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COUNSEL TO GREAT COMPANIES

February 10, 2021

ACC National Capital Region: *Nonprofit and Associations Year in Review 2020*

Overview of Today's Program

- **Goals:**
 - Understand important tax-exempt legal developments from 2020 that impact in-house counsel
 - Anticipate what's coming in 2021
- **Format:**
 - 1 hour, 45 minutes of presentation materials
 - Type questions into the chat feature on your screen at any time throughout the program

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Today's Presenters

Presenters

Heising-Simons Foundation

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The Perkins Coie logo, with "PERKINS" in red and "coie" in black.

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Framing Today's Discussion

Overview

- To guide our discussion of recent and upcoming developments in exempt organizations law, we have put together a fact pattern involving three related tax-exempt organizations.
- For each topic, we will provide a few additional facts about these related organizations to frame our discussion of the topic.

Basic Fact Pattern

- D.C. entity consists of three affiliated organizations: a 501(c)(6) trade association, a 501(c)(3) public charity, and a 501(c)(4) social welfare organization. The 501(c)(6)'s members are U.S. food companies.
- Each organization has a 7-member Board of Directors.
 - The 501(c)(6) and 501(c)(4) share 4 Board members.
 - The 501(c)(6) and the 501(c)(3) share 3 Board members. The 501(c)(3) and the 501(c)(4) share 4 Board members.
 - None of the organizations share corporate officers.

Today's Topics

- ✓ Resource-sharing among affiliated organizations
- ✓ Donor advised funds – upcoming developments
- ✓ Unrelated business income – final regulations
- ✓ Excess compensation – final regulations
- ✓ Donor disclosure update
- ✓ Diversity grantmaking and advocacy activity

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Affiliated Organization Resource Sharing

Resource Sharing: Facts

- Each organization has 7 Board members.
- The 501(c)(6) and 501(c)(4) share 4 Board members.
- The 501(c)(6) and 501(c)(3) share 3 Board members.
- The 501(c)(3) and 501(c)(4) share 4 Board members.
- None of the organizations share officers.
- All 3 organizations share 100% of their employees.
- The 501(c)(3) serves as the common paymaster.

Resource Sharing: PLR 2020-05-020

- Parent entity: 501(c)(3) healthcare system.
 - Parent was sole shareholder in a Subsidiary for-profit corporation. Subsidiary establishes section 527.
 - Parent and subsidiary enter into “Management and Administrative Services Agreement.”
 - Parent also provides Subsidiary with contact list to comply with federal solicitation restrictions and will be paid fair market value.
- Rulings:
 - Services agreement constitutes political intervention & private benefit.
 - Provision of the list constitutes political intervention.

Resource Sharing: Contrary Analysis

- PLR 2011-27-013
 - 501(c)(3) healthcare system formed and controlled a 501(c)(4), which itself formed and controlled two section 527 PACs. It used a cost allocation system.
 - Ruling: proposed structure was permissible.
- *Regan v. Taxation with Representation of Washington*
 - Ruling: Congress could limit 501(c)(3) lobbying; however, concurrence made clear that was only due to the “safety valve of a related section 501(c)(4) organization” and result would be different if the IRS imposed a “significant restriction on this channel of communication.”

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Donor Advised Funds: Upcoming Developments

Donor Advised Funds: Facts

- The 501(c)(3) is funded primarily by distributions from a single large donor advised fund.

Donor Advised Funds

- Current law:
 - DAF contributions count as public support under section I.R.C. § 170(b)(1)(A)(vi), including funds originally from private foundations.
 - DAFs have no payout requirements.
- Proposals by IRS and others included:
 - Payout rule (15 year or deferred deduction)
 - DAF funds would not count as public support
 - Private foundation payout would not include distributions to DAFs



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Unrelated Business Income: Final Regulations

UBI Silo Regulations: Facts

- The 501(c)(4) brings in revenue through the sale of two types of products:
 - The sale of political merchandise (e.g., t-shirts supporting candidates) through its independent expenditure program; and
 - The sale of a book that the 501(c)(4) wrote and published about nonprofit advocacy tactics.
- The 501(c)(4) also owns 1% of the profits and 1% of the capital interest in two separate partnerships, but does not significantly participate in either partnership.

UBI Silo Regulations: Back to Basics

- What is Unrelated Business Income?
 - Income from a trade or business;
 - Regularly carried on;
 - Not substantially related to exempt purpose.

UBI Silo Regulations: Highlights

- Effective for tax years after December 2020, if more than one unrelated trade or business, UBTI is calculated separately for each.
- Each unrelated trade or business identified by first 2 digits of NAICS code.
- Investment activities treated as one unrelated business:
 - Qualifying partnership interests;
 - Qualifying S corporation interests;
 - Debt-financed properties.
- Does *not* impact (c)(3) public support test.

UBI Silo Regulations: Application

- In our fact pattern, the 501(c)(4) has two separate unrelated trades or businesses under the UBIT silo regulations:
 - The sale of political merchandise; and
 - The two partnership interests.
- Both businesses are unrelated to 501(c)(4)'s advocacy exempt purpose. If regularly carried on, the income from both will qualify as UBTI, which will need to be calculated separately for each.
- Sales of the advocacy book are likely not unrelated to the 501(c)(4)'s exempt purpose, and are probably not taxable.



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Executive Compensation: Final Regulations

Executive Compensation: Facts

- The 501(c)(3) has an annual operating budget of \$30 million. It shares a CEO with the 501(c)(4), which has an annual operating budget of \$15 million.
- The CEO earned \$1.1 million in compensation in 2020 from the two organizations combined.
- The 501(c)(6)'s annual budget is \$20 million, and its Executive Director earned \$700,000 in compensation from the 501(c)(6) in 2020.

26 U.S. Code § 4960 Regulations Background

- 26 U.S. Code § 4960 was enacted as part of the 2017 Tax Cuts and Jobs Act.
- Under section 4960, an applicable tax-exempt organization that pays a covered employee remuneration in excess of \$1 million or any excess parachute payment in an applicable year is subject to an excise tax (currently 21%).
- On January 19, 2021, the final regulations were published on the Federal Register, making them official.

26 U.S. Code § 4960 Regulations Overview

- Applicable Tax-Exempt Organization (“ATEO”) includes:
 - Organization exempt from taxation under section 501(a)
 - Farmers cooperative organization under section 521(b)(1)
 - Organization that has income excluded from taxation under section 115(1)
 - Political organization described in section 527(e)(1)

26 U.S. Code § 4960 Regulations Overview, Cont.

- Covered Employee: One of the 5 highest compensated employees of the organization for the taxable year or was a covered employee of the organization (or any predecessor) for any preceding taxable year beginning after December 31, 2016
 - Exceptions:
 - Bona fide independent contractors
 - Directors
 - Minor services by unpaid officers
 - Others, depending on service hours/payments
- Remuneration: means “wages” as defined in section 3401(a); must consider remuneration paid by ATEO and related organizations

26 U.S. Code § 4960 Regulations – Key Questions

- Is your organization an applicable tax-exempt organization?
- Who are your covered employees (include remuneration paid by ATEO + related organizations)?
- Were any covered employees paid more than \$1 million (in aggregate), including taxable fringe benefits?
- Did you make any parachute payments?

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Donor Disclosure Update

Donor Disclosure: Facts

- The 501(c)(4) advocates for policy changes aimed at promoting food equity at the local, state, and federal levels.
- The 501(c)(4) is funded largely by contributions from high net worth individual donors, along with occasional grants from the 501(c)(6) and 501(c)(3).
- The 501(c)(3) is funded primarily by distributions from a single large donor advised fund.

IRS Schedule B: Goodbye to C4 and C6 Donor Disclosure

- In May of 2020 the IRS issued new regulations on Schedule B donor disclosure.
 - New regulations accomplish the same goal as Rev. Proc. 2018-38, but with the required notice and comment period.
- Tax exempt organizations, except 501(c)(3)s, no longer need to disclose the name and addresses of substantial contributors on Schedule B of their annual 990.
- Requirement to maintain this information still applies, but no longer need to affirmatively disclose.

What about the state level?

- The IRS regulatory change gets rid of non c3 donor disclosure on the federal level.
- As part of the charitable registration process, some states require non-profit organizations to disclose donors.
 - California –requires nonprofits to provide Schedule B of their IRS 990
 - New York – requires c4s that make expenditures for “covered communications” in an aggregate amount exceeding \$10,000 / year to disclose the name and address of any donor of a “restricted donation” that is received by the organization in whole or in part for the support of the covered communication.

SCOTUS and State Donor Disclosure

- SCOTUS granted cert on two cases that challenge whether the California AG can require nonpublic disclosure of Schedule B as part of charitable registration
 - As-applied challenge, two cases brought by separate non-profits. Claim is that the disclosure requirement unconstitutionally burdens their right to association.
 - Courts weighted the state's interest in obtaining Schedule B information, the potential chilling effect of disclosure on donations to the non-profits and the likelihood of inadvertent public disclosure.
 - 9th circuit ultimately rejected both as applied challenges after extensive back and forth with the District court
 - District court essentially applied strict scrutiny, which is not the test. The right standard is the “exacting scrutiny standard” - requires a substantial relation between the disclosure requirement and a sufficiently important governmental interest.
 - Why do we care? Because the case will have an impact on states that impose independent donor disclosure requirements, like NY.

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Diversity Grantmaking & Advocacy Work

Diversity & Advocacy Work: Facts

- In 2021, the 501(c)(3) seeks to expand its program activities in two key ways:
 - Making grants to nonprofit organizations led by persons of color, and
 - Making grants to grassroots organizations focused on racial justice advocacy.

Relevant Laws

- **Federal, state, and local employment laws**
 - Prohibit discrimination on the basis of protected characteristics
 - What is considered employment?
 - Some exceptions, but rarely applied
- **Federal non-discrimination laws related to higher education and recipients of federal funding**
 - *Race-conscious* decision making in compliance with federal law
 - Equal Protection Clause, Civil Rights Act of 1964, SCOTUS cases
- **Civil Rights Act of 1866**
 - Prohibits discrimination on the basis of race in the making and enforcement of private contracts
 - Little applicable case law (only non-profits, no foundations)

An Analytical Approach

Understand activities

- What kind of organization are you supporting?
- Who is being included/excluded and on what basis?
- What specifically are the activities to be conducted?

What law(s) apply?

- Is the organization public or private? A higher education institution?
- Are the activities related to employment?
- Is the relationship a contractual one?

Any exceptions available?

- Are there ways to be neutral and achieve desired impact?
- Does the context allow race consciousness vs. race exclusivity?
- Is the exclusion supported by constitutional association rights?

Exceptions and Other options

- Establish criteria that are neutral with respect to protected characteristics
- Pursue race-conscious approach where available
- First amendment associational right (*narrowly* applied)
- No-strings attached gifts
- Portfolio theory
- Accept the risk

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