similar to its grantmaking screening process to ensure that each project it agrees to undertake for a clients will provide data about the health and well-being of metro region children, their families, and their communities
- All of the data and information provided by the client for the project is added to the Foundation's repository for use in other projects as needed by the Foundation and completed projects are made available to the public on its website
- The Foundation will (1) not charge for requests that require less than four hours of staff time; (2) scope its pricing in alignment with clients' ability to pay; and (3), on a case by case basis, charge fees less than cost

How Much UBTI Is Too Much?

Operational test v. commensurate-in-scope test

- Treas. Reg. § 1.501(c)(3)-1(c)(1)
  - Provides that an organization will not be regarded as operated exclusively for exempt purposes (as required by section 501(c)(3) “if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.“
- Treas. Reg. § 1.501(c)(3)-1(e)(1)
  - “An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business”
- Is there any inconsistency between these two provisions? If so, does the latter override the former?

Questions about Treas. Reg. § 1.501(c)(3)-1(e)(1)

"An organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business"

- When this provision says a section 501(c)(3) organization may operate "a trade or business as a substantial part of its activities" does that include an unrelated trade or business?
- What does the condition, "if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes," mean?
  - Does it mean the business must be "substantially related" to the organization's exempt purpose "aside from the need of such organization for income or funds or the use it makes of the profits derived" as provided in section 513?
  - Does producing income to fund an exempt purpose "furthers" that exempt purpose?

Treas. Reg. § 1.501(c)(3)-1(e)(1) and Rev. Rul. 64-182

Sole precedential authority interpreting Treas. Reg. § 1.501(c)(3)-1(e)(1) is Rev. Rul. 64-182.

- Considered an organization that derived its income "principally" from the rental of space in a large commercial office building that it owned, maintained, and operated.
- The IRS deemed the organization “to meet the primary-purpose test of section 1.501(c)(3)-1(e)(1)" so long as it carried on "a charitable program commensurate in scope with its financial resources.”
- In various GCMs, the IRS made clear that it—
  - Viewed the commercial leasing activity described in Rev. Rul. 64-182 as "necessarily an unrelated trade or business," GCM 32689 (Apr. 27, 1964),
  - Did not view the conclusion in Rev. Rul. 64-182 to be "limited to situations involving real estate operations," GCM 34682 (Nov. 17, 1971), and
  - Saw the principles in Rev. Rul. 64-182 as applicable to business operations such as department stores and farms. GCMs 34682 and 34176 (July 30, 1969).

Commensurate-in-scope test as explained in rulings

In TAM 9521004, the IRS concluded that an unrelated business that generated half of an organization's revenue did not jeopardize its tax-exemption based on the following reasoning:

> "[An organization's] exemption is not jeopardized merely because it conducts an unrelated business as a substantial part of its total activities, as section 1.501(c)(3)-1(e)(1) of the regulations indicates. The key issues are the reason why the business is carried on and the organization's primary purpose. A purpose to raise funds to support the organization's exempt functions is a legitimate reason for an organization to conduct a business, although it would have to pay tax on any unrelated business taxable income derived from [the] business . . . As long as the conduct of such business is not the organization's primary purpose, as determined by the facts and circumstances, the organization may conduct such business consistent with section 501(c)(3)."

Commensurate-in-scope test as explained in rulings (cont)

In TAM 9636001, the IRS concluded that a school's unrelated publishing business ("M") that "amounted to more than one-half of the organization's total receipts" did not jeopardize its tax-exemption:

> "While the operation of M was a substantial part of the overall operations of the organization during the years under consideration, the available information clearly indicates the presence of substantial and significant activities as evidenced by the elementary, secondary, and college level programs of the organization. There is no evidence that any of the funds generated by M were not properly used to further the organization's educational purposes in some manner. . . [T]the subject organization meets the primary purpose test of section 1.501(c)(3)-1(e)(1) of the regulations, because it is carrying on an exempt program commensurate in scope with its financial resources. Consequently, the organization continues to qualify for exemption under section 501(c)(3) of the Code."

Commensurate-in-scope test as explained in rulings (cont.)

As a final example, the IRS concluded in TAM 200021056 that an unrelated business that generated two-thirds of an organization's income did not jeopardize its tax-exemption:

> "As provided in section 1.501(c)(3)-1(e) of the regulations, an organization may meet the requirements of section 501(c)(3) of the Code although it operates a trade or business as a substantial part of its activities if the trade or business is in furtherance of the organization's tax exempt purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business. It is important to note that section 1.501(c)(3)-1(e) does not require that the trade or business in question must be related to exempt purposes within the meaning of sections 511 through 513 of the Code, only that it be in furtherance of the exempt purposes. One way in which a trade or business may be in furtherance of exempt purposes is to raise money for the exempt purposes of the organization, notwithstanding that the actual trade or business activity may be taxable under sections 511 through 513."

Commensurate-in-scope test as explained in GCMs

In a series of general counsel memoranda (GCMs) spanning decades, the IRS interpreted Treas. Reg. 1.501(c)(3)-1(e)(1) to mean that—

- An “organization may have a substantial unrelated trade or business and still establish that it is operated primarily in furtherance of an exempt purpose if it can demonstrate that it is carrying on a real and substantial charitable program reasonably commensurate with its resources,” GCM 39684 (Dec. 10, 1987),
- A section 501(c)(3) organization could "derive the bulk of its income from unrelated trade or business activities without jeopardizing its exempt status," GCM 38742 (June 3, 1981), and
- "[T]here is no quantitative limitation on the 'amount' of unrelated business an organization may engage in under section 501(c)(3), other than that implicit in the fundamental requirement of charity law that charity properties must be administered exclusively in the beneficial interest of the charitable purpose to which the property is dedicated," which could include "putting property to business use for the production of income for such purpose." GCM 34682.
- *See also* LCM TL-14 (Jan. 22, 1988) (noting that “a charity may carry on substantial unrelated business so long as the business is in furtherance of its exempt purposes . . . by using the profits from the business for charitable purposes, including aiding other charitable organizations.”)

Inconsistency between operational test and commensurate-in-scope tests?

- Some GCMs acknowledged that an inconsistency could be perceived to exist between Treas. Reg. § 1.501(c)(3)-1(c)(1)'s substantiality threshold and the Treas. Reg. § 1.501(c)(3)-1(e)(1) primary-purpose test, given that unrelated business activities could be construed to "not in themselves further an exempt purpose." GCM 34176.
- However, the IRS repeatedly concluded that "for the purpose of resolving [these] internal inconsistencies in the present regulations, the 'primary purpose' test enunciated in section 1.501(c)(3)-1(e) should be given controlling force in determining what limitations on the conduct of unrelated business are to be considered applicable." GCM 34682. *See also*
  - GCM 34176 ("controlling weight")
  - GCM 37596 (July 3, 1978) (in considering the apparent inconsistency, Treas. Reg. § 1.501(c)(3)-1(e)(1) "should control")
  - EO CPE Text, "IRC 502 — Feeder Organizations," at pp. 8-9, available at irs.gov/pub/irs-tege/eotopicf83.pdf, which notes that Treas. Reg. § 1.501(c)(3)-1(e)(1) and Treas. Reg. § 1.501(c)(3)-1(c)(1) "appear to contradict one another" but that "because Reg. 1.501(c)(3)-1(e)(1) specifically refers to business activities, it controls."

Legislative history support

- “It is not intended that the tax imposed on unrelated business income will have any effect on the tax-exempt status of any organization. An organization which is exempt prior to the enactment of this bill, if continuing the same activities, would still be exempt after this bill becomes law.” S. Rep. No. 81-2375
- The provision in the Revenue Act of 1950 that had an effect on tax-exempt status was section 502, the so-called “feeder” rule, which says “An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.”

Do the commerciality cases suggest a substantiality threshold?

- The commerciality cases generally examine whether an organization's predominant or sole (revenue-raising) activity is carried out in a "manner not significantly distinguishable from a commercial endeavor" and, if not, have denied exemption based on a "substantial nonexempt purpose" in the form of a "nonexempt commercial purpose" *Airlie Foundation, supra*.
- At least one court has upheld the revocation of an organization's tax-exempt status at least in part because the organization was engaged in a commercial activity (auto races) that "exceeded the benchmark of insubstantiality" *Orange County Agricultural Society, Inc.*, 893 F.2d 529 (2d Cir. 1990).

What questions do you have?

Thank you!

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

Learn about us: **kpmg.com**

TEGE | Exempt Organizations Council

Break

DC Bar Continuing Legal Education

gwscpa learn | connect | lead

Lowenstein Sandler

IRS CHIEF COUNSEL AND TREASURY UPDATE

March 7, 2024

PANELISTS

- Rachel Levy, Associate Chief Counsel (EEE)
- Lynne Camillo, Deputy Associate Chief Counsel (EEE)
- Christopher Hyde, IRS
- Casey Lothamer, IRS

- Moderator
- Meghan Biss, Caplin and Drysdale

- Materials prepared by Elinor Ramey with no input from IRS or Treasury

REGULATORY AND GUIDANCE UPDATE
DONOR ADVISED FUNDS

- November 13, 2023, Treasury released Proposed Regulations relating to donor advised funds
- 2023-2024 PGP had divided DAF guidance into four parts
  - Regulations under section 4966
  - Regulations under section 4967
  - Regulations under section 4958
  - Guidance regarding the public-support computation with respect to distributions from DAFs

- Comment period for proposed regulations ended on February 15, 2024
- 173 Comments posted on Regulations.gov
- Public hearing has been set for May 6

DAF PROPOSED REGULATIONS OVERVIEW

- **Primarily Definitional**
  - Donor Advised Fund
  - Donor
  - Donor Advisor
  - Advisory Privileges
  - Taxable Distributions
- **Do not provide guidance on other issues:**
  - Private Foundation use of DAFs
  - More than incidental benefit (pledges and bifurcated payments)
  - Public support
  - Payout

DAF PROPOSED REGULATIONS OVERVIEW

DAF is a Fund or Account

1. That is **separately identified** by reference to contributions of a **donor or donors;**

2. Owned and controlled by a sponsoring organization; and

3. At least one donor or **donor-advisor** has, or reasonably expects to have, **advisory privileges** with respect to the **distribution or investment** of amounts held in the fund by reason of the donor's status as a donor

DAF PROPOSED REGULATIONS OVERVIEW

- **Separately Identified**
  - Formal record of contributions of a donor or donors or
  - Facts and circumstances
    - Account balance reflects contributions, dividends, distributions, expenses, gains and losses
    - Named after a donor or related person
    - Referred to as a DAF or agreement with a donor that it is a DAF
    - At least one donor regularly receives a fund or account statement
    - Sponsoring organization generally solicits advice before making distributions
- **Donor**
  - Any person, except does not include a governmental unit or a section 501(c)(3) public charity (except disqualified supporting organizations)
  - If there is no donor then the fund is not a DAF, so any fund that is solely funded by entities that are not donors then it is not a DAF and none of the other limitations apply. For example, a (c)(3) can set up a scholarship fund at a community foundation and not have to fall within the DAF scholarship fund exceptions.

DAF PROPOSED REGULATIONS OVERVIEW

- **Donor Advisor**
  - Person appoint or designated by the donor
  - Person who establishes the fund or account and advises as to distributions or investments (memorial fund, wedding fund)
  - Personal Investment Advisors
    - Manages both the assets in a DAF and the personal assets of a donor to that DAF
    - Not a donor-advisor if providing services to the sponsoring organization as a whole
    - Effect of this definition is that personal investment advisors cannot receive compensation from the DAF (under section 4958)
  - Donor-recommended Advisory Committee Member unless:
    - Objective criteria
    - Committee of 3 or more and majority not recommended by the donor
    - Not a related person

DAF PROPOSED REGULATIONS OVERVIEW

- **Advisory Privileges**
  - Facts and circumstances
  - Include privileges from service on an advisory committee
  - Applied to the entire fund – if one donor or donor advisor has advisory privileges then the fund is a DAF
  - Does not generally include officers, directors, or employees of the sponsoring organization
  - If donor has advisory privileges then it is deemed to be by reason of their status as a donor
    - Advisory Committee Exception
      - Appointment based on objective criteria
      - Three or more individuals on the committee and no more than one third are related persons
      - Appointee is not a significant contributor to the fund or account at the time of appointment

DAF REGULATIONS OVERVIEW

- **Distribution**
  - Any grant, payment, disbursement, or transfer from a DAF
  - Not investments and reasonable investment or grant-related fees
  - Use of DAF assets that results in a more than incidental benefit to a donor
- **Taxable Distribution**
  - To a natural person; or
  - To any other person if it is not for a charitable purpose; or
  - If the sponsoring organization does not exercise expenditure responsibility
- **Non-taxable Distributions**
  - Distributions to an organization described in 170(b)(1)(A) (but must be for a charitable purpose), allows for equivalency determination
  - The sponsoring organization of the DAF
  - Any other DAF
- **Daisy Chain Anti-Abuse**

DAF PROPOSED REGULATIONS OVERVIEW

- **Excepted Funds**
  - Single Identified Organization –
    - Fund only makes distributions to a single governmental entity or public charity (except disqualified supporting organizations)
    - Cannot give to third parties on behalf of the organization, and cannot daisy chain
  - Scholarship Funds
    - Advice of the donor is part of a committee and the members of the committee are appointed by the sponsoring organizations
    - Donors do not control the selection committee
    - Nondiscrimination, objective selection, and adequate records
  - Scholarship Funds Established by (c)(4)
  - Disaster Relief Funds (broader than employer funds that were previously allowed)

OTHER UPDATES

- **Rev. Proc. 2024-5 – Annual Revenue Procedure on EO Determinations**
  - Section 3.01(1) provides that EO Determinations will issue a determination letter reclassibying a section 501(c)(3) organization as another type of section 501(c) organization if, as of the date of application, the organization:
    - Has distributed its assets to another section 501(c)(3) organization or governmental entity; and
    - Otherwise meets the requirements for the section 501(c) status requested
  - Determination effective as of the date of submission of the reclassification application
    - Must file Form 8976 within 60 days of submission if seeking reclassification as a section 501(c)(4) entity.

OTHER UPDATES

- **Employee Retention Tax Credit**
  - Moratorium on processing new employee retention credit ("ERC") claims through "at least the end" of 2023, announced in September 2023.
  - Commissioner said that there is now "no definitive timetable" for ending the moratorium.
  - Special withdrawal process announced in October 2023 for taxpayers that submitted an ERC claim, but have not yet received a refund.
  - Voluntary Disclosure Program announced in December 2023 to help taxpayers that received a refund, but want to pay back the money they received after filing ERC claims in error.

LITIGATION UPDATES

- **Memorial Hermann Accountable Care Organization v. Commissioner, No. 4412-22**
  - On January 16, 2020, the IRS issued a proposed adverse determination letter concluding that Memorial Hermann Accountable Care Organization ("Memorial Hermann") had not met its burden of showing that it is an organization described under Section 501(c)(4). After exhausting its administrative remedies, Memorial Hermann filed a petition with the Tax Court.
  - The issue before the Tax Court was whether the IRS erred in denying Memorial Hermann, an accountable care organization, tax-exempt status as a Section 501(c)(4) social welfare organization.
  - On May 16, 2023, the Tax Court issued an opinion which held that Memorial Hermann did not meet its burden of showing that it is an organization described in Section 501(c)(4) because Memorial Hermann's non-Medicare Shared Savings Program activities primarily benefited insurance companies and health care providers and, thereby, constitute a substantial non-exempt purpose.
- **Mayo Clinic v. United States, 130 A.F.T.R.2d 2022-6540 (D. Minn. 2022) (ongoing)**
  - Mayo Clinic ("Mayo") is the parent organization of several hospitals, clinics, and the Mayo Clinic College of Medicine and Science. In connection with an audit, the IRS asserted that Mayo owed taxes on certain income that it received from partnerships. However, Mayo argued it was entitled to a tax exemption for this partnership income based on an exception to the debt-financed property rules in Section 514 that is available only to educational organizations. The IRS concluded that Mayo was not entitled to that exemption because it is not an educational organization.
  - Mayo brought a lawsuit seeking a refund of $11,501,621 in federal income tax for 2003, 2005-2007, and 2010-2012.
  - On November 22, 2022, the District Court, on remand from the 8th Circuit, held that Mayo is an "educational organization" and has a "substantial" (primary) educational purpose.
  - On September 1, 2023, the government appealed to the 8thCircuit.

LITIGATION UPDATES

- **The Buckeye Institute v. Internal Revenue Service, No. 2:22-cv-04297 (S.D. Ohio 2022) (ongoing)**
  - On December 5, 2022, the Buckeye Institute filed a lawsuit seeking a declaratory judgment and injunctive relief prohibiting the IRS from collecting the names and addresses of its contributors pursuant to Section 6033(b)(5).
  - The Buckeye Institute is claiming that the Department of the Treasury and the IRS are violating the First Amendment by compelling the Buckeye Institute to disclose the names and addresses of its contributors.
  - Interlocutory Appeal to Sixth Circuit appeal granted to determine whether "exacting scrutiny" is the appropriate standard.
- **Freedom Path v. Internal Revenue Service, No. 1:20-cv-01349 (D.D.C.) (ongoing)**
  - Freedom Path contends that the "facts and circumstances" test in Revenue Ruling 2004-6 used by the IRS to determine whether a group has engaged in an "exempt function" and, thus, may have taxable income violates the First and Fifth Amendments.
  - The Revenue Ruling's explicit purpose is to provide guidance on the tax implications of advocacy that meets the definition of political campaign activity.

TEGE | Exempt Organizations Council

Break

DC Bar Continuing Legal Education

gwscpa learn | connect | lead

TEGE
EXEMPT ORGANIZATIONS COUNCIL

MARCH 7-8, 2024

WASHINGTON, D.C.

State Regulation of Charitable Organizations and Fundraisers

Elizabeth Kim
Senior Assistant Attorney General - California Department of Justice,
Office of the Attorney General

Beth Short
Charitable Outreach Supervisor - Ohio Attorney General

Gregg Lam, Moderator
Partner - Copilevitz, Lam & Raney, P.C.

Roadmap

- NASCO Updates
- What's On Our Minds?
- Recent State Enforcement Actions
- California Charitable Fundraising Platform Update
- State Outreach Efforts

NASCO

The National Association of State Charity Officials is an association of state offices charged with the regulation and oversight of charitable organizations and charitable solicitation. NASCO has been operating for over 40 years.

https://www.nasconet.org/

NASCO Updates

- NASCO letters
  - Letter to IRS: 1023-EZ concerns and timely data
  - Letter to FTC: Charitable imposters
- Regulator trainings and collaborations
- NASCO partnerships
- Join us October 8, 2024, in Baltimore, Maryland

On Our Minds

Recent State Enforcement Actions

Cases: Deceptive Solicitations

- The Hope Box, Inc. GA charity to "provide services to infants and mothers in crisis" was determined to have misused donor funds, operated as an unregistered charity and made misrepresentations about the organization. Result: Charity must cease operations and fiduciaries barred from charitable fundraising.

- Farmhouse Veggies NP, Inc. Unregistered GA charity used donations for volunteer housing rather than its purpose to feed persons in need. Result: Cease and desist order to halt all activities.

Cases: Governance

- American Irish Historical Society. 100 year old+ charity determined to sell its historical real estate and community complained. NY OAG investigated and discovered governance and financial wrongdoing. Result: restructuring of the board, retention of property, stabilization of organization.

- Oak Forest Lions Club Youth Stadium. 501(c)(4) filed suit to acquire real property of a defunct charity by adverse possession. TX OAG intervened to advocate for *cy pres* to charity with a similar purpose. Result: Court agreed and *cy pres'd* to local charity with similar purpose.

Cases: Trusts and Estates, etc.

- Harold and Helen Gottlieb Foundation. Two attorneys used their positions as fiduciaries for a charitable trust and a private foundation for personal gain. In settlement, the NY OAG obtained restitution, a bar on service to another nonprofit, a CLE training requirement and dissolution of the foundation and *cy pres* of its assets.

- Lebanon Town Green. CT OAG aided in facilitating the resolution of mulit-year litigation involving land ownership and a dispute between two charities and a municipality. Issues included title, fee interest, "public use," and preservation and conservation restrictions.

Cases: Other Actions

- Minnesota: Otto Bremer Trust ($1.4 billion in assets)

  https://www.ag.state.mn.us/Office/Communications/2024/02/07_Bremer.asp

- Minnesota: Enforcement action against 23 nonprofits in $250 million fraud scheme - with1023-EZ implications.

  https://www.ag.state.mn.us/Office/Communications/2023/10/18_FoodFraud.asp

- Washington: Health Care Initiative

  https://www.atg.wa.gov/news/news-releases/ag-ferguson-providence-must-provide-1578-million-refunds-and-debt-relief

CA - Legislative and Regulatory Developments

Charitable Fundraising Platforms (AB 488)

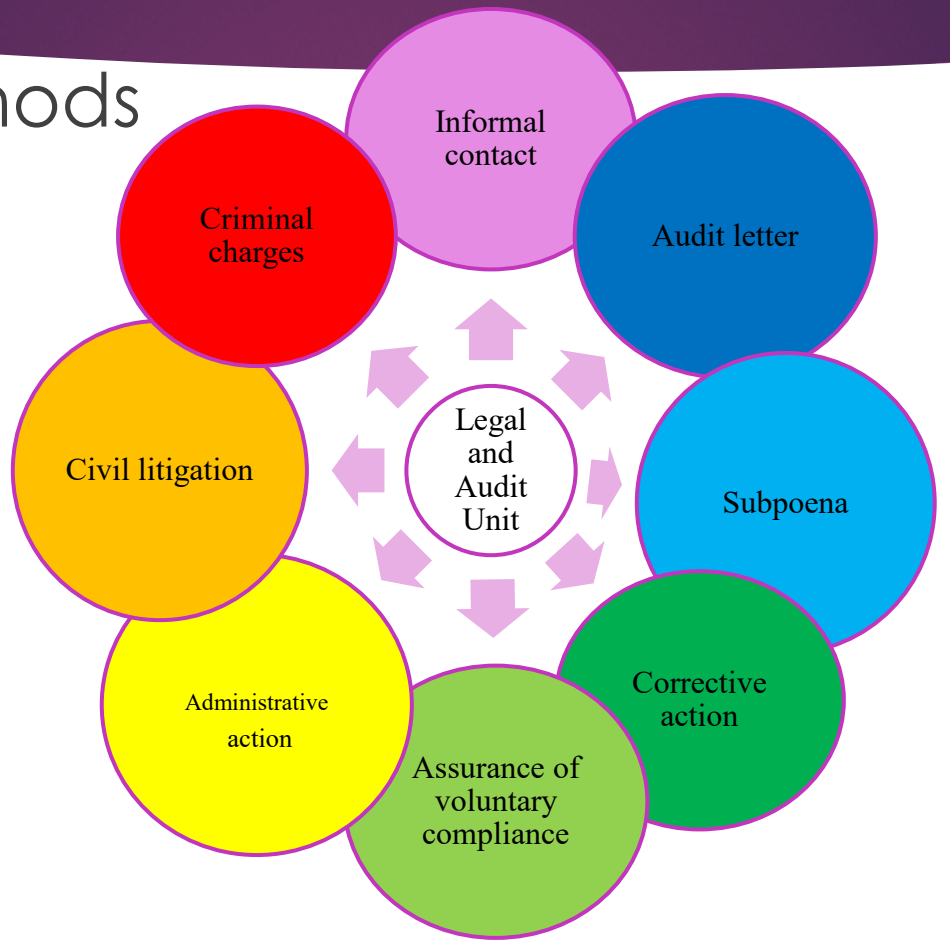
- California Government Code, section 12599.9-12599.10
- Implementing Regulations
  - Cal. Code Regs., tit. 11, sections 314-323
  - Where are we?

CA - Legislative and Regulatory Developments

- Probate Code 16110: charitable trustees selling all or substantially all of trust's assets must give written notice to the Attorney General at least 20 days before the trustee sells, leases, conveys, exchanges, transfers, or otherwise disposes of all or substantially all of the charitable assets.
- Cal. Code Regs., tit. 11, section 328.1: among other provisions, defines what is meant by "substantially all" within the context of nonprofit corporations and charitable trusts selling substantially all of their assets as 75% of the value of all assets.
  - Applies to Probate Code section 16110 trustee sales and to Corporations Code sections 5913, 9633
- Raffle regulations: sections 415-426 of Title 11 of the CA Code of Regulations. Covers A to Z of conducting charitable raffles in California under Penal Code section 320.5. Went into effect April 1, 2023.

CA Attorney General's Enforcement Actions

Enforcement methods



CA - Orders to Cease and Desist

Grounds to issue C&D Orders: operating in violation of the Supervision of Trustees and Fundraisers for Charitable Purposes Act (Gov. Code, § 12580 et seq.)

- Examples:
  - Operating without being registered
  - Refusal to produce records to the Attorney General
  - Making material false statements in an application, statement or report required to be filed with a government agency
  - Failure to file or filing an incomplete financial report
  - Solicitation related violations under Government Code § 12599.6
- Authority: Gov. Code, § 12591.1, Cal. Code Regs., tit. 11, § 999.6

CA - Recent Cease and Desist Orders

- Examples of recently issued C&D Orders:
  - Compton Animal Rescue and Damian Wesley: Soliciting charitable donations without registering. Several active social media fundraising campaigns, including GoFundMe. Animal control rescued over 140 live animals (some very ill), and impounded over a dozen deceased animals.*
  - Mickey Barreto and Mickey Barreto Missions: Filing false records. Cease and desist order issued and revocation of registration. C&D Order upheld following an administrative hearing.

*This order can still be appealed.

CA - Assurance of Voluntary Compliance

In the Matter of Neal Zeavy, Raffle Administration Corp., NZ Consulting, Inc.

- Raffle Administration Corp. (RAC) and NZ Consulting provided services to charities related to conducting raffles for charitable fundraising. RAC and NZ Consulting were both owned and operated by Zeavy. They provided these services for compensation, including administering the raffles, from 2006-2018. Sometimes their compensation was based on a set fee per raffle ticket sold.
- RAC, NZ Consulting, and Zeavy were not registered as professional fundraisers or fundraising counsel.
- In CA, only employees of the charity can receive compensation in connection with a raffle. (Penal Code, § 320.5.) And, only the charity can hold a financial interest in the raffle. (*Id*.)
- Terms of the AVC: without admitting liability, a five-year sector ban, including charitable fundraising; agreement not to violate Penal Code section 320.5 and Gov. Code sections on charitable fundraising; and a payment of $5.5M (attorney's fees & costs, and penalties)

CA - Settlement Post-Investigation/Pre-Filing

African-American Male Achiever's Network

- In 2017, the charity paid its founding directors (husband and wife), $2,401,100 as compensation for "25 years of service" from 1991 to 2017. These directors worked unpaid but alleged that the board of directors of the charity promised to compensate them if funding became available.
- The charity sold its primary asset, a real estate, for $4.1M in 2017.
- Our office alleged excessive compensation, lack of compensation study, lack of supporting documents supporting the board's promise, and lack of independent directors to approve
- Resolved through a settlement: the directors returned $1.7M back to the charity.

CA - Settlement Post-Filing

People v. Aid for Starving Children

- We filed an action against Aid for Starving Children and its directors alleging misleading solicitations. The charity used images of starving children for its solicitations, but its programs consisted mostly of distributing pharmaceutical drugs to foreign countries, and not food. It also used misleading pie charts to show its revenue and program expenses.
- Settlement for injunctive relief, including: charity to adopt policies and practices to guard against misleading donors and the public; keep records to show the time, place, pictures and anecdotes for solicitation campaigns; for grants to foreign recipients, keep records that show the charity made the grants and recipient's acknowledgement of same; for grants to the intermediary who will distribute the grants, have a written agreement where the intermediary agrees to restrict the use for the charity's specific charitable purpose.

CA - Settlement Post-Filing

People v. Move America Forward, et al.

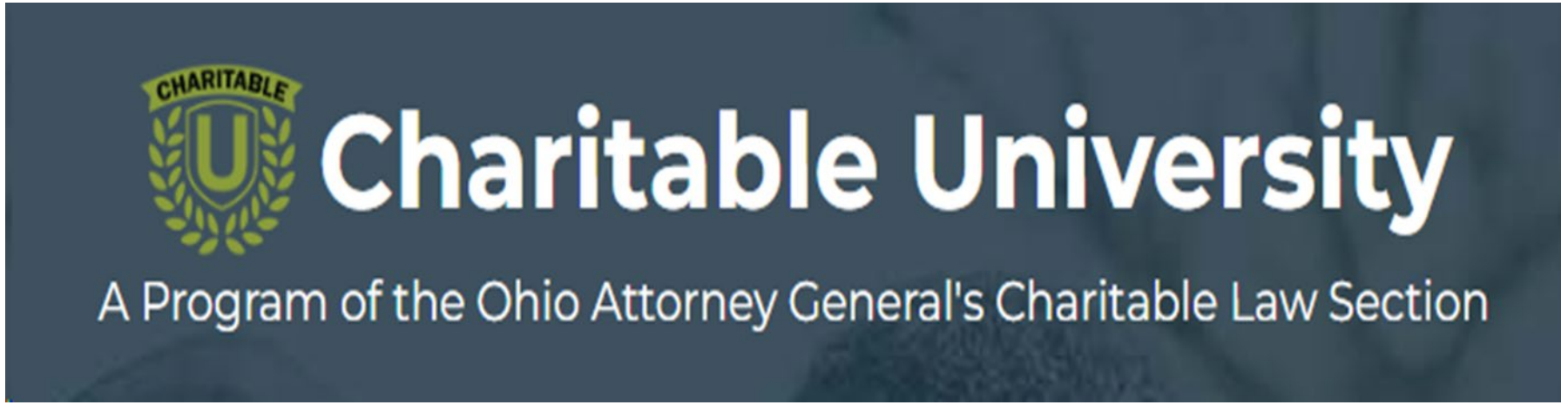
- Move America Forward sends care packages to active-duty troops abroad. We filed an action for breach of fiduciary duty, self-dealing, deceptive solicitation, false reports, and unfair competition in the operation of the charity and in campaigns for charitable donations.
- Settlement for injunctive relief, including for the most culpable defendant to step down as a director and to stop doing business with the charity through his for-profit company, and the payment of $100,000.

OH – Enforcement Actions

Ohio Clean Water Fund. $140K+ raised after train derailment in Ohio. Misrepresented partnership with food bank, which was given only $10K of donations. Result: dissolution and recovery of funds, as well as penalties to organizers.

Impact With Hope. Criminal and civil actions involving Charitable Law Section taken in this situation. Extreme care taken to wall off criminal and civil activities.

Outreach – The Ohio Model



TEGE | Exempt Organizations Council

Lunch Break

DC Bar Continuing Legal Education

gwscpa learn | connect | lead

Office of Professional Responsibility

Elizabeth Kastenberg
Jacqueline Manasterli

March 8, 2024

Office of Professional Responsibility -- Topics

- **Introduction**
- **Office of Professional Responsibility**
- **Circular 230**
- **Referrals**
- **Processing Referrals**
- **Sanctions**
- **OPR Updates**

Office of Professional Responsibility

To protect taxpayers and the tax system by promoting and enforcing high standards of professional conduct for tax practitioners (as well as appraisers).

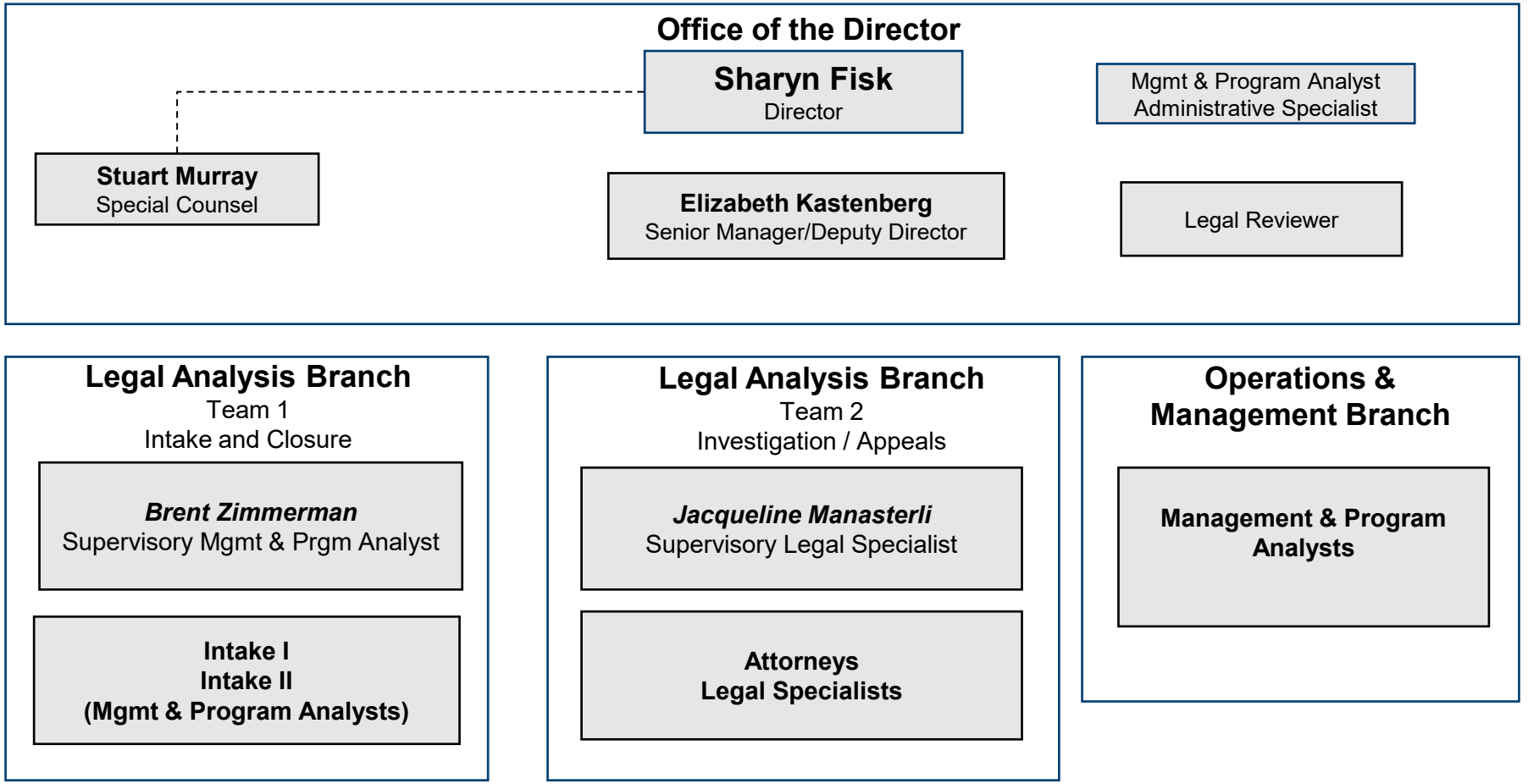
OPR is a Title 31 (Money and Finance) function that:

- Assists with tax administration by protecting taxpayers and the IRS from unqualified or unscrupulous practitioners.
- Supports the IRS's strategy to enhance enforcement by ensuring practitioners adhere to professional standards and follow the law.

The OPR is responsible for all matters related to tax practitioner professional standards that includes:

- Investigating alleged violations of the standards of tax practice under Treasury Circular 230 and taking appropriate disciplinary actions, including suspensions, disbarments, and monetary penalties.
- Conducting significant outreach and education to tax professionals about their obligations under Treasury Circular 230 to clients and tax administration.

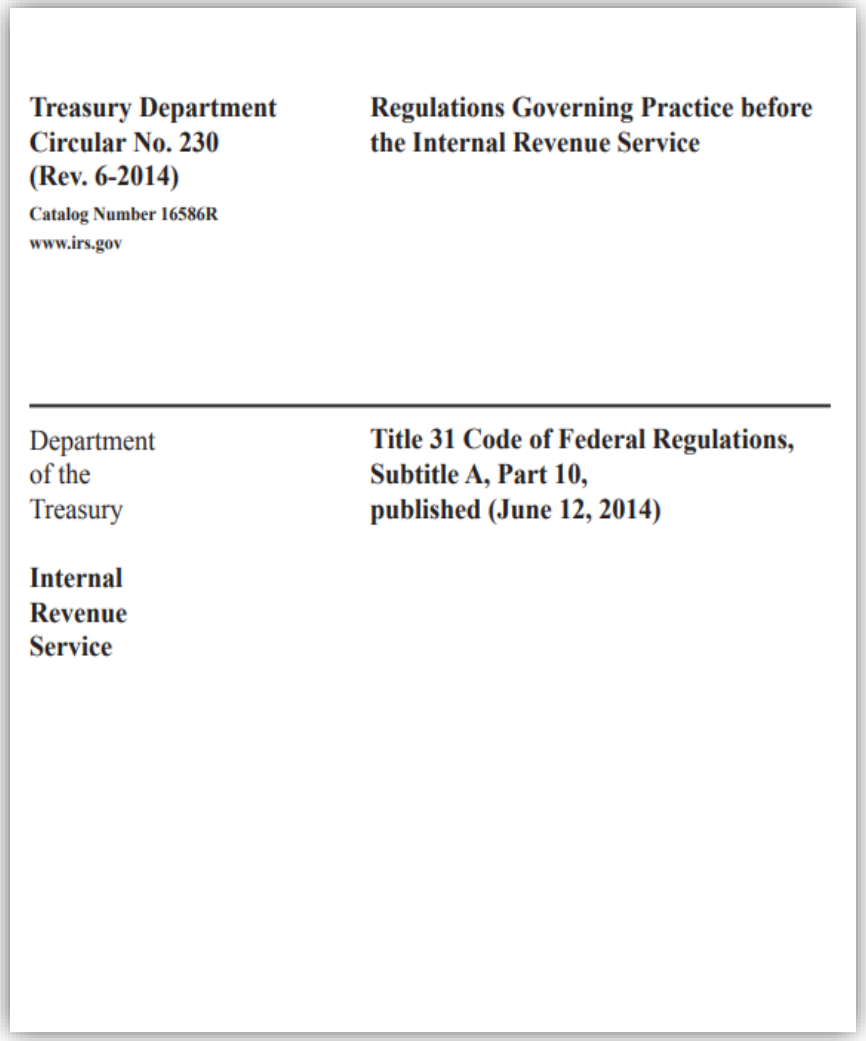
Current OPR Organization



Circular 230

- **Enforcement Regulations under 31 USC Sec. 330 (31 C.F.R. Subtitle A, Part 10) are commonly referred to as "Circular 230."**
- **Comprehensive regulations containing:**
  - Ethical/conduct provisions.
  - Applicable sanctions.
  - Disciplinary procedures.

Available at: https://www.irs.gov/pub/irs-pdf/pcir230.pdf



Treasury Department
Circular No. 230
(Rev. 6-2014)

Catalog Number 16586R
www.irs.gov

Regulations Governing Practice before the Internal Revenue Service

Department of the Treasury

Internal Revenue Service

Title 31 Code of Federal Regulations, Subtitle A, Part 10, published (June 12, 2014)

OPR's Authority

31 USC Sec. 330 (1884) authorizes:

- The regulation of the practice of representatives of persons before the Department of the Treasury, including the IRS, and determinations of practitioner "fitness" to practice (31 USC Sec. 330(a)).
- Types of disciplinary action also includes monetary penalties (31 USC Sec. 330(c)).
- The regulation of certain appraisers (31 USC Sec. 330(d)).
- Setting standards for certain written advice (31 USC Sec. 330(e)).

Fitness to Practice

What is “fitness to practice” in tax practice before the IRS?

Section 330 of Title 31, provides:

- Good character
- Good reputation
- Necessary qualifications to provide valuable service to the client
- Competency to advise and assist persons in presenting their cases

Practitioner Community

- Attorneys and CPAs
- Enrolled Agents, Enrolled Retirement Plan Agents, and Enrolled Actuaries
- Individuals who engage in a limited practice with limited practice rights under IRS Rev. Proc. 2014-42 (Annual Filing Season Program)
- Appraisers who submit appraisals supporting tax positions.
- A representative designated on a Form 2848 in a representative capacity (such as an officer or general partner, an in-house tax professional, or a member of the taxpayer's immediate family)

Practice Before the IRS

"Practice before the IRS" contemplates all matters connected with the presentation to the IRS regarding a taxpayer's rights, liabilities, and privileges under laws and regulations administered by the IRS.

- Advocating/representing a client in an examination, before Collections, and/or appearing before Appeals
- Preparing or filing documents for submission to the IRS (not tax return preparation)
- Communicating (written and oral) to the IRS regarding a taxpayer
- Advising clients or providing appraisals regarding tax positions

Unregulated Community

While many attorneys, CPAs, and enrolled agents prepare tax returns, mere “return preparation” is not practice before the IRS.

Most paid return preparers hold no professional credential and are not part of the regulated community.

- Under IRC 6109(a), even uncredentialed preparers must have a Preparer Tax Identification Number (PTIN) and are subject to potential preparer penalties, e.g., under IRC 6695(g), for failure to be diligent in determining eligibility for certain tax benefits.
- Preparer misconduct may be reported to the Return Preparer Office (RPO) on Form 8484, *Suspected Practitioner Misconduct Report* (by IRS employees) or Form 14157, *Complaint: Tax Return Preparer* (by taxpayers or other non-IRS employees).

Special Rules for Foreign Practitioners

- Under the “limited practice” rules of Circular 230, even if an individual is not a licensed attorney, CPA, or Enrolled Agent, they may represent an individual or entity, who is outside the United States, before personnel of the IRS when the representation also occurs outside the United States. (Circular 230, §10.7(c)(1)(vii).)

- Thus, a foreign lawyer or accountant may represent an individual or entity who is outside the United States if the representation occurs outside the U.S.

Common Circular 230 Concerns

Four broad sources of misconduct

1. When advising taxpayers on filing positions or transactions
2. During taxpayer representation before IRS
3. On practitioner's own tax filing or tax payment responsibilities
4. External misconduct (moral turpitude)

Circular 230's Focus

Subpart C, Section 10.51, outlines incompetent and disreputable conduct that could subject a practitioner to sanction, including unprofessional conduct.

Subpart B encompasses all duties and restrictions relating practice and includes, among other things, a practitioner's duty to:

- Be diligent and competent;
- Maintain certain standards with respect to tax returns and any other documents presented to the IRS;
- Cooperate with the IRS by furnishing information and avoiding undue delay; and
- Address conflicts of interest

Examples of Practitioner Misconduct from IRM 1.25.1.3

- Inaccurate or unreasonable entries or omissions on tax returns, financial statements, and other documents for submission to the IRS.
- Failing to ascertain all relevant facts and applicable law before preparing documents prior to filing, making submissions, giving oral or written opinions in connection with a federal tax matter, or giving tax advice to clients.
- Reckless disregard for the law and regulations administered by the IRS or giving advice when incompetent to do so.
- "Patterns" of behavior in violation of the regulations that govern practice involving multiple years or multiple clients or inappropriate or unprofessional conduct demonstrated to multiple IRS employees.
- Continuing to represent a taxpayer in the context of an unresolved conflict of interest, such as representation of separated or divorcing spouses during an examination of a jointly filed tax return or when representation is hampered by practitioner self-interest.

10.51 Incompetence and Disreputable Conduct

- Incompetence - failing to meet the standards of 10.35.
- Disreputable conduct —
  - Certain criminal convictions (10.51(a)(1)-(3))
  - Giving false or misleading information to IRS (10.51(a)(4))
  - Willful noncompliance by practitioner (10.51(a)(6))
  - Willfully assisting, counseling or encouraging a client to evade taxes or payment thereof (10.51(a)(7))
  - Attempting to influence IRS personnel by use of threats, false accusations, etc. (10.51(a)(9))
  - Disbarment or suspension from practice as an attorney or CPA (10.51(a)(10))
  - Contemptuous conduct (10.51(a)(12))
  - Giving false opinions (10.51(a)(13))
  - Willful Title 26 violations re client's return (10.51(a)(14)-(15))

Key Provisions of Sub. B

Three important provisions:

- Section 10.22 Diligence as to accuracy
- Section 10.35 Competence
- Section 10.34 Standards with respect to tax returns and document affidavits, and other papers

Provisions involving interaction with IRS:

- Section 10.20 Information to be furnished
- Section 10.23 Prompt disposition of pending matters

Other key provisions:

- Section 10.29 Conflicting interests
- Section 10.31 Refund checks
- Section 10.37 Requirements for written advice

Sources of OPR Referrals

- B&B (Board and Bar) notices
  - Received from state accountancy and state bars
  - OPR checks of state licensing websites
- External referrals (Form 14157, *Return Preparer Complaint*) from public
- Internal referrals (Form 8484, *Report of Suspected Practitioner Misconduct*) from other IRS business operating divisions – mandatory and discretionary

Title 26 Penalties – Mandatory Referrals

6694(b) Willful attempt to understate the liability for tax

6695A Appraiser penalty

6700 Promoting abusive tax shelters

6701(a) Aiding and abetting understatement of a tax liability

7407 Injunction of a Tax Return Preparer

7408 Injunction restraining specified conduct relating to tax shelters and reportable transactions

Title 26 Penalties – Discretionary Referrals

6111 and **6112** Failure to comply with tax shelter registration requirements
6662 Accuracy related penalty with facts suggesting lack of due diligence
6694(a) Negligent or intentional disregard of tax rules and regulations (looking for a pattern)
6695 (a) Failure to furnish copy of return; **(b)** Failure to sign return; **(d)** Failure to keep a copy of tax return or a list of taxpayers
6695 (f) Negotiation (direct/indirect, electronic or paper) of refund checks
6702 Frivolous tax returns or submissions

Referrals Regarding Disreputable Conduct

“Abusive practitioner” or “zealous advocate”?

- Threats of violence should be reported immediately to TIGTA. At the conclusion of the TIGTA investigation, the TIGTA report will be forwarded to OPR, which will take appropriate follow-up action.
- Abusive conduct rises to a sanctionable level when the behavior is so seriously offensive or obstructionist that it interferes with the mission of the IRS.

Threats and abusive behavior should be contemporaneously documented.

- A carefully detailed chronology maintained throughout the course of the exam or collection activity will help establish the misconduct (e.g., everything that was said, dates and times, names of any witnesses, etc.) Preserve threats left on voicemail.

Referrals Regarding Disreputable Conduct (*cont'd)*

Abusive conduct rises to a sanctionable level when the behavior is so seriously offensive or obstructionist that it interferes with the mission of the IRS, for example:

- Physically detaining an IRS employee
- Credible threats against the IRS and/or its employees

After Referral . . .

Referents (internal and external) receive acknowledgment that referral was received

OPR conducts a tax compliance check on all referred practitioners

OPR may follow up with referent

- Clarify information/allegations made on referral
- Seek additional documentation, e.g., related to examination and preparer penalties
- Obtain testimony and affidavits for use in administrative proceedings

Internal referent may ask for status report, but may not receive information regarding ongoing investigation due to OPR's independence and IRC 6103 restrictions

OPR Discipline Process

- OPR will determine whether it has jurisdiction (i.e., practitioner as defined in Circular 230, practicing before the IRS).
- Conduct an independent investigation of any potential Circular 230 violation.
- Accord practitioners due process rights during the process — the opportunity to review the allegations, obtain representation, submit evidence, and engage in pre-trial discovery, negotiations, and a settlement conference.
- Settlement or administrative hearing.

OPR Considerations

Willfulness

- Voluntary, intentional violation of a known legal duty.
- OPR must prove practitioner had a duty under Circular 230, practitioner knew of this duty, and practitioner voluntarily and intentionally violated that duty.
- Applies to nearly all duties and obligations in Circular 230 (Subpart B).

Burden of Proof

- “Clear and Convincing” to impose a monetary penalty, disbarment, or suspension of 6 months or longer.

OPR Considerations (*continued)*

Evidence of Pattern

- Document “patterns” affecting multiple years, multiple clients, conduct w/ multiple IRS employees.
- Depending on severity of misconduct, OPR may decide to not take action for first offense, however, record of referral and OPR investigation relevant to subsequent referral regarding practitioner.

Extraordinary Measures Taken By IRS

- Summons Enforcement.
- Bypass Letter.

Sanctions

- Soft (warning) letter (private)
- Letter of reprimand (private censure)
- Public censure
- Suspension (indefinite or 60 months or less)
- Disbarment (5-year prohibition)
- Appraiser disqualification
- Monetary penalty

Disciplinary Announcements

Sample Examples of Disciplinary announcements that are published in the Internal Revenue Bulletin

City & State	Name	Professional Designation	Disciplinary Sanction	Effective Date(s)
California				
San Mateo	Miyabara, Morris	Enrolled Agent	Disbarred by ALJ default decision	July 8, 2016
Corona Del Mar	Cassidy, Carl R.	CPA	Disbarred by decision on appeal by Treasury Appellate Authority	April 20, 2015
Florida				
Boynton Beach	Merl, Eric L.	Attorney	Suspended by default decision in expedited proceeding under 31 C.F.R. § 10.82(b)	Indefinite from August 4, 2016

OPR Disciplined Practitioner List

Where to Search for Disciplined Tax Professionals

https://www.irs.gov/tax-professionals/search-for-disciplined-tax-professionals

OPR's disciplinary look-up contains searchable information regarding censures of practitioners for Circular 230 misconduct and suspensions and disbarments of individuals from practice before the IRS.

Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code

1023-EZ, Streamlined Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code

1024, Application for Recognition of Exemption Under Section 501(a) or Section 521 of the Internal Revenue Code

1024-A, etc.

How do the rules apply?

- Not a tax return, but also not written advice
- Cir. 230, §10.22 (due diligence)
- Cir. 230, §10.34(b) (standards for documents submitted to IRS)

Due Diligence

Who is your client?

- Assessing the information
- Source of information
- Complete information
- How do you advise client about non-compliance, error or omissions?
- How do you advise client about issues that may raise prompt further questions by the IRS during the review process?
- How do you advise client about estimated budget and public support test?

Assessing audit risk.

Relying on and interpreting instructions

ASC 740-10 (formerly FIN 48) Opinions

- Disclosure of uncertain tax positions: more likely than not

Evaluation of authorities

- All relevant authorities should be addressed (supportive and contrary)
- Hierarchy of authority

Evaluating Authority

Evaluation of authorities

- If the document is > 10 years old, generally accorded very little weight.
  - However, the persuasiveness and relevance of a document, viewed in light of subsequent developments, should be taken into account along with the age of the document.
  - How does this apply in the EO context where much of the guidance is older?
- What about materials that may lack relevant analysis?
  - PLR 8351111 (1983) – private foundation wanted to pay a board member for architectural services in connection with a grant to a state hospital for the design and construction of new facilities (board member previously performed such services to the hospital). Compensation based on standardized state fees/schedules. IRS held no self-dealing based on two reasons: architectural services are "necessary" and fee is reasonable. No analysis whether architectural services qualify as "personal services."

Level of Authority

Level	Application / Likelihood of Success
Will/Is	- General – Highest level of certainty; required for borrower's opinions of Section 501(c)(3) status
Should	- General – 80%+? - ASC 740 – 90%+
More Likely Than Not	- General / Circ. 230 / ASC 740 - What if it's 50/50?
Substantial Authority	- Circ. 230 / 1.6662-4(d) - Understatement penalties - ASC 740 – 40-50%, the relevant authorities supporting position significantly outweigh contrary authorities
Realistic Possibility of Success	- ABA Formal Opinion 85-352 - ASC 740 – a good faith argument
Reasonable Basis	- Understatement penalty, Circ. 230 - ASC 740 – 25-35% - supported by one or more relevant authorities
Frivolous	- ASC 740

Written Advice

Circular 230 §10.37

Requirements for Written Advice on Federal Tax Matters

Must be based on reasonable factual and legal assumptions, including assumptions as to future events

Must reasonably consider all relevant facts and circumstances that the practitioner knows ***or should know***

Must use reasonable efforts to identify and ascertain relevant facts

Must not rely on representations of the taxpayer or others if reliance would be unreasonable

Must relate applicable law and authorities to facts

Must not take into account the possibility that a tax return will not be audited, or that a matter will not be raised on audit

Written Advice, continued

Circular 230 §10.37:

Requirements for Written Advice on Federal Tax Matters

Requirements for written tax advice apply broadly, e.g., emails, texts

Evaluate whether every written communication regarding federal tax issues satisfies the requirements

Does not apply to:

- Government submissions on general policy
- CLE presentations

Best Practices for Tax Advice

Circular 230 § 10.33: Best Practices for Tax Advice

- Communicate clearly with the client regarding the terms of the engagement
- Establish the facts, determine which facts are relevant, evaluate reasonableness of any assumption or representations, relate the applicable law to the relevant facts, and arrive at a conclusion supported by the facts
- Advise the client regarding the import of the conclusions reached including, e.g., whether the taxpayer may avoid accuracy-related penalties if the taxpayer relies on the advice
- Act fairly and with integrity in practice before the IRS
- Take reasonable steps to ensure that the firm's procedures for all members, associates and employees are consistent with the above best practices

OPR Outreach

Business Unit News articles and Alerts issued in FY2023

BUNS

- *Business Unit Referrals to OPR* (FY2023 Q1) (Feb. 2023)
- *Making Referrals to the Office of Professional Responsibility Form 8484* (Mar. 2023)
- *Conflicts of Interest Concerns in Promoter Transactions* (Mar. 2023)
- *Doing Your Diligence: Refer to the OPR Practitioners Who Fail to Meet Their Obligation to Exercise Due Diligence* (Apr. 2023)
- *Making Referrals to the Office of Professional Responsibility (Form 8484)* (May 2023)
- *Understanding How the Rules of Practice and Authorized Disclosure Apply in International Cases* (May 2023)
- *h Designations and their Limitations* (Jun. 2023)
- *OPR: What to Do When an "Inactive" Attorney or CPA is Attempting to Practice before the IRS* (Jul. 2023)
- *Business Unit Referrals to OPR* (FY2023 Q3) (Aug. 2023)
- *Preparer Penalties and Referrals to OPR* (Aug. 2023)

Alerts

- *Not All Powers are the Same: Using a Durable Power of Attorney rather than a Form 2848 in Tax Matters* (Alert 2023-08)
- *Announcement of Disciplinary Sanctions from the OPR* (Alert 2023-07)
- *Does your organization or association want a presentation by the OPR* (Alert 2023-06)
- *Best Practices: How to Prepare For and What to do When a Tax Practitioner Dies* (Alert 2023-05)
- *In-house Tax Professionals and Circular 230* (Alert 2023-04)
- *Announcement of Disciplinary Sanctions from the OPR* (Alert 2023-03)
- *Professional Responsibility and the Employee Retention Credit (Alert 2023-02)*
- *Announcement of Disciplinary Sanctions from the OPR* (Alert 2023-01)
- *Refer Practitioner Misconduct to the Office of Professional Responsibility* (OPR) (Alert 2022-02)

OPR Accomplishments

Cir 230 Statute of Limitation

- To address timing concerns between when a referral is sent to OPR (conclusion of the examination) and OPR's default 5-year limitations period per 28 USC 2462, OPR created a *Consent to Extend the Time to Initiate Proceedings*.

Servicewide Collaboration

- OPR employees continue to participate in significant Servicewide projects, including:
  - Tax Pro Account
  - Employee Retention Credit (coordinating ongoing outreach to practitioner community with Stakeholder Liaison)
  - LB5 Joint Working Initiative on Changing Advisor Behavior of Concern (involving tax authorities in United States [LB&I and OPR], Australia, Netherlands, Canada, and the UK); the group's final report on improving compliance, transparency, and certainty amid the large business taxpayer population was released in October 2023.)

OPR Contact Information

Address: 1111 Constitution Ave. N.W.
SE:OPR Room 7238
Washington, D.C. 20224

Phone: 202-317-6897 (main line)

EEFax: 855-814-1722

https://www.irs.gov/Tax-Professionals/Circular-230-Tax-Professionals

Any Questions?

TEGE | Exempt Organizations Council

Break

DC Bar Continuing Legal Education

gwscpa learn | connect | lead

TEGE | Exempt Organizations Council

Donor Advised Funds – Proposed Regulations and Comments

Roger Colinvaux, Columbus School of Law, Catholic University
Geoff Green, CalNonprofits
Darryll Jones, Florida A&M University College of Law
Alexander L. Reid, Baker & Hostetler LLP, Washington, DC
Ward Thomas, IRS Chief Council EEE

March 8, 2024

Disclaimer

TEGE | Exempt Organizations Council

- These materials were prepared without assistance from, or review by, any employee or representative of the IRS or the Department of the Treasury.
- The content of this presentation is not intended as a statement of the views of the speakers, the Department of the Treasury, the Office of Associate Chief Counsel, or the Internal Revenue Service.
- This presentation contains general information only, and the presenters are not, by means of this presentation, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services.
- The presenters shall not be responsible for any loss sustained by any person who relies on this presentation.

Proposed Regulations

TEGE | Exempt Organizations Council

- On November 13, 2023, Treasury released the first installment of Proposed Regulations under Section 4966 (REG-142338-07) relating to donor-advised funds ("DAFs").
- PGP divided the DAF rulemaking project into four parts; these Regulations do not address 4967, 4958 or public support
- Primarily definitional
- Comment period extended to February 15, 2024
- Over 170 comments have been submitted to date
- Effective only for tax years ending after the date final regulations are published in the *Federal Register.*

What is a DAF?

TEGE | Exempt Organizations Council

DAF IS A FUND OR ACCOUNT:

- That is separately identified by reference to contributions of a donor or donors;
- Owned and controlled by a sponsoring organization; and
- At least one donor or donor advisor has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of amounts held in the fund by reason of the donor's status as a donor.

Proposed §4966 Regulations

TEGE | Exempt Organizations Council

DONOR:

Any person (as described under Section 7701(a)(1)) other than Section 501(c)(3) public charities (that aren't disqualified supporting organizations) and governmental units described in Section 170(c)(1)

DONOR ADVISOR:

- Person appointed or designated by the donor or donor advisor to have advisory privileges re: distributions and investments from the fund/account
- Person who establishes the fund or account and advises as to distributions or investments
- Personal investment advisors who manage and advise on the investment of both the DAF assets and the personal assets of a DAF donor, regardless of whether the door appointed, designated, or recommended the advisor
  - Exception if providing services to the sponsoring organization as a whole
  - Cannot receive compensation from the DAF (under Section 4958)
- Donor-recommended advisory committee members (with exceptions)

Proposed §4966 Regulations

TEGE | Exempt Organizations Council

ADVISORY PRIVILEGES:

- Facts and circumstances analysis
- Does not on its own include advice provided solely as an officer, director or employee of the sponsoring organization
- If the donor to a fund is the only person with advisory privileges, the donor is deemed to have advisory privileges by reason of status as a donor.
- Special rules for advisory committee members that are donor-recommended or where donors, donor-advisors, or related persons serve on the committee
- Lays out facts that are sufficient to find advisory privileges
- Substance over form

Proposed §4966 Regulations

TEGE | Exempt Organizations Council

DISTRIBUTION:

- Any grant, payment, disbursement, or transfer, whether in cash or in kind, from a DAF
  - Excludes investments and reasonable investment and grant-related fees

TAXABLE DISTRIBUTION

- Distribution to a natural person, or
- Distribution to any other person if not for a charitable purpose or the sponsoring organization does not exercise expenditure responsibility

DEEMED DISTRIBUTION (TAXABLE DISTRIBUTION):

- Use of DAF assets that results in a more than incidental benefit (Sec. 4967) to a donor, donor-advisor, or related person
- Expense charged solely to DAF that is paid to a donor, donor-advisor, or related person

Proposed §4966 Regulations

TEGE | Exempt Organizations Council

EXPENDITURE RESPONSIBILITY:

- Expenditure responsibility is the same as that in Section 4945(h) except that the distributee also is required to agree to not:
  - Make a grant to an organization that does not comply with the expenditure responsibility requirements;
  - Make a grant to a natural person; or
  - Make/pay a grant, loan or compensation, or other similar payment to a donor, donor-advisor, or related person of the DAF using the DAF grant funds
- Similar to Section 53.4945-6(c)(2) of the Treasury Regulations, grants to an organization will not be considered to be for exempt purposes under Section 170(c)(2)(B) unless the grantee agrees to separately account for grant funds or segregate the grant funds

Proposed §4966 Regulations

TEGE | Exempt Organizations Council

NON-TAXABLE DISTRIBUTIONS:

- Organizations described in Section 170(b)(1)(A) so long as distribution is for a charitable purpose
  - Equivalency determinations for foreign organizations permitted
- Sponsoring organization of the DAF
- Another DAF

DAF EXCEPTIONS:

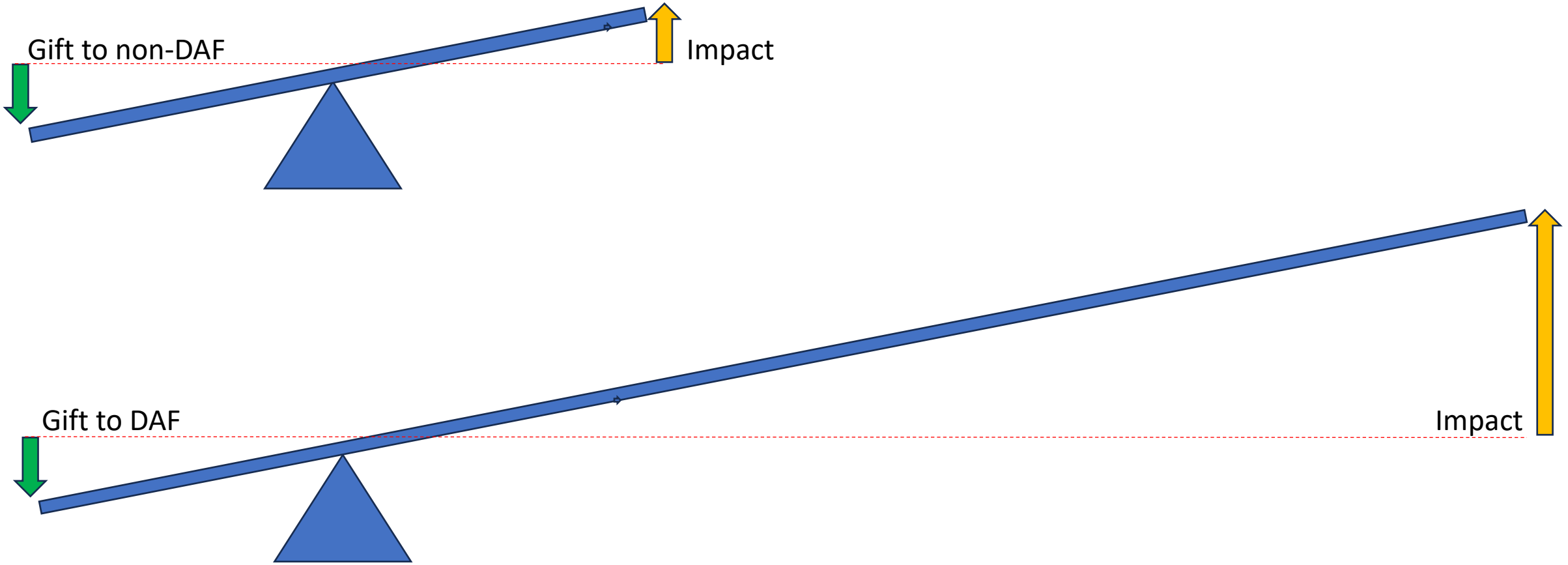
- A fund that makes distributions only to a single identified organization
  - Must be Section 501(c)(3) public charities or Section 170(c)(1) governmental entities (for public purposes)
  - Cannot be private foundations, disqualified supporting organizations, foreign organizations, or noncharitable organizations
- Certain scholarship funds, including certain scholarship funds established by a Section 501(c)(4) advisory committee
- Certain disaster relief funds

ANTI-ABUSE RULES

Treasury 2011 Report to Congress

- **No Donor Control**. [T]he fact that DAFs have high approval rates for donor recommendations is not in itself indicative of donors' exerting excessive control over their donated assets. The public comments correctly point out that high approval rates for grant recommendations are not sufficient to support the claim that the gifts should not be considered "complete."
- **Warehousing Not a Concern**. There may be a lag between when a donor contributes assets to a DAF sponsoring organization or an SO—and may claim a charitable contribution deduction—and when the donated assets are used for direct charitable activities. The issue of the lag between contribution and final use of assets is no different at DAF sponsoring organizations and SOs than it is for other public charities that may operate charitable funds or maintain endowments. Thus, it is appropriate that the contribution deduction rules faced by donors to SOs and DAF sponsoring organizations are the same as those applicable to donors to other public charities.
- **No Need for Payout Requirement**. Compared to private foundations, the mean payout rates for Aggregate DAFs in tax year 2006 appear to be high for most categories of DAF sponsoring organizations. Current law disallows a charitable contribution deduction for a contribution to any charity that does not meet the standard of a completed gift, including in the case of a gift to a DAF or SO. However, as is the case with gifts to other charities, if all existing tax and other legal requirements are met, donations to a DAF or an SO may be completed gifts and become the property of the donee organization. Although donee organizations may feel an obligation to It would be premature to recommend a distribution requirement for DAFs at this point. As more years of data become available, analysis of trends with respect to DAF sponsoring organizations and the DAF assets they administer will be possible.

A DAF Is Like a Lever—
It Multiplies the Impact of a Gift



Cancel the show!

Here’s some advice…

Advice is not control.

TEGE | Exempt Organizations Council

Thank you for attending today's program.

DC BAR Continuing Legal Education

gwscpa learn | connect | lead

TEGE | Exempt Organizations Council

Save the Dates:

June 7, 2024 – Live in DC and Dallas

November 22, 2024 - Virtual

DC BAR Continuing Legal Education

gwscpa learn | connect | lead