

Exempt Organizations

1) Benefits

- a) States: most states will give a property and income tax exemption.
 - i) Some states piggy-back their exemptions on the federal, others reach the same result by statute
 - ii) Other states construe things more narrowly, requiring an organization to relieve the burdens of government, or fit specifically into the educational scheme of the state¹
 - (1) States generally are stricter about granting a property tax exemption: holding that the property must be completely used for the charitable exemption²
 - (a) While they are stricter, cities will often set up voluntary payment of taxes regimes, or regimes for tender of services
 - (b) E.g. Pennsylvania's five-part test in Hospital Utilization Project
 - (i) Advance a charitable purpose
 - (ii) Donate or render gratuitous a substantial portion of services
 - (iii) Benefits a substantial and indefinite class of persons who are legitimate subjects of charity
 - (iv) Relieves the government of some of its burden
 - 1. but, constitutionally, a state can't deny a tax exemption to a charity that is aimed at out of states³
 - (v) Operate entirely free of profit motive
 - (2) Non-profit Hospitals, which are largely funded by insurance and Medicaid might not be charitable for state tax purposes.⁴
- b) Federal
 - i) unincorporated association: No exemption unless constitution and bylaws. (Corporation for these purposes is construed to include unincorporated associations)
 - ii) 501(c)(1): government agencies
 - (1) gifts to them are deductible⁵ so long as it relieves the burdens of government
 - iii) 501(c)(3): must be organized as corporation (not as unincorporated association) to avail itself of benefits
 - (1) gifts are deductible
 - (a) 170 income tax deduction
 - (b) estate 2055, 2522

¹ Michigan United Conservation Clubs

² Alpha Gamma Zeta

³ Camps Newfoundland

⁴ Intermountain Health Care (Utah)

⁵ 170(c)(1) (c) Charitable contribution defined.--For purposes of this section, the term "charitable contribution" means a contribution or gift to or for the use of--

(1) A State, a possession of the United States, or any political subdivision of any of the foregoing, or the United States or the District of Columbia, but only if the contribution or gift is made for exclusively public purposes.

5

7

9

11

13

15

17

19

21

23

25

27

30

32

34

36

38

40

42

44

46

48

50

52

54

(2) types of 501(c)(3): *domestic organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), for the prevention of cruelty to children or animals*⁶ and testing for public safety

(a) organized test: must be organized as a nonprofit corporation or as a “community chest, fund or foundation”, or unincorporated association or charitable trust⁷ -- facts don’t matter: what matters is what is written in the articles

(i) the articles need not be specific: can be as broad as the code itself

(ii) articles may not empower the board to engage in imprmissible activities

(iii) restrictions on dissolution: must specify, in charter, where the money goes when the organization dissolves

1. state law can step in, organization must expressly dedicate its assets to one or more exempt purposes in the event of dissolution⁸

2. in determining whether or not a dissolution clause is acceptable, must distinguish between a **mutual benefit organization** and a **public benefit organization** (note for **federal purposes everything must say in the stream of charity**)

a. mutual benefit organization: may distribute their benefits on dissolution to their members or in accordance with the bylaws⁹

i. may have to inquire as to whether the organization was *really* a public benefit or a mutual benefit organization

b. public benefit organization:

i. state: must be transferred to other organizations engaged in similar purposes¹⁰

⁶ 170(c)(2) (note: testing for public safety is not included)

⁷ 1.501©(1)(b)(1)(i) Organizational test--(1) In general. (i) An organization is organized exclusively for one or more exempt purposes only if its articles of organization (referred to in this section as its "articles") as defined in subparagraph (2) of this paragraph:

⁸ 1.501(c)(3)-1(b)(4) (4) Distribution of assets on dissolution. An organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the Federal Government, or to a State or local government, for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized. However, an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders.

⁹ LA county Pioneer Society

¹⁰ Model 46(c)

- ii. federal 501(c)(3) test: either used for an exempt purpose or would have been distributed by a court under state law to an organization that would have carried out that purpose¹¹

(iv) types of dissolution

1. voluntary (can adopt by resolution)
 - a. procedure
 - i. by resolution
 - ii. notice to creditors
 - iii. public benefit organizations: play must specify distributes – and the AG must be notified and approved (in general).
 - iv. if the creation of the organization was approved by an agency, the agency usually must approve its dissolution
 - b. reasons for dissolution
 - i. bankruptcy (but exempt organizations are immune from involuntary bankruptcy)
 - ii. disposition of corporate assets
 - iii. failure to conduct an activity for a certain period of time
 - iv. finite duration as defined in charter
 - v. loss of all members
 - vi. corporate surrender of a subsidiary to a principal
 - c. criteria that courts use to determine if the dissolution is correct
 - i. source of funds (were they public or via a will or investment)
 - ii. purposes and powers of the corporation in its charter
 - iii. the activities that were actually carried out by the corporation
 - iv. the relationship of the activities and purposes of the distributes to those of the dissolving corp.
 - v. the bases for the distribution recommended by the board¹² -- in fact, an organization can decide where the money will go, and so long as it is charitable (and validly decided) it will be upheld by the courts. So, in

¹¹ 1.501(c)(3)-1(b)(4): (4) Distribution of assets on dissolution. An organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision in the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the Federal Government, or to a State or local government, for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized. However, an organization does not meet the organizational test if its articles or the law of the State in which it was created provide that its assets would, upon dissolution, be distributed to its members or shareholders

¹² MS 68 ny2d 32, 35

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

this case, the doctrines of *cy pres* and deviation is not relevant

2. involuntary
 - a. abandonment of activity
 - b. insufficient assets
 - c. board deadlock
 - d. internal dissention
 - e. fraudulent mismanagement
 - f. failure to carry out corporate purposes
 - g. waste pf assets
 - h. failure to pay creditors as liabilities become due
 - i. violation of statutes
 - j. failure to pay taxes¹³
 - k. failure to adhere to recordkeeping recordedkeeping
- (b) operated tests: exclusively for religious charitable, scientific, testing for public safety, or educational purposes, or for sports (but not for equipment or athletics)¹⁴
 - (i) the tests is not met if *An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.* 1.501(c)(3)-1(c)(1)
 1. determining whether an activity would qualify as an exempt purpose
 - a. new rule: commerciality: really looks to the way that the organization compares to the competition
 - i. see rules for hospitals p. 23 (referring to rev. rul 69-545)
 - b. old rule: destination of interest test
 - (ii) the service tolerates insubstantial non-exempt activitiy – UBIT tests
 1. defining substantial relationship
 - a. Is there a nexus between the charitable purpse and whatever the activity is
 - i. E.g. a university travel tour must have formal instruction or not
 - b. Presence of competition: Will look to scale of competitors – will too to whether it is commensurate with the educational needs of the school. If it is substantially larger

¹³ Model 14.0 NY Tax L. 203-a(1)

¹⁴ 1.501(c)(3)-1(a):

(a) Organizational and operational tests.

(1) In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

(2) The term "exempt purpose or purposes", as used in this section, means any purpose or purposes specified in section 501(c)(3), as defined and elaborated in paragraph (d) of this section.

than what the school needs, than the IRS will seek to tax all or some substantial part of it

- i. If an organization does something on a seasonal basis where there is commercial competition it will not lose its exemption – unless the commercial entity does so on a seasonal basis

2. exceptions:

- a. rent if, for personal services and personal property – if you can stay withing the exception

- i. won't protect personal property rental and personal services
- ii. 0-10: deminius
- iii. 10-50: taxable on income
- iv. 50 and above all taxable

- b. research income

- i. routine testing generates income
- ii. organizations that exist to run clinical trials
- iii. there is authority that “translational research” will qualify as tax exempt research income if the research involves educating medical students, residents, and fellows
- iv. research does not

- c. certain deriviatives and securities

- d. lobbying and political activities

- i. underlying concept is that no substantial part of your activities can involve lobbying
- ii. probably around 15% or less, and you lose tax exempt statuts, and may be subject to exise taxes on lobbying expenditures
- iii. therefore, the government would like tax-exempt organizations to elect under 501(h) about the amount of lobbying and the tax treatment of the expenditures
- iv. general exceptions
- v. non-partisan analysis
- vi. technical advice to a governmental body
- vii. self-defense exception
- viii. most schools, colleges, etc. do engage in this kind of lobbying
- ix. membership organizations can communicate with members: has to fall short of a call to action

- e. truly passive activity

- i. dividends
- ii. royalty income
- iii. Statutory exclusions
- iv. Convention and trade show activities
- v. Services to small hospitals

5

7

9

11

13

15

17

19

21

23

25

27

30

32

34

36

38

40

42

44

46

48

50

52

54

- vi. Bingo games
- vii. Mailing list rentals and exchanges
- f. unrelated, but run by volunteers will be acceptable
 - i. Something that is not related income: volunteer personnel. If the particular trade or business is carried on with volunteers
 - g. convenience exclusions (you can do things for these people that would otherwise be considered to be UBIT). fee income from these categories generates NOT UNRELATED INCOME – but burden is on the taxpayer to show that it is divided up
 - i. members
 - ii. students
 - iii. patients
 - iv. officers
 - v. employees
- 3. “not unrelated” activities (by statute)
 - a. Something that is not related income: volunteer personnel. If the particular trade or business is carried on with volunteers
- 4. special rules for associate members of trade organizations
 - a. Identify the purpose of a mutual benefit organization: reference point is which purpose you are working for
 - i. Restaurants open to the public (function business) run by fraternal organizations
 - b. For trade associations and like organization, non-member income is, in general, taxable
 - i. otherwise the rule for UBIT is that it is taxable at Subchapter C rates
 - ii. if you have more than 15% that will cause you lose the exemption altogether
- (iii) religious organizations do not have to demonstrate that they serve a disadvantaged class
- (c) no private inurement**
- (d) restrictions on lobbying**
 - (i) no substantial part of the activities can be lobbying
 - 1. but can lobby for its own survival
 - (ii) organization may not participate or intervene in political campaign on behalf of or in opposition
 - 1. no de minimis allowance
 - 2. can’t endorse or recommend against – this abuts the educational territory
 - a. there are a range of things you can do that will be treated as protected education
 - 3. things they can do in the campaign world
 - a. voter registration

5

7

9

11

13

15

17

19

21

23

25

27

30

32

34

36

38

40

42

44

46

48

50

52

54

- i. even if you are doing all your voter registration in an area, it is still probably ok
 - b. voter guides
 - i. summaries of ballot initiatives
 - c. all these things could be okay as exempt educational activities
 - d. sponsoring candidate forums if it is open to educational activities
 - i. can exclude some candidates based on neutral (non-belief-related) principle
 - e. rating candidates
 - i. not impossible, but difficult
 - f. issue advertisements: hard to do
- 4.
 - (e) filing requirements for 501(c)(3)s
 - (i) non-churches must notify service that they intent to claim exemptions (churches just take it)
 - (ii) afterwards it files a Form 1023, which requires the narrative and the details of its operation
 - 1. can now seek review of adverse determination in Tax Court, District Court or Ct. Cl.
 - a. denial: no deduction at all
 - b. **revocation safe harbor**: contributions made during proceedings will be deductible until the court's adverse proceedings, and there must be clean hands – up to only \$1,000 under sec. 7428
- (3) Deductibility of contributions to 501(c)(3)s
 - (a) Donor directed funds are allowed. If this is not really a donor directed fund, the donors lose their timing advantage, their deduction
 - (i) For an individual taxpayer, there is a payment requirement (payment required for donor-advised world... at end of year it is gift of stock and transfer (check this))
 - 1. If it is a gift in cyberspace, it is still your until exercised by the broke
 - (ii) But, corporate taxpayers have three month wiggle-room before it becomes an incomplete gift (individuals have to be complete before end of tax year)
 - 1. Pledge is deductible when paid
 - 2. Pledge is legally enforceable
 - 3. Gift of option is deductible when exercise. P. 907 (substantiation requirement) – required if \$250 or more, and if there is any gift back must allow for it
 - a. Tiered membership with more deductible portion at higher level
 - b. If the property is 5k or more, the charity has to sign off on fv, but takes no position on value

5

7

9

11

13

15

17

19

21

23

25

27

30

32

34

36

38

40

42

44

46

48

50

52

54

- c. Nixon said that crap had value
- 4. Unclear if there is still a donative intent requirement—**but there needs to be something positive to happen to the charity**
- (b) Deductions not allowed for contributions to organizations that **test for public safety**
- (c) Place of use
 - (i) by individuals: Deductions are allowed for deductions to domestic 501(c)(3), even if the funding is used abroad.¹⁵
 - (ii) by corporations:
 - 1. if donating to trusts or noncorporate donees: deduction only allowed if must be used in the US or possessions¹⁶
 - 2. if donating to domestic corporations will always be deductible¹⁷
 - (iii) configuring of foreign charities
 - 1. no deduction allowed if it is a foreign charity which sets up a US subsidiary¹⁸ or if the charter specifies periodic payments

¹⁵ 1.170A-8(a)(1): Percentage limitations--(1) In general. An individual's charitable contributions deduction is subject to 20-, 30-, and 50-percent limitations unless the individual qualifies for the unlimited charitable contributions deduction under section 170(b)(1)(C). For a discussion of these limitations and examples of their application, see paragraphs (b) through (f) of this section. If a husband and wife make a joint return, the deduction for contributions is the aggregate of the contributions made by the spouses, and the limitations in section 170(b) and this section are based on the aggregate contribution base of the spouses. A charitable contribution by an individual to or for the use of an organization described in section 170(c) may be deductible even though all, or some portion, of the funds of the organization may be used in foreign countries for charitable or educational purposes.

¹⁶ 170(c)(2) A corporation, trust, or community chest, fund, or foundation--

(A) created or organized in the United States or in any possession thereof, or under the law of the United States, any State, the District of Columbia, or any possession of the United States;

(B) organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals;

(C) no part of the net earnings of which inures to the benefit of any private shareholder or individual; and

(D) which is not disqualified for tax exemption under section 501(c)(3) by reason of attempting to influence legislation, and which 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.

A contribution or gift by a corporation to a trust, chest, fund, or foundation shall be deductible by reason of this paragraph only if it is to be used within the United States or any of its possessions exclusively for purposes specified in subparagraph (B). Rules similar to the rules of section 501(j) shall apply for purposes of this paragraph

¹⁷ Rev. Rul. 69-80: A domestic commercial corporation is entitled to a charitable contribution deduction for an unrestricted contribution to a domestic charitable corporation even though the contribution is used in a foreign country.

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

2. “specific foreign purpose” meant to separate charities from grant-making organizations¹⁹
 3. acceptable if a domestic charity furthers its purpose by sending money abroad, or if it forms a foreign subsidiary²⁰
- (iv) “fiscal sponsorship” : for short term projects sponsored by a 501(c)(3)
1. sponsoring agent cannot act as the agent of the non-exempt organization
 2. qualified 501(c)(3) must retain control of the project – and ensure that the qualified charity’s purposes are fulfilled
 3. contributions to the charity can’t be earmarked for the project.
 4. Corporate sponsorships
 - a. Corporation gives charity money in exchange for association
 - b. Regs.
 - i. In general, the underlying concept is that it is good non-taxable, if there is no substantial return benefit to the donor
 - ii. Can have name associated with the event or the institution
 - iii. Can’t evaluative information (unless the logo has evaluative information in it)
 - c. It matters from the charity’s point of view because the advertising income might be taxable
 - i. From the corporation it is deductible as a charitable expense – but charitable deductions are limited to 10%
 - d. There is no requirement of consistency treatment between donee and donor side
- (v) Exclusivity arrangements: An exclusivity arrangement (if the school agrees only to sell Pepsi) this makes it advertising
1. Sounds like an evaluative statement
 2. because there is a substantial benefit
 3. can be an exclusive sponsor, but not an exclusive provider

¹⁸ Rev. Rul. 63-252: Moreover, it seems clear that the requirements of [section 170\(c\)\(2\)\(A\)](#) of the Code would be nullified if contributions inevitably committed to go to a foreign organization were held to be deductible solely because, in the course of transmittal to the foreign organization, they came to rest momentarily in a qualifying domestic organization. In such cases the domestic organization is only nominally the donee; the real donee is the ultimate foreign recipient.

¹⁹ Similarly, those contributions to the domestic organization described in the third example which are given for the specific purpose of being turned over to the foreign organization are held to be nondeductible.

²⁰ 63-252: Consequently, the domestic organization is considered to be the recipient of such contributions for purposes of applying [section 170\(c\)](#) of the Code. Similarly, the domestic organization described in the fifth example is considered to be the real beneficiary of contributions it receives for transmission to the foreign organization. Since the foreign organization is merely an administrative arm of the domestic organization, the fact that contributions are ultimately paid over to the foreign organization does not require a conclusion that the domestic organization is not the real recipient of those contributions.

4. exclusive providers have to demonstrate that there is no benefit
- (d) divisions
- (i) **public charities** a.k.a. not private foundations (things that fail the test in § 509)
 - 1. either a (school, church or hospital) or is publically supported
 - (ii) private foundations (things that fail the test in § 509)
 - 1. **types of private foundations**
 - a. operating foundations (intermediate category)
 - i. basic requirement is that it is actively involved in carrying out the activities that it funds – and it has a relationship to the charitable objective, that involves more than just funding it, it is possible to fit oneself into this category
 - ii. they are not subject to the special treatment of appreciated property
 - iii. get deductions up to fair market value (not up to the basis as in private foundations)
 - iv. have to be more actively involved in charitable enterprises (check this)
 - v.
 - b. **exempt operating foundations:** had status at start of 1983, or a past history of public support and a board that represented the general public (and was not donor controlled)
 - c. **non-operating foundations**
 - 2. private foundation gifts to foreign charities: will not be viewed as a distribution and taxed upon a certification that the foreign entity that is receiving the money is taking the payment²¹
- (e) Private foundations (less good than being a publically supported
- (i) 1969 foundation rules were passed
 - (ii) if you are granted 501(c)(3) you are deemed to be a private foundation, unless you demonstrate that you qualify as a publically supported charities by meeting one of three sets of tests
 - 1. by statute, hospitals, schools, churches, by statute go into 509(a)(1)-(3)
 - 2. ratio – at least 1/3 must be “good support” in 509(a)(1)
 - a. in the numerator: gifts, grants, and contributions from individuals and government
 - i. if you have a contribution from an individual or a corporation that is not a publically-supported charity and not the government, and that gift exceeds 2% of the total support of that charity, the portion that you can count in numerator part, is capped at 2%
 - ii. current gifts all count, and therefore FIDELITY gift funds are support fractions

²¹ Rev. Proc. 92-94

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

- b. denominator: membership dues, gross investment income, etc.
- 3. can ask for an “unusual grant” ruling request if something is unexpected: 9 requirements.
- 4. “facts and circumstances”
 - a. at least 10% good support
 - b. have to be organized and operated to attract new and additional public support
 - c. have to show that you are using the monies for people outside the donors
- 5. 509(a)(2) (another fraction)
 - a. numerator: gifts, grants, contributions, from government, public, receipts from investment activities
 - b. denominator: investment income, receipts from exempt activities, fees, etc.
 - c. not more than 1/3rd is gross investment income
- 6. 509(a)(3): derivative status (relationship test)
 - a. 509(a)(3): supporting organizations. (organization it supports is a supported organization)
 - b. e.g. parent-sub, can demonstrate that by having as “as little as” a single board person overlap
 - i. the longer the historical relationship, the more tolerant, the IRS is over a slight relationship
 - c. have to demonstrate dominance
 - i. legally enforceable obligation to pay over trust income
 - ii. if it is set up (chartered) to carry out a specific purpose on behalf of the supported organization
 - iii. the loser the corporate relationship,
- 7. ownerous reporting requirements
- 8. personal requirements
 - a. upside: friends and family can dominate everything
 - b. downside: deduction limit is only 30%
 - i. excise, operating, etc. requirements
- 9. excise tax on investment income: 2%, which can be reduced to 1% § 4940
 - (iii)place of use (international restrictions)
 - 1. can’t specially earmark for foreign charity
 - 2. foreign beneficiaries must have some similarity to a 501(c)(3)
- iv) 501(c)(4)-(24)non-charitables or *mutual benefit* (carrying forward the private interest of their members, but subject to the non-distribution and private inurnment constraints). Gifts are **generally not deductible** (except for veterans groups, nonprofit cemeteries, and fraternal benefit organizations that will use the gift for charitable purposes)²²
 - (1) 501(c)(7): nonprofit clubs.

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

- (a) This is actually a “shifting of money from one pocket to another” for “exempt function income” (rest is taxed at regular corporate rates). In *McGlotten v. Connelly*, there may have been no encouragement of discrimination.
- (b) By statute, however, a club which discriminates **in the taxable year** cannot receive this benefit
 - (i) Under an exceptions, a social club can discriminate on the basis of religion²³
 - (ii) Income from non-member activities. A club’s activities must “substantially all” be for the benefit of its members, within these guidelines
 - 1. Usually a facts and circumstances test
 - 2. Safe harbors²⁴
 - a. It is intended that these organizations be permitted to receive up to 35% of their gross receipts, including investment income from non-member sources²⁵
 - b. In applying the 35% test, not more than 15% of the gross receipts may be derived from the rental of the facilities to the general public.²⁶
 - c. Defining gross receipts: normal and usual activities of the club (that is, those activities they have traditionally conducted) including charges, admissions, membership fees, dues, assessments, investment income (such as dividends, rents, and similar receipts), and normal recurring capital gains on investments, but excluding initiation fees and capital contributions²⁷
 - i. exception: unusual amount (e.g. from sale of buildings) that income is not to be included in the formula²⁸

²³ **(i) Prohibition of discrimination by certain social clubs.**--Notwithstanding subsection (a), an organization which is described in subsection (c)(7) shall not be exempt from taxation under subsection (a) for any taxable year if, at any time during such taxable year, the charter, bylaws, or other governing instrument, of such organization or any written policy statement of such organization contains a provision which provides for discrimination against any person on the basis of **race, color, or religion**. The preceding sentence to the extent it relates to discrimination on the basis of religion shall not apply to--

(1) an auxiliary of a fraternal beneficiary society if such society--

(A) is described in subsection (c)(8) and exempt from tax under subsection (a), and

(B) limits its membership to the members of a particular religion, or

(2) a club which in good faith limits its membership to the members of a particular religion in order to further the teachings or principles of that religion, and not to exclude individuals of a particular race or color.

²⁴ SENATE REPORT NO. 94-1318

²⁵ SENATE REPORT NO. 94-1318

²⁶ SENATE REPORT NO. 94-1318

²⁷ SENATE REPORT NO. 94-1318

²⁸ SENATE REPORT NO. 94-1318

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

- (2) 501(c)(8): Fraternal orders. Taxed on unrelated business taxable income. So, there is actually a benefit, and therefore the government is involved.
 - (a) Contributions are to these organizations are deductible: 170(c)(4), 642(c), 2055, 2106, 2522
- (3) 501(c)(13): nonprofit cemetery companies²⁹
 - (a) deductible if no private inurnment³⁰
- (4) 501(c)(23) veterans organization
 - (a) deductible if the gift is from an individual is to be used for religious, charitable, scientific literary, etc purposes. 170(c)(4) – (can't be used for parties)
- v) Political parties (different section of code)
- 2) Corporate form
 - a) Individual: it is not possible to operate an exempt organization as an individual or a partnership³¹
 - b) Unincorporated association
 - i) Can be used by associations in the incorporation process
 - ii) Model act not widely adopted
 - iii) Might have to look to agency law
 - iv) Can have constitution or bylaws
 - c) Charitable non-profit corporations (statutes are similar to state corporate law)
 - i) Must be organized in this form to be registered as a 501(c)(3)
 - (1) (technically, it seems that an unincorporated association could be a 501(c)(3) if it has a constitution and bylaws)
 - ii) can earn a profit, just can't be private inurnment or distribution³²
 - iii) just about anything can be a nonprofit corporation³³
 - (1) Model code: mutual benefit corporations³⁴ and public benefit corporations³⁵ or religious corporations³⁶
 - (a) Note: public benefit corporations often have no members, and the board is the only thing that can run it

²⁹ (13) Cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit; and any corporation chartered solely for the purpose of the disposal of bodies by burial or cremation which is not permitted by its charter to engage in any business not necessarily incident to that purpose and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

³⁰ 170(c)(5)

³¹ Emerson Institute

³² RMNCA 1.40 (10) "Distribution" means the payment of a dividend or any part of the income or profit of a corporation to its members, directors or officers.

³³ RMNCA 1.40(6): "Corporation" means public benefit, mutual benefit and religious corporation

³⁴ RMNCA 1.40 (23) "Mutual benefit corporation" means a domestic corporation which is formed as a mutual benefit corporation pursuant to chapter 2 or is required to be a mutual benefit corporation pursuant to section 17.07

³⁵ RMNCA 1.40 (28) "Public Benefit Corporation" means a domestic corporation which is formed as a public benefit corporation pursuant to chapter 2 or is required to be a public benefit corporation pursuant to section 17.07.

³⁶ RMNCA 1.40 (30) "Religious Corporation" means a domestic corporation which is formed as a religious corporation pursuant to [chapter 2](#) or is required to be a religious corporation pursuant to [section 17.07](#).

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

- (2) New York (not for profit corporation types) in Sec. 201 of the Not for Profit Corp. L (if a corporation is two types it gets the lesser (e.g. A and B = B)³⁷
- (a) Type A: non-business purpose or purposes including, but not limited to, any one or more of the following non-pecuniary purposes: civic, patriotic, political, social, fraternal, athletic, agricultural, horticultural, animal husbandry, and for a professional, commercial, industrial, trade or service association.
 - (b) Type B: charitable, educational, religious, scientific, literary, cultural or for the prevention of cruelty to children or animals.
 - (c) Type C: business purpose to achieve a lawful public or quasi-public objective.
 - (d) Type D: when it is authorized by any other law of the state
- iv) Regulation by AG
 - v) defining members: people who can vote for directors³⁸ (other things don't count)
 - vi) what must be in articles of incorporation³⁹ for a non-profit corporation
 - (1) corporate name;
 - (2) whether it is a public benefit corporation, a mutual benefit corporation or religious corporation;
 - (a) mutual benefit corporations⁴⁰ and public benefit corporations⁴¹ or religious corporations⁴²

³⁷ (c) If a corporation is formed for purposes which are within both type A and type B above, it is a type B corporation. If a corporation has among its purposes any purpose which is within type C, such corporation is a type C corporation. A type D corporation is subject to all provisions of this chapter which are applicable to a type B corporation under this chapter unless provided to the contrary in, and subject to the contrary provisions of, the other corporate law authorizing formation under this chapter of the type D corporation. (c) If a corporation is formed for purposes which are within both type A and type B above, it is a type B corporation. If a corporation has among its purposes any purpose which is within type C, such corporation is a type C corporation. A type D corporation is subject to all provisions of this chapter which are applicable to a type B corporation under this chapter unless provided to the contrary in, and subject to the contrary provisions of, the other corporate law authorizing formation under this chapter of the type D corporation.

³⁸ RMNCA 1.40(21) "Member" means (without regard to what a person is called in the articles or bylaws) any person or persons who on more than one occasion, pursuant to a provision of a corporation's articles or bylaws, have the right to vote for the election of a director or directors.

A person is not a member by virtue of any of the following:

- (i) any rights such person has as a delegate;
- (ii) any rights such person has to designate a director or directors; or
- (iii) any rights such person has as a director.

³⁹ RMNCA 2.02(a)

⁴⁰ RMNCA 1.40 (23) "Mutual benefit corporation" means a domestic corporation which is formed as a mutual benefit corporation pursuant to chapter 2 or is required to be a mutual benefit corporation pursuant to section 17.07

⁴¹ RMNCA 1.40 (28) "Public Benefit Corporation" means a domestic corporation which is formed as a public benefit corporation pursuant to chapter 2 or is required to be a public benefit corporation pursuant to section 17.07.

- (3) street address of the corporation's initial registered office and the name of its initial registered agent at that office;
- (4) name and address of each incorporator;
- (5) whether or not the corporation will have members;
 - (a) (public benefit corporations don't have members)
 - (b) mutual benefit corporations have members who must ratify
 - (i) mergers⁴³
 - (ii) dissolutions
 - (iii) election of directors
- (6) provisions not inconsistent with law regarding the **distribution of assets on dissolution.**
- (7) Each incorporator and director named in the articles must sign the articles.
- d) Charitable trust (from statute of uses)
 - i) "fiduciary relationship" with respect to the property arising as a result of the manifestation of an intent to create it
 - ii) benefits
 - (1) faster than corporation to incorporate
 - (2) fewer housekeeping requirements and formalities than corporate form
 - iii) requirements
 - (1) property must be irrevocably dedicated to charitable use
 - (2) instrument lists
 - (a) trustees
 - (b) charitable purpose
 - (c) policies for administration
 - (d) distribution of assets and dissolution
 - (e) successor trustees or methods of selection
 - (f) duration of trust
 - (3) can be self-perpetuating
 - (4) no need for prior approval
 - iv) differentiating charitable trust from other trusts
 - (1) doesn't fail if the people cease to exist
 - (2) lack of experience of trustees doesn't matter
- 3) Standards of care of officers and directors of the corporation: over time, it seems that courts are holding the officers of exempt organizations to a lower, corporate, standard of care
 - a) Duty of care: degree of care that an ordinary person would use with respect to their own business endeavors
 - i) Due diligence: including the duty to understand that a contract might not be provided for free⁴⁴
 - b) Duty of loyalty: no conflicts of interest
 - i) Defining interested persons
 - (1) Up to ½ of the board can be interested

⁴² RMNCA 1.40 (30) "Religious Corporation" means a domestic corporation which is formed as a religious corporation pursuant to [chapter 2](#) or is required to be a religious corporation pursuant to [section 17.07](#).

⁴³ RMNC 11.03(a)(2)

⁴⁴ Adelphi

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

- (2) Either a compensated person, or their relative
- ii) Cannot act in a manner which would harm the corporation
 - (1) Avoid using their position to improperly obtain a personal benefit or advantages
 - (a) Putting money into your own bank accounts and not properly managing them is considered to be a lesser violation (but still a violation)⁴⁵
 - (b) In NY, it is possible to administratively remove trustees of colleges (though an action by the AG is required to disgorge monies): contracts with ones own corporations, or using ones own travel agencies is another example
 - (c) Overly high compensation can be another example
 - (i) Must make decisions using comparable salary data⁴⁶
 - (d) Failure to follow corporation formalities seems to be prima facie examples of a conflict
 - (2) Must place interest of corporation ahead of themselves
 - (3) Must not “usurp a corporate opportunity”
 - (4) Must not use material nonpublic organizational information or position
 - (5) Must avoid corporate waste (voting themselves salaries at times of deficits) – but one could argue that voting people high salaries is the only way to save things
 - (6) Must not compete with the organization
- iii) But, interested transactions may be a healthy necessity (but some argue that there should be absolute prohibitions)
 - (1) Interested director must recuse themselves – though he can present the nature of his conflict to the board
 - (2) Corporation can choose to avoid the conflict of interest
 - (a) Recusal from deliberation and the vote
 - (3) Management: If you have a conflict of interest you are supposed to recuse from deliberation and vote
 - (4) In various jurisdictions may have to get approval from AG or from court
- iv) *If you have a situation where you could be on both sides of the table you are in the wrong place*
- v) Remedies for breach of duty of loyalty under state law:
 - (1) Model act: liable for difference above what would have been paid had the act not been violated – and can seek contribution from officers who were in on the deal
 - (2) New York: not necessarily voidable
 - (3) California, can rescind contract
- vi) Federal prohibitions against self-dealing
 - (1) Self-dealing: prohibits any transaction between a private foundation and a “disqualified person”
 - (a) Definition of disqualified person⁴⁷ for private foundations

⁴⁵ Sibley

⁴⁶ Adelphi

⁴⁷ IRC 3936

- (i) Types of disqualified people
 - 1. a substantial contributor to the foundation,
 - 2. a foundation manager (officer, director, or trustee of a foundation (or an individual having powers or responsibilities similar to those of officers, directors, or trustees of the foundation), and with respect to any act (or failure to act), the employees of the foundation having authority or responsibility with respect to such act (or failure to act).
 - 3. an owner of more than 20% of total combined voting power of a corporation profits interest of a partnership, or the beneficial interest of a trust or unincorporated enterprise, which is a substantial contributor to the foundation
 - 4. for private foundations use the “substantially controlled” test
 - 5. substantial contributor (for private foundations)
 - a. any person who gave more than 5% if that amount is more than 2% of the total contributions per year⁴⁸
 - b. creditors are always substantial contributors
- (ii) allocation rules
 - 1. any members of their families:
 - a. spouse
 - b. ancestors
 - c. children
 - d. grandchildren
 - e. great grandchildren
 - f. spouses of children, grandchildren, and great grandchildren.
 - 2. any corporation or partnership, or trust which is controlled, at least by 35% by the disqualified people (or partnership interest)
 - a. use fmV of date of the gift
 - b. the taint of a substantial contributor ends 10 years later⁴⁹
- (b) actus rea for private foundations
 - (i) sale or exchange, or leasing, of property between a private foundation and a disqualified person;
 - 1. assumption of mortgage which a disqualified person put on the property is considered a sale⁵⁰ within 10 years of the transfer

⁴⁸ 507(d)(2)(A) Definition.--For purposes of paragraph (1), the term "substantial contributor" means any person who contributed or bequeathed an aggregate amount of more than \$5,000 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the foundation before the close of the taxable year of the foundation in which the contribution or bequest is received by the foundation from such person. In the case of a trust, the term "substantial contributor" also means the creator of the trust.

⁴⁹ 507(d)(2)(C)

⁵⁰ 4941(d)(2)(A): (A) the transfer of real or personal property by a disqualified person to a private foundation shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the foundation assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer;

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

2. free goods are not within this prohibition⁵¹
 3. if the goods are provided on the same basis as everyone else, this is ok⁵²
- (ii) lending of money or other extension of credit between a private foundation and a disqualified person – unless it is an interest free loan and the money all goes to charity⁵³
 - (iii) furnishing of goods, services, or facilities between a private foundation and a disqualified person;
 - (iv) payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person;
 - (v) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation; and
 - (vi) agreement by a private foundation to make any payment of money or other property to a government official (as defined in section 4946(c)), other than an agreement to employ such individual for any period after the termination of his government service if such individual is terminating his government service within a 90-day period.
- (c) mens rea requirement For private foundations
 - (i) in general: participation (general intent)
 - (ii) Government official (super-specific intent): **knowing that it is such an act.**⁵⁴
 - (iii) Must be willful⁵⁵
 - (d) Penalty: must find amount involved. For private foundations
 - (i) Amount involved

⁵¹ 4941(d)(2)(B) the furnishing of goods, services, or facilities by a disqualified person to a private foundation shall not be an act of self-dealing if the furnishing is without charge and if the goods, services, or facilities so furnished are used exclusively for purposes specified in section 501(c)(3);

⁵² 4941(d)(2)(D) the furnishing of goods, services, or facilities by a private foundation to a disqualified person shall not be an act of self-dealing if such furnishing is made on a basis no more favorable than that on which such goods, services, or facilities are made available to the general public;

⁵³ 4941(d)(2)(B) the lending of money by a disqualified person to a private foundation shall not be an act of self-dealing if the loan is without interest or other charge (determined without regard to section 7872) and if the proceeds of the loan are used exclusively for purposes specified in section 501(c)(3);

⁵⁴ IRC 4941(a)(1) (1) On self-dealer.--There is hereby imposed a tax on each act of self-dealing between a disqualified person and a private foundation. The rate of tax shall be equal to 5 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period. The tax imposed by this paragraph shall be paid by any disqualified person (other than a foundation manager acting only as such) who participates in the act of self-dealing. In the case of a government official (as defined in section 4946(c)), a tax shall be imposed by this paragraph only if such disqualified person participates in the act of self-dealing knowing that it is such an act.

⁵⁵ 4941(a)(2): (2) On foundation manager.--In any case in which a tax is imposed by paragraph (1), there is hereby imposed on the participation of any foundation manager in an act of self-dealing between a disqualified person and a private foundation, knowing that it is such an act, a tax equal to 2 1/2 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period, unless such participation is not willful and is due to reasonable cause. The tax imposed by this paragraph shall be paid by any foundation manager who participated in the act of self-dealing.

1. goods: greater of the amount of money and the fair market value of the other property given or the amount of money and the fair market value of the other property received
 2. services: excess compensation
- (ii) Amount of tax
1. In general (on self-dealer): 5% of percent of the amount involved with respect to the act of self- dealing for each year (or part thereof) in the taxable period – use fmv at time of self-dealing⁵⁶
 - a. if it isn't corrected in the taxable year, the tax becomes 200%⁵⁷ -- use highest fmv during the time improper deals were occurring⁵⁸
 - b. **corrected** means (seems to be a good faith standard) “undoing the transaction to the extent possible, but in any case placing the private foundation in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.”
 2. Foundation manager (officers, directors, etc.): 2 1/2 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period, *unless such participation is not willful and is due to reasonable cause*
 - a. if it isn't corrected in the taxable year, the tax becomes 50%⁵⁹
 - i. **corrected** means (seems to be a good faith standard) “undoing the transaction to the extent possible, but in any case placing the private foundation in a financial position not worse than that in which it would be if the disqualified person were dealing under the highest fiduciary standards.”⁶⁰
 - b. up to 10,000⁶¹
- (iii)structure of penalty
1. taxes must be paid by the person – if they are paid by someone else, it is income to the person

⁵⁶ 4941(e)(2)(A) in the case of the taxes imposed by subsection (a), shall be determined as of the date on which the act of self-dealing occurs; and

⁵⁷4941(b)(1) **On self-dealer.**--In any case in which an initial tax is imposed by subsection (a)(1) on an act of self-dealing by a disqualified person with a private foundation and the act is not corrected within the taxable period, there is hereby imposed a tax equal to 200 percent of the amount involved. The tax imposed by this paragraph shall be paid by any disqualified person (other than a foundation manager acting only as such) who participated in the act of self-dealing

⁵⁸ 4941(e)(2)(B) in the case of the taxes imposed by subsection (b), shall be the highest fair market value during the taxable period.

⁵⁹ 4941(e)(2)(A) B) in the case of the taxes imposed by subsection (b), shall be the highest fair market value during the taxable period.

⁶⁰ 4941(e)(3)

⁶¹ 4941(c)(2) **\$10,000 limit for management.**--With respect to any one act of self-dealing, the maximum amount of the tax imposed by subsection (a)(2) shall not exceed \$10,000, and the maximum amount of the tax imposed by subsection (b)(2) shall not exceed \$10,000.

2. joint and several liability for all persons involved
- vii) federal requirements that private foundations distribute⁶²
 - (1) must distribute at least 5% of their assets a year
 - (2) can set aside amounts for future payments (e.g. have to relinquish control)
 - (3) penalties
 - (a) if they don't do it, they have to pay a tax of 15% of their net income
 - (b) if they don't correct it (usually within two years), there is a 100% tax
 - viii) federal prohibition on private foundations owning too much of the family's business
 - (1) limit on size = 20% minus ownership interest of disqualified persons⁶³
 - (a) if effective control of the business is held by non-disqualified persons, the limit on size is 35% minus ownership interest of disqualified persons
 - (2) if they own over 20% they must completely divest – but they can always own 2% or less
 - (a) divestment must be in 5-10 years if the interest is received by gift or bequest
 - (3) tax
 - (a) 5% -- if failure to correct, tax is 200%
 - ix) federal prohibitions for private foundations on investing in things that might jeopardize status (could be commodity futures and short sales)
 - (1) managers: 5% penalty (with 5000 cap)⁶⁴
 - (a) if failure to correct, 25% with 10,000 cap
 - x) federal prohibitions against private foundations doing things that are taxable
 - (1) usually political activity
 - (2) numerous safe harbor for other than through making available the results of nonpartisan analysis, study, or research.⁶⁵, and activities not directed at an election period
 - (3) penalty
 - (a) foundation: 10%
 - (i) if failure to correct 100%
 - (b) managers 2.5% (capped at 5,000)
 - (i) if failure to correct 50%
 - xi) intermediate sanctions on public charities under 4958 – intermediate sanctions (applies to 501(c)(3), and (4) but not private foundations)
 - (1) called “intermediate” because it is not a total revocation
 - (2) defining insiders: outside contracts cannot be insiders⁶⁶ (but the contractor could be using undue influence)
 - c) Loans to officers:
 - i) Model code: generally prohibited
 - ii) *New York: per se violation of duty of loyalty*

⁶² 4942

⁶³ 4943

⁶⁴ 4944

⁶⁵ 4945

⁶⁶ United Cancer Hospital

- d) If you serve on the board of a charitable corporation, there is a **duty of obedience** or duty of obedience to mission
- e) Statutory duties
- f) Statutory Filing requirements
 - i) Minutes must be kept⁶⁷
 - ii) Annual report: which can be inspected by the members, provided that they act in good faith
 - iii) Registration
 - (1) Usually with AG
 - (a) Annual reports in most cases (a copy of an IRS 990 will do, in most cases)
 - (2) Professional fundraisers usually have to specifically register
 - (3) Federal
 - (a) Form 990⁶⁸ must be filed even before it can be recognized as exempt⁶⁹
 - (i) Private foundations file a 990-PF
 - (ii) Organization with more than 1000 more of unrelated trade or business income must file a 990T⁷⁰
 - iv) Conversion to for-profit entity
 - (1) Conversions in place (usually for HMOs)
 - (a) Only allowed in AZ and CA
 - (b) Change in name and status
 - (c) No need to reobtain business licenses
 - (d) IRS's view
 - (i) conversion of taxable corporations to tax exempt -- not exempt § 337(d)
 - 1. if all or substantially all of the assets in a taxable organization become tax exempt, it is treated as a deemed sale (and the built-in gain) gets taxed
 - 2. Rev. Proc. That says that if you are transferring less than 70% of gross assets and 90% of the net assets, then it will be deemed to be less than all or substantially all. So, if you are leaving behind 30% of the gross assets or more, and 10% of the net or more, and the assets are operating.
 - a. You do this revenue stream by revenue stream, and it is possible to have dual use facilities
 - (2) Asset sales
 - (a) Need to obtain business licenses
 - (b) Sold at FMV to a for-profit corporation
 - (c) Proceeds must still be kept in the charitable stream
 - (3) Mergers
 - (a) Permitted in a few states
 - (b) Merged in in exchange for cash and notes

⁶⁷ RMNPCA 16.01 – Cal. Corp. 6329, NYNPL 621

⁶⁸ IRC 6033

⁶⁹ 1.6033-2(e)

⁷⁰ 6043(b)

5

7

9

11

13

15

17

19

21

23

25

27

30

32

34

36

38

40

42

44

46

48

50

52

54

- (c) The for-profit and the not-for-profit corporation exist afterwards
 - (4) Drop-down conversion
 - (a) Transfers some of the assets to a for-profit sub
 - (b) In exchange for cash or notes
 - (c) For-profit sub can take on notes
 - (d) Charity forms a new for-profit corporation and a 501(c)(4)
 - g) Enforcement
 - i) AG's duties
 - (1) To protect charities when an attack is made on their property
 - (2) Remove directors or trustees
 - (3) Dissolved
 - (4) Bring actions for accounting
 - (5) *Quo warranto* to assure that gifts are used according to the terms of their gifts
 - (6) *Gather information – has subpoena power*
 - (7) *Can regulate solicitation*
 - ii) *Limits on AG's power*
 - (1) Does not have power to force charities to sue people (e.g. charities are not the AG's agent) even when the charity stands to lose money
 - (2) Can't direct charities to sue to collect stuff
 - (3) Can't intervene in contested wills involving charities
 - (4) California uses "relators" who have to seek approval to sue – most first post a bond and get the AG's approval. AG has control over the matter.
 - 4) Powers and responsibilities of people within the corporation
 - a) Functions in the corporation
 - i) Powers of a member (people who have a legal interest in the corporation as defined by the bylaws and/or articles)
 - (1) Amend the articles
 - (a) If someone challenges the amendment of articles
 - (i) Standing: Individuals who donate don't have standing under trust law or corporate theory, but they may under a contract theory
 - 1. Trust theory: Honeman case: But a donor can enforce the carrying out of the terms of his donation under contract theory (under a "trust" theory)
 - a. It is less clear as to whether later-accumulated assets are used (and how far the tracing concept goes)
 - 2. Contract theory
 - 3. attorney general standing
 - (2) Amend the bylaws
 - (3) Approve sale of assets
 - (4) Approve mergers and consolidations
 - ii) Directors and officers are held to a fiduciary standard
 - (1) Remedies for breach of fiduciary standard
 - iii) Board and management: Management is to be accountable to the board
- 5) Government regulation of corporations
 - a) Tax exempt statutes

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

- i) Specific purpose enumerated with in § 501(c)(3) (from Statue of Elizabeth)
 - (1) Federal law⁷¹ refers to uses that a charity might have under state law and judicial decisions
 - (a) Relief of the poor and distressed or of the underprivileged
 - (i) Voluntary contributions from people that an organization seeks to help will not disqualify it
 - (ii) Hospitals may charge patients (because this is the provision of health services), but the service requires that they also comply with certain standards: general rule: emergency rooms must be kept open⁷² regardless of ability to pay
 - 1. non-emergency care to everyone who can pay: but specialized hospitals need not have emergency rooms, but must do thing that evidence their commitment to health care in the community⁷³
 - a. either has an emergency room⁷⁴ that is available to everyone or is exempted from this provision because it is a specialty hospital (e.g. eye hospital) or there is limited need for an emergency room in that area⁷⁵
 - 2. open medical staff policy⁷⁶: teaching hospitals don't have to have open medical staff
 - 3. reinvestment of surplus⁷⁷
 - 4. broad-based board of directors⁷⁸ -- IRS will look to see that its governing board is not made up of doctors, but rather of civic leaders⁷⁹

⁷¹ 1.503(c)(3)-1(d)(2): (2) Charitable defined. The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions. Such term includes: Relief of the poor and distressed or of the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency. The fact that an organization which is organized and operated for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily prevent such organization from being exempt as an organization organized and operated exclusively for charitable purposes. The fact that an organization, in carrying out its primary purpose, advocates social or civic changes or presents opinion on controversial issues with the intention of molding public opinion or creating public sentiment to an acceptance of its views does not preclude such organization from qualifying under section 501(c)(3) so long as it is not an "action" organization of any one of the types described in paragraph (c)(3) of this section.

⁷² 69-545

⁷³ 83-157

⁷⁴ 69-545; Eastern Kentucky Welfare rights: In this case, the D.C. Circuit rejected the argument that a nonprofit hospital should be required to provide free or below- cost care to those unable to pay as a condition to qualification under section 501(c)(3).

⁷⁵ 83-157

⁷⁶ 83-157

⁷⁷ 83-157

- a. an an "integrated delivery system" the service requires that no more than 20% of the board be made up of doctors
- b. if the hospital is a multi-entity system, are corporate formalities respected⁸⁰
- 5. payment
 - a. treatment of medicare and Medicaid patients⁸¹ (including interviewing ambulance drivers, and the like). This is taken very seriously
 - i. previous rule was that they had to the poor⁸² -- but the service still thinks that it can enforce this⁸³
 - b. can only serve paying patients (because it still serves a health interest), but the hospital must still accept medicare
 - c. split in thinking about relief of poverty
 - i. service: we are free to demand that hospitals relieve poverty
 - ii. *Eastern KY Welfare Rights*: The service is free to ignore the relief of poverty test. But some people think this means the poverty test is gone.
- 6. must be organized for a large enough charitable class (e.g. not a hospital for 100 or so old people, but an entire community)
 - a. must have a large enough charitable class: Reed's landing (state case) – a 124 bed retirement home was not enough
- 7. its board cannot be made up just of doctors – must be made up from the community at large
- (b) advancement of religion
 - (i) churches do not have to serve a large charitable class
 - (ii) Religion: establishment clause not violated by providing tax exemptions (good works, benevolent neutrality). See IRM 7.26.2.2.1 <http://www.irs.gov/irm/page/0,,id%3D22114,00.html>
 - 1. Congress cannot regulate over matters of mere opinion, but can regulate over their actions
 - a. Service will only look to see whether there is a clear showing that the beliefs are not sincerely held GCM36993
 - 2. Mail order churches can be denied if they have a substantial for-profit motive (to run a business) (E.g. church was nothing more than a commercial tax service)
 - 3. Auxiliary organization (churches are “conclusively presumed” not to be private organizations)
 - a. Must be integrated 1.6033-2(h)(1)

⁷⁸ 83-157

⁷⁹ 69-545 and 1992-22 IRB 59

⁸⁰ 69-545 and 1992-22 IRB 59

⁸¹ 83-157

⁸² 83-157

⁸³ 69-545 and Eastern Kentucky Welfare Rights

- b. Benefits Integrated auxiliaries of the churches do not have to file the 990
 - i. Along with schools and colleges they are statutorily exempt
 - ii. Tests in 509(a)(1)-(3) ← by statute, they are in the public charity status
 - iii. No need for annual information filing
 - iv. Don't have to demonstrate public charity status
 - v. Audit limits – service is restricted in its ability to audit churches (has to make a certain showing)
 - vi. In MA: you can organize by posting in a public place your intention to do so
- 4. filing Churches don't need to file, but do anyway
- 5. general criteria for determining what is a religion
 - a. whether the beliefs address fundamental and ultimate questions concerning the human condition,
 - b. whether the beliefs are comprehensive in nature and constitute an entire system of belief instead of merely an isolated teaching, and
 - c. whether the beliefs are manifested in external forms.
- (c) advancement of education
 - (i) safe harbors of 86-43
 - 1. Presence of any of the following mean it is not educational (methodology test) affirmed in Nationalist Movement v. Comm
 - a. Unsupported by facts – if a significant portion of the organization's communications
 - b. Distortion
 - c. Inflammatory and disparaging terms
 - d. Not aimed at developing an understanding in the audience because it doesn't consider their background and training in the subject matter
 - 2. Content test of 67-4 (for publications)
 - a. Content of the publication is educational
 - b. Preparation of the materials is educational in character
 - c. Distribution of materials is necessary or valuation in achieving organization's goal
 - d. Manner in which the distribution is accomplished is distinguishable from commercial practices
 - (ii) Consistent with § 501(c)(3) status to charge a fee
 - (iii) Note: child care organizations under 501(k) are exempt: if 1) all of the care is to let the parents work; 2) services are provided to the general public
 - (iv) general criteria
 - 1. two sets of standards
 - a. Educating people on skills and stuff
 - b. Educating public on issues

5

7

9

11

13

15

17

19

21

23

25

27

30

32

34

36

38

40

42

44

46

48

50

52

54

- i. 75-384: civil disobedience not okay
 - ii. 78-305: fostering tolerance about gays okay because it was disseminating information about a “full and fair exposition of the facts” – the fact that it is controversial doesn’t bar the right to an exemption
 - iii. full and fair doesn’t necessarily mean “neutral”
 - iv. BMR: *full and fair standard exposition standard* is unconstitutional
 - v. Rev. Proc on 426-428
 - vi. Service is anti-safe harbors
 - vii. Holocaust deniers, etc.
 - viii. Things that are not susceptible to ordinary standard of proof
 - ix. Violence of language
 - x. Look to “aggregate” (one professors advocating civil disobedience)
2. Still must not participate in political activities (except for self-preservation)
 3. can’t specifically “advocate”
 4. evenhandedness requirement:
 - a. However, organizations which attempt to be evenhanded about issues that might not be fully acceptable (e.g. homosexuality) may be acceptable. 78-305
 - b. *Cf.* National alliance: hate group was not eligible for § 501(c)(3) status
 5. can’t urge **criminal actions** even if they seek to educate⁸⁴
- (v) look to aggregate of the institution’s actions
- (vi) constitutional issues
1. advocating break some laws might be protected constitutionally
 2. Big Mamma Rag: regulations cannot be vague as to what constitutes an educational institution (regulation defining what was education v. what was advocacy considered to be unconstitutional)
 - a. *Cf.* National alliance: hate group was not eligible for § 501(c)(3) status
- (d) advancement of science
- (e) environmental: but must preserve land
- (i) must provide some form of access
 - (ii) must be something special amount the land (can’t just be ordinary farm land)
- (f) erection or maintenance of public buildings, monuments, or works
- (g) lessening of the burdens of Government
- (i) promotion of health is a burden of government, therefore a hospital need not only treat the poor to be a non-profit corporation

⁸⁴ 75-384

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

- (h) promotion of social welfare by organizations designed to accomplish any of the above purposes, or (i) to lessen neighborhood tensions; (ii) to eliminate prejudice and discrimination; (iii) to defend human and civil rights secured by law; or (iv) to combat community deterioration and juvenile delinquency. The fact that an organization which is organized and operated for the relief of indigent persons may receive voluntary contributions from the persons intended to be relieved will not necessarily prevent such organization from being exempt as an organization organized and operated exclusively for charitable purposes.
- (i) "action" organizations only eligible if they don't exist for certain legislation: acceptable for an organization to advocate for social or civic change – but not through specific legislation
 - (i) defining action organizations: as its main purpose an attempt to influence legislation if the organization through propaganda, that urges the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation; or Advocates the adoption or rejection of legislation⁸⁵

⁸⁵ 26 CFR § 1.501(c)(3)-1(c)(3)

(3) "Action" organizations.

(i) An organization is not operated exclusively for one or more exempt purposes if it is an "action" organization as defined in subdivisions (ii), (iii), or (iv) of this subparagraph.

(ii) An organization is an "action" organization if a substantial part of its activities is attempting to influence legislation by propaganda or otherwise. For this purpose, an organization will be regarded as attempting to influence legislation if the organization:

- (a) Contacts, or urges the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation; or
- (b) Advocates the adoption or rejection of legislation.

The term "legislation", as used in this subdivision, includes action by the Congress, by any State legislature, by any local council or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure. An organization will not fail to meet the operational test merely because it advocates, as an insubstantial part of its activities, the adoption or rejection of legislation. An organization for which the expenditure test election of section 501(h) is in effect for a taxable year will not be considered an "action" organization by reason of this paragraph (c)(3)(ii) for that year if it is not denied exemption from taxation under section 501(a) by reason of section 501(h)

(iii) An organization is an "action" organization if it participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.

The term "candidate for public office" means an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, State, or local. Activities which constitute participation or intervention in a political campaign on behalf of or in opposition to a candidate include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to such a candidate.

(iv) An organization is an "action" organization if it has the following two characteristics: (a) Its main or primary objective or objectives (as distinguished from its incidental or secondary objectives) may be attained only by legislation or a defeat of proposed legislation; and (b) it

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

- (2) State law
 - (a) Must have a charitable purpose
 - (i) Charitable is defined as relief of the poor or promotion of health
 - (ii) Courts certify religious institutions (Ezra 7:24) – and they don't need to be for a religious class
 - (b) Need not be termed to be charity in the gift, so long as it is described as charitable⁸⁶ -- o
 - (c) Categories of charity (from restatement 2d of trusts § 368⁸⁷) – has been some discussion over time (from the statute of uses) about whether the enumerated definitions are the be-all-and-end-all of what might constitute charity
 - (i) Relief of poverty
 - (ii) Advancement of education
 - 1. note: need not serve a large charitable class (can be a school for the rich)
 - (iii) Promotion of health
 - 1. must be public-benefit, so a hospital that was organized for the benefit of its doctors is not in the public benefit⁸⁸ to qualify under § 501(c)(3)
 - (iv) Government or religious purposes
 - 1. note: need not serve a large charitable class (can be a school for the rich)
 - (v) Other purposes beneficial to the community
 - 1. Also included: roads, bridges, matchmaking, prisons, lower rent or taxes⁸⁹
- ii) **Organized and operated tests:** (primarily organized for a charitable purpose)
 - (1) Organized
 - (a) Must state that you are organized for a charitable purpose (charter)

advocates, or campaigns for, the attainment of such main or primary objective or objectives as distinguished from engaging in nonpartisan analysis, study, or research and making the results thereof available to the public. In determining whether an organization has such characteristics, all the surrounding facts and circumstances, including the articles and all activities of the organization, are to be considered.

(v) An "action" organization, described in subdivisions (ii) or (iv) of this subparagraph, though it cannot qualify under section 501(c)(3), may nevertheless qualify as a social welfare organization under section 501(c)(4) if it meets the requirements set out in paragraph (a) of § 1.501(c)(4)-1.

⁸⁶ Jackson

⁸⁷ Nature Of Charitable Purposes § 368.

Charitable purposes include

- (a) the relief of poverty;
- (b) the advancement of education;
- (c) the advancement of religion;
- (d) the promotion of health;
- (e) governmental or municipal purposes;
- (f) other purposes the accomplishment of which is beneficial to the community.

⁸⁸ 69-545 and Eastern Kentucky Rights Organization. Was temporarily voided, but ultimately upheld

⁸⁹ William Langland's Poem: Vision of Piers the Plowman

- (b) Must include a dissolution provision
- (2) Operated
 - (a) Submit a budget with balance sheet and income statements (not binding, usually quasi-fictional)
 - (b) Narrative provisions wherein one fills out what their activities or proposed activities are
 - (c) Needs to be an account of what you are intending to do
- iii) Federal tax criteria Baseline limitations for federal tax exempt statutes
 - (1) Private inurement to individuals or insiders
 - (a) Can't create an economic interest akin to what an owner would have
 - (b) The tests (at least in MN) is not whether or not the corporation makes a profit, but rather wheter or not dividends or pecuniary reimbursement go to the shareholders
 - (c) But fee-collections (such as for investment advice), which make an organization self-supporting, will render a corporation, for profit. ⁹⁰
 - (d) Remedy is in the form of an excise tax under § 4958
 - (e) Some states allow the issuance of stock (Alabama and PA)
 - (2) No political activity
 - (a) No lobbying
 - (b) Anything with campaigns or elections
 - (i) Educational organizations which are dedicated to "education" may run afoul of this if they appear to be campaigning for one party or another
 - (ii) Hierarchy of kosher activities for a § 501(c)(3) corporation safest ground if "broadcasting facts" (the more it looks like a "call to action" the less likely it is to qualify for § 501(c)(3) status
 - 1. sponsor "evenhanded debate" that is okay
 - 2. **reasoned study** that talks about the benefits of tax cuts
 - (c) low income housing
 - (i) there are a series of safe harbors which allow the developer to mix rich and poor folks
 - (ii) required interests served
 - 1. relieving the burdens of government
 - 2. serving a large, poor, charitable class
 - 3. avoidance of community deterioration
 - 4. need to demonstrate that they meet the safe harbors
 - (d) public interest law firms can be organized under § 501(c)(3)⁹¹: must provide benefit to the community as a whole, where such interest is not ordinarily provided by private firms – "charitability rests no upon the positions advanced, by upon the provision of a facility for resolution of issues of broad public importance"⁹²

⁹⁰ Common Fund v. Town of Fairfield

⁹¹ 75-74

⁹² Rev. Proc. 92-59: The engagement of the organization in litigation can reasonably be said to be in representation of a broad public interest rather than a private interest. Litigation will be considered to be in representation of a broad public interest if it is designed to present a position on behalf of

- (i) boardmembers
 1. must have board made up of, in part, the public
- (ii) selection of clients
 1. financial interests at stake would warrant representation from private legal sources⁹³
 2. likelihood of fees can't be a criteria
 3. policies of the board are not controlled by the actual litigators⁹⁴
- (iii) general prohibitions
 1. litigation does not attempt to achieve its objectives through a program of disruption of the judicial system⁹⁵
 2. can't be confused (e.g. in same office) as a private firm
 3. reporting requirement: files with its annual information return a description of cases litigated and the rationale ... [for why they would] benefit the public generally⁹⁶
 4. No participation in any campaign for public office
- (iv) fees
 1. no deduction for the cost of litigation that is for the private benefit of the donor.
 2. may be reimbursed for expenses
 3. can accept from opposing party if such fees are paid by opposing parties and are awarded by a court or administrative agency or approved by such a body in a settlement agreement.
 4. litigants must not be able to hire a private firm
 5. The total amount of all attorneys' fees (court awarded and received from clients) must not exceed 50 percent of the total cost of operation of the organization's legal functions
 6. All attorneys' fees will be paid to the organization
 7. Client-paid fees may not exceed the actual cost incurred in each case
 8. Once having undertaken a representation, a public interest law firm may not withdraw from the case because the litigant is unable to pay the contemplated fee.
- (v) have to look at whether or not it is a traditional charitable class

the public at large on matters of public interest. **Typical of such litigation may be class actions in which the resolution of the dispute is in the public interest; suits for injunction against action by government or private interests broadly affecting the public; similar representation before administrative boards and agencies; test suits where the private interest is small;** and the like.

⁹³ Rev. Proc. 92-59

⁹⁴ Rev. Proc. 92-59: The policies and programs of the organization (including compensation arrangements) are the responsibility of a board or committee representative of the public interest, which is not controlled by employees or persons who litigate on behalf of the organization nor by any organization that is not itself an organization described in section 501(c)(3) of the Code

⁹⁵ Rev. Proc. 92-59

⁹⁶ Rev. Proc. 92-59

- (e) Nonprofit housing organizations from **Rev. Rul. 70-585** (note: they must file an application), and must demonstrate that they meet safe harbors
 - (i) It is held generally that where an organization is formed for charitable purposes and accomplishes its charitable purposes through a program of providing housing for low and, in certain circumstances, moderate income families, it is entitled to exemption
 - (ii) eliminate prejudice and discrimination and to lessen neighborhood tensions, it is engaged in charitable activities
 - (iii) eliminating neighborhood deterioration is acceptable
 - (iv) providing homes to moderate-income people is not
- (f) environment – copy from 76-204
 - (i) policy of enhancing the accomplishment of the express national policy of conserving the nation's unique natural resources⁹⁷
 - (ii) can be an exempt organization if you preserve land that is somehow important
 - (iii) has to balance access and ecological importance: might have to provide some form of access.
- (g) education⁹⁸
 - (i) instructions of training
 - (ii) instruction of the community
 1. jazz festival okay
 2. alumni associations
 3. zoos
 4. education about tolerance of homosexuals⁹⁹

⁹⁷ 78-384

⁹⁸ 3) Educational defined—

(i) In general. The term "educational", as used in section 501(c)(3), relates to:

- (a) The instruction or training of the individual for the purpose of improving or developing his capabilities; or
- (b) The instruction of the public on subjects useful to the individual and beneficial to the community.

An organization may be educational even though it advocates a particular position or viewpoint so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion. On the other hand, an organization is not educational if its principal function is the mere presentation of unsupported opinion.

(ii) Examples of educational organizations. The following are examples of organizations which, if they otherwise meet the requirements of this section, are educational:

Example 1. An organization, such as a primary or secondary school, a college, or a professional or trade school, which has a regularly scheduled curriculum, a regular faculty, and a regularly enrolled body of students in attendance at a place where the educational activities are regularly carried on.

Example 2. An organization whose activities consist of presenting public discussion groups, forums, panels, lectures, or other similar programs. Such programs may be on radio or television.

Example 3. An organization which presents a course of instruction by means of correspondence or through the utilization of television or radio.

Example 4. Museums, zoos, planetariums, symphony orchestras, and other similar organizations

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

- (iii) 75-384: education though illegal means is not allowable, under trust law principles
- (3) no violations of public policy: under *McGlotten v. Connally*, it was held that an exemption from state income tax, was state action, and therefore unconstitutional.
 - (a) 501(c)(8): Fraternal orders. Taxed on unrelated business taxable income. So, there is actually a benefit, and therefore the government is involved.
 - (i) But, 501(c)(7)s, in which the government simple views this an excluded (rather than exempted) from income, may constitutionally discriminate, because there is an immunity rather than a protection.
 - (b) 501(i)(2): statutory prohibition against giving the exemption to racially discriminatory schools and clubs (mistake in book)¹⁰⁰
 - (i) safe harbor: if minority enrollment was 20% of the community of a minority (e.g. Jewish schools)¹⁰¹
 - (c) Bob Jones University: Racially discriminating university had its charitable exemption revoked, after the IRS issued a Rev. Rul., holding that no organization could be tax exempt if it discriminated racially – this was based on the civil rights act, which was grounded, somehow in the constitution. Dissent pointed out that what constitutes "public policy" changes from time to time, and this is vesting too much power in the IRS.
 - (i) Can spin off other divisions, so long as those other divisions, so long as none is an “essential party” of the university Schools must

⁹⁹ 78-305

¹⁰⁰ **(i) Prohibition of discrimination by certain social clubs.**--Notwithstanding subsection (a), an organization which is described in subsection (c)(7) shall not be exempt from taxation under subsection (a) for any taxable year if, at any time during such taxable year, the charter, bylaws, or other governing instrument, of such organization or any written policy statement of such organization contains a provision which provides for discrimination against any person on the basis of race, color, or religion. The preceding sentence to the extent it relates to discrimination on the basis of religion shall not apply to—an auxiliary of a fraternal beneficiary society if such society—

(A) is described in subsection (c)(8) and exempt from tax under subsection (a), and

(B) limits its membership to the members of a particular religion, or

(2) a club which in good faith limits its membership to the members of a particular religion in order to further the teachings or principles of that religion, and not to exclude individuals of a particular race or color.

¹⁰¹ Rev. Proc 75-50: (a) If for the preceding three years the enrollment of a parochial or other church-related school consists of students at least 75 percent of whom are members of the sponsoring religious denomination or unit, the school may make known its racially nondiscriminatory policy in whatever newspapers or circulars the religious denomination or unit utilizes in the communities from which the students are drawn. These newspapers and circulars may be those distributed by a particular religious denomination or unit or by an association that represents a number of religious organizations of the same denomination. If, however, the school advertises in newspapers of general circulation in the community or communities from which its students are drawn and paragraphs (b) and (c) of this subsection are not applicable to it, then it must comply with paragraph (a) of subsection 1 of this section.

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

- advertise in a non-discriminatory fashion. However, the IRS does not aggressively target violators (in part, this may be because any private litigant who wins gets an equitable decree which changes the nature of the place, and anyone who loses has proven the school not to discriminate)
1. gross violations seem to be the only thing that the IRS, itself targets *per se*, (according to professor) there can't be facially discriminatory language in the wording of the school's charter
 - (ii) major policy problems because
 1. IRS has no real idea of what public policy is
 2. would be easy to exclude less popular ideas
 - (d) the tax code should not attempt to enforce government orthodoxy on individuals.
 - (i) (Irish) Subjective view that gifts and trusts are to be viewed from the perspective of whether or not the creator thought they were to be charitable or not – and charities are to be protected from a tyranny of the majority
 - (e) violation of criminal statutes: federal anti-kickback statute may be grounds for denial of status, because various HMOs may be in existence solely for the purpose of kicking back money
 - (i) 75-384: activist organizations which block roads
 - (4) unrelated trade or business
 - (a) something that is “not unrelated” may actually be housed in a non-profit office building. E.g. a Starbucks may be in the first floor of a college
 - (b) receipt of dividends do not compromise an organization’s exempt status
 - (c) royalty income does not compromise an organization’s exempt status
 - b) state regulation of charities based on whether or not their charters violate public policy:
 - i) **general rule**: secretaries of state are generally not endowed with the power to determine whether or not a given non-profit corporation (with its articles) violates "public policy" (though some secretary of states have thought otherwise)
 - ii) **exception**: however, in Ohio, at one point, the secretary of state was allowed to refuse to incorporate a gay organization, because he determined it to be violative of public policy (no criminal statute)¹⁰² – but most states do not allow their secretaries of state to adjudicate or to have such discretion
 - iii) **criminal prohibitions**: federal anti-kickback statute may be grounds for denial of status
 - 6) procedure
 - a) if you want to secure tax exempt status, you have to submit an application
 - i) non-churches
 - (1) in Mass, there is a form PC, and in other states exempt status is derivative
 - (a) churches don't have to file, and **§ 501(c)(4)**,

¹⁰² Grant v. Brown

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

- (2) if you are denied § 501(c)(3) status, under § 7428, you can seek a declaratory judgment that you are exempt (but it isn't applicable to a § 501(c)(4))
- ii) churches: don't have to file, but they can simply claim exempt status
 - iii) § 501(c)(4): don't have to file, can simply claim exempt status
 - iv) schools: Schools must advertise in a non-discriminatory fashion. However, the IRS does not aggressively target violators (in part, this may be because any private litigant who wins gets an equitable decree which changes the nature of the place, and anyone who loses has proven the school not to discriminate)
- b) judicial intervention:
- i) in disputes over churches, courts will not interpret church doctrine, only corporate law
 - ii) standing
 - (1) although usually only the AG has standing, in general, to sue for the misuse of funds for improper charitable uses.
 - (2) Members of the corporation has standing to sue if their roles are not being properly recognized
 - (3) Can sue under an equitable or contract theory to have the corporation's charter changed. However, by statute, the court has little guidance, so courts look to trust law: *cy pres* and deviation (trust doctrines) – these are not *per se* applicable to charitable corporations, but in many states statutes make them applicable by statute, which gives the court discretion (e. g. MA and NY). Courts look to these doctrines in order to reform a charitable corporation whose purpose deems difficult. Remember: the members, on dissolution, by statute, can decide where the funds will go, so long as it is done validly. Amounts of money in a trust or corporation can be divided between those which are bound by a contract theory and those which are not.
 - (a) *cy pres*: doctrine allowing reformation of the trust when the purpose becomes **impossible, inexpedient, or impracticable**¹⁰³ -- strict impossibility not required¹⁰⁴
 - (i) strictly construed
 - 1. Buck Trust: just because there was no real need for charity in the area that the trust was supposed to be used in, didn't require *cy pres*, or deviation
 - (ii) general scope of intent
 - 1. acceptable
 - a. home for cats + insufficient funds = donation to human society¹⁰⁵
 - b. help free slaves + no more slavery = donation to poor neighborhoods and freed slaves¹⁰⁶

¹⁰³ Jackson v. Phillips

¹⁰⁴ US v. Cerio: Trust to Coast Guard was modified b/c the CG didn't want big jackpots to physics students

¹⁰⁵ Shannon v. Eno

¹⁰⁶ Jackson v. Phillips

- c. scholarship for white kids + unconstitutional = reformed for all kids¹⁰⁷
- d. may be open question in NY as to what constitutes impossibility that would warrant some variance¹⁰⁸
- 2. courts are less likely to apply cy pres to gender than race discrimination, and may find that there is actually **no state action involved**¹⁰⁹: courts can broadly construe words like “men” to mean “everyone”¹¹⁰
- (iii) in a charitable trust, the settlor must have had a general charitable intent¹¹¹
 - 1. must be implied consent
 - a. a reversionary interest is evidence of a lack of implied consent
 - b. e.g. trust to help free slaves was used to help remaining freed slaves and poor black people¹¹²
 - 2. degree of change must be small
 - 3. three part-test
 - a. valid charitable trust
 - b. settlor’s specific obligation is frustrated
 - i. so, in the face of an illegal or unconstitutional condition, the trust can go to a residuary
 - ii. but, in the absence of such a provision, the courts can simply change the trust
 - c. settlor’s charitable intent is not restricted to precise purpose identified in trust instrument
- (b) deviation:¹¹³ when it becomes **difficult, impossible or illegal** (based on circumstances not known to the trustor at the time) to administer the trust, the standard for deviation is "impracticable" or inconvenient
 - (i) will change the trust’s purpose
 - (ii) can’t change the original charitable objective¹¹⁴

¹⁰⁷ Trustees of U. Dell.

¹⁰⁸ CSS

¹⁰⁹ In Re. Wilson (NY)

¹¹⁰ Ebitz

¹¹¹ Restatement 2d of Trusts Sec. 399: If property is given in trust to be applied to a particular charitable purpose, and it is or becomes impossible or impracticable or illegal to carry out the particular purpose, and if the settlor manifested a more general intention to devote the property to charitable purposes, the trust will not fail but the court will direct the application of the property to some charitable purpose which falls within the general charitable intention of the settlor.

¹¹² Jackson v. Phillips

¹¹³ Restatement 2d of Trusts Sec. 381 The court will direct or permit the trustee of a charitable trust to deviate from a term of the trust if it appears to the court that compliance is impossible or illegal, or that owing to circumstances not known to the settlor and not anticipated by him compliance would defeat or substantially impair the accomplishment of the purposes of the trust.

¹¹⁴ Restatement 2d of Trusts Sec. 381 comm a. Scope of the rule. The rule stated in this Section is the same as the rule applicable to private trusts. See §§ 165-167. The rule stated in this Section has to do with the powers and duties of the trustees of charitable trusts with respect to the administration of the trust; it has to do with the methods of accomplishing the purposes of the trust. The question of the extent to which the court will permit or direct the trustee to apply the trust property to

5
7
9
11
13
15
17
19
21
23
25
27
30
32
34
36
38
40
42
44
46
48
50
52
54

- (iii) applies to administrative provisions only¹¹⁵
- c) IRS intervention
- i) intermediate sanctions requirements
- (1) First bite rule: if you are a 3d party entering into the initial contract, you can't be a disqualified person (because you are not inside)
- (a) Only one intermediate sanctions: Stayhome
- (b) Adelphi: relations between salary and insider deals
- (c) Sibley: board never attended the meetings, and the financing committee didn't meet for a decade
- (2) Defining third parties
- (a) United Cancer Council case: charity went to a fundraiser which kept most of the fundraising proceeds. Held: third-parties cannot be insiders, so there is no private inurement. (but still a question of fact as to whether the contract was fairly negotiated)
- (i) He raised as a factual question whether this was a reasonable question in light of the alternatives
- (3) Size of sanctions
- (a) Remedy for private inurement is in the form of an excise tax under § 4958

charitable purposes other than the particular charitable purpose designated by the settlor where it is or becomes impossible or illegal or impracticable to carry out the particular purpose involves the doctrine of cy pres, which is dealt with in § 399.

¹¹⁵ In re Barnes Foundation

1

3

5

7

9

11

13

15

17

19

21

23

25

27

30

32

34

36

38

40

42

44

46

48

50

52

54