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National Capital Region – Association of Corporate Counsel

ACC NCR Nonprofit Year in Review & 2023 Forecast

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Presented by Richard L. Sevcik, Brian Svoboda, Simona Roesch, and Jami Wyatt

Perkins Coie LLP

Agenda

- Corporate philanthropy
  - Scholarship programs
  - Economic relief
  - Grant programs
- Alternate structures for charitable giving
- Advocacy communications
- State controversies
- Application of Foreign Agents Registration Act
- Updates

Corporate Philanthropy: Scholarship programs

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Corporate Private Foundations vs. Corporate Public Charities – Scholarship Programs

- The rules for corporate scholarship programs differ between private foundations and public charities
- Corporate private foundation scholarship programs must be approved in advance by the IRS
- Employer-related scholarships are treated as taxable expenditures of private foundations unless they are awarded on an objective, nondiscriminatory basis, they meet the requirements to be excluded from the recipient's gross income, and they are used to study at a qualifying educational institution
- There is no definitive authority addressing employer-related scholarship programs administered by public charities—a public charity should adhere to as many of the criteria established for private foundations as possible

Corporate Private Foundations vs. Corporate Public Charities – Scholarship Programs

- Employer-related scholarships are excluded from the recipient's gross income if they are "qualified scholarships" received by an individual who is a candidate for a degree
  - A "qualified scholarship" is any amount received by an individual as a fellowship or grant to the extent such funds are used for qualified tuition and related expenses
- A scholarship does not qualify for tax-free treatment if it is given in payment for teaching, research or other services

Corporate Private Foundations vs. Corporate Public Charities – Scholarship Programs

- Requirements for corporate private foundation scholarship programs:
  - The employer and the foundation may not use the program to recruit employees or induce employees to continue their employment
  - The selection committee must be made up entirely of independent individuals who are not connected to the employer or the foundation
    - This is often the reason why foundations turn to third party service providers
  - The program must impose minimum requirements for scholarship eligibility. Any minimum period of employment required may not exceed three years.

Corporate Private Foundations vs. Corporate Public Charities – Scholarship Programs

- Requirements for corporate private foundation scholarship programs *(continued*)*:*
  - Selection of recipients must be based solely on objective standards unrelated to employment
  - Once a scholarship is awarded, it cannot be terminated if employment changes
  - Courses of study for which scholarships are available cannot be limited to those benefitting the employer
  - The terms must be consistent with a disinterested purpose of enabling the recipients to obtain education for their own benefit

Corporate Private Foundations vs. Corporate Public Charities – Scholarship Programs

- In addition, corporate private foundation scholarship programs must either meet a percentage test or satisfy a facts and circumstances test:
  - Under the percentage test, if grants are awarded to children of employees, the number of recipients must not exceed 25% of applicants who were eligible, applied, and were considered, or 10% of the number of eligible recipients, regardless of whether they applied
  - If grants are awarded to employees, the number of recipients must not exceed 10% of applicants who were eligible, applied, and were considered

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Corporate Private Foundations vs. Corporate Public Charities – Scholarship Programs

- Under the facts and circumstances test, the IRS considers several factors, including:
  - The history of the program (including funding sources)
  - Courses of study for which scholarships are available
  - Eligibility requirements
  - Publicity for the program
  - The degree of independence of the selection committee
  - The standards used for selecting recipients
  - The percent of applicants normally receiving scholarships
  - The number of grants awarded to individuals other than employees' children or employees

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Corporate Philanthropy: Economic relief

Corporate Private Foundations vs. Corporate Public Charities – Hardship and Disaster Relief

- The IRS has issued guidance outlining when distributions from employer-related disaster relief programs are permitted
  - The IRS distinguishes disaster relief programs from economic hardship programs
  - A corporate private foundation may not conduct an economic hardship program, and corporate private foundation disaster relief programs are subject to additional restrictions
- If the guidelines are followed, funds distributed will not be taxable income to the employee-recipient and the distribution will not be treated as conferring an impermissible private benefit

Corporate Private Foundations vs. Corporate Public Charities – Hardship and Disaster Relief

- Disaster relief programs of both corporate public charities and corporate private foundations permitted if:
  - The class of beneficiaries is large or indefinite,
  - The recipients are selected based on objective determination of need, and
  - Either an independent selection committee or adequate substitute procedures are used

Corporate Private Foundations vs. Corporate Public Charities – Hardship and Disaster Relief

- Disaster relief programs of corporate private foundations are subject to additional requirements:
  - Payments may only be made to employees living in a presidentially declared disaster area – payments may not be made for other disasters or to address economic hardship
  - The self-dealing rules apply – e.g. payments cannot be made to directors, officers or trustees of the foundation or members of the selection committee

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Corporate Philanthropy: In-person events

- With most Covid-19 restrictions having been lifted, 2023 will likely see the return of in-person philanthropy events.
    - Consider the application of any local mask mandates
- Otherwise, no changes from a legal perspective regarding philanthropy events.

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Alternate Structures for Charitable Giving: Patagonia

Alternate Structures for Charitable Giving - Patagonia

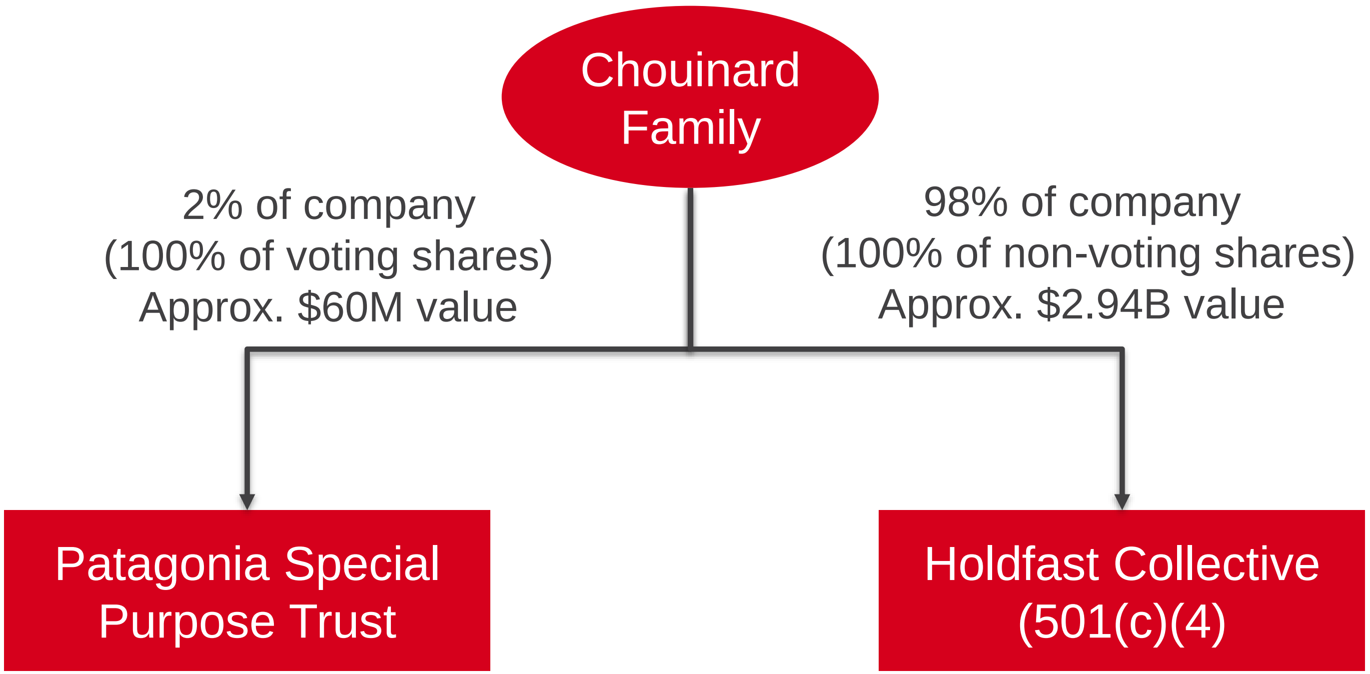
- Yvon Chouinard (founder), along with wife and two children, owned 100% of Patagonia stock worth $3 billion
- Wanted to dispose of stock while ensuring that Patagonia would continue to operate in alignment with its core environmentalist values
  - Certified B corp; has pledged 1% of sales to environmental causes since 1985

Alternate Structures for Charitable Giving - Patagonia

- Considered several options, including:
  - Selling stock to a new owner and donating the proceeds
  - Going public
  - Becoming a nonprofit
  - Turning Patagonia into a cooperative with the employees as owners
  - Turning over Patagonia to Chouinard children

Alternate Structures for Charitable Giving - Patagonia

- Transaction structure



Alternate Structures for Charitable Giving - Patagonia

- Tax consequences

Transfer to Trust	Transfer to 501(c)(4)
• $17.5 million gift tax	• No gift taxes • No capital gains taxes (current or future) • No charitable contribution deduction

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Alternate Structures for Charitable Giving - Patagonia

- Benefits of this transaction structure:
  - Chouinard family retains control over Patagonia through the Trust
  - All company profits will be used for charitable purposes–combatting climate change and promoting environmental objectives
  - 501(c)(4) organization can engage in political activities

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Alternate Structures for Charitable Giving: Chan Zuckerberg Initiative

Alternate Structures for Charitable Giving – Chan Zuckerberg Initiative

- Mark Zuckerberg and his wife Priscilla Chan announced their intent to give away 99% of Facebook shares during their lifetimes
- To do so, they formed an LLC, the Chan Zuckerberg Initiative (CZI)
  - CZI is not a tax-exempt organization

Alternate Structures for Charitable Giving – Donor Advised Funds vs Private Foundations

- Benefits of using an LLC:
  - More flexibility in investments (e.g. investments in for-profit startups)
  - Unlimited lobbying activities and political donations
  - No need for state registrations
  - Can make tax deductible charitable contributions

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Alternate Structures for Charitable Giving: Donor advised funds vs. private foundations

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Private Foundations

Private foundations

- Separate legal organization
  - Directors and officers are responsible for management of organization, investment of its assets and grant decisions
  - May employ individuals, including family members
  - Responsible for all IRS filings and compliance matters
- Private foundations are tax-exempt 501(c)(3) organizations that do not meet the various tests to qualify as a public charity

Restrictions on private foundation operations

- Private foundations are subject to various taxes designed to influence the manner in which private foundations operate
- Violation of these excise taxes will result in the imposition of a punitive excise tax, potentially against the individuals responsible for the violation

Restrictions on private foundation operations

Self-dealing

- ☑ Payment of compensation or reimbursement of expenses
- ☑ Transfers of foundation income or assets to, for the use of by, or for the benefit of, a disqualified person
- ☑ Providing of loans or credit
- ☑ Furnishing of goods, services or facilities

Restrictions on private foundation operations

Distribution requirements

- Required to distribute annually an amount roughly equal to 5% of annual value of non-charitable assets

Excess Business Holdings

- General rule: private foundations, in combination with all disqualified persons, may not own more than 20% of the voting stock of a business enterprise
- Effective control by non-disqualified persons (percentage increases to 35%)
- 2% de minimis rule

Restrictions on private foundation operations

Taxable Expenditures

- Lobbying and political activities
- Grants directly to individuals for scholarships, awards, etc.
  must be subject to a program approved in advance by the IRS
- Grants to other private foundations or non-public charities
  are subject to “expenditure responsibility”

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Donor-Advised Funds

Donor-advised funds

- An account or fund that is owned and controlled by a sponsoring organization, with which donors have advisory privileges
- Addressed and defined in the Pension Protection Act of 2006
- Requirements to be treated as a DAF:
  - Donors have advisory privileges over distributions and investments
  - Sponsoring organization holds ownership and control over assets
  - Each fund is separately identified

Restrictions on DAF operations

Restrictions on transactions with donors and donor advisors of a DAF

- Restrictions on grants, loans, compensation or similar payments (25% of entire amount)
- Prohibition on more than incidental payments, e.g., donor benefits (125% of benefit)

Restrictions on distributions

- No distributions to individuals under any circumstances
- Distributions to foreign charities subject to restrictions
- Distributions to private foundations and other non-public charities require expenditure responsibility

Excess business holdings rules

Restrictions on DAF operations

IRS Notice 2017-73

- Fulfillment of pledges by donors and donor advisors
- Purchase of tickets for charity events
- Public support calculation and use of DAFs

Advantages & Limitations

Advantages and limitations

Operational Differences

- Legal and financial control of foundation assets rests with the foundation board. Legal control of DAF assets, by definition, is held by sponsoring organization.
- A private foundation can exist in perpetuity.
- DAF succession options will vary by the policies of the sponsoring organization.

Advantages and limitations

- A private foundation may operate its own charitable programs and pay for any related expenses.
- A DAF generally is not able to conduct charitable programs directly.

Advantages and limitations

Tax Treatment and Deductions

Private foundations

- 30% AGI deduction for cash
- 20% AGI deduction for appreciated assets (public traded securities held > 1 year)
- 10% AGI deduction for contributions by corporations
- Cost basis and 20% AGI deduction for other long-term capital assets such as real property, notes, bonds or privately held stock
- 1-2% excise tax on annual investment income

Donor-advised funds (public charities)

- 60% AGI deduction for cash
  50% AGI deduction limitation for cash when used in combination with appreciated assets, or DAF/PF combo
- 30% AGI deduction for appreciated assets (held > 1 year, both public and non-public)
- 10% AGI deduction for contributions by corporations
- No excise tax

Advantages and limitations

Transactions with Donors

- DAFs are not permitted to pay compensation or reimburse expenses of donors or donor advisors

Advantages and limitations

Grants to Individuals

Private foundations

- May make grants to individuals for economic hardships and emergencies as long as IRS criteria are met.
- With advanced IRS approval of the program, a foundation may provide scholarships to individuals.

DAFs

- May not make grants to individuals or provide scholarships directly to individuals.

Advantages and limitations

Grants to Third Parties

- Both private foundations and DAFs are required to exercise expenditure responsibility for grants to non-public charities.
- Both are required to exercise expenditure responsibility or conduct an equivalency determination for grants to foreign charities.

PRIs

- A private foundation may provide PRI loans, loan guarantees and equity investments.
- A DAF typically only issues grants to organizations.

Advantages and limitations

DAFs are not subject to any minimum distribution requirements.

Privacy

- Private foundations must file IRS Form 990-PF, which is a public document
- Donors can grant anonymously from their DAFs. The sponsorship organization files a Form 990 and can keep individual donor records private

Planning Opportunities

Planning Opportunities

Why use a DAF or Private Foundation vs. Direct Giving?

- Future planning implications - Separation of timing of tax deduction with grant distributions
- Administrative structure - One tax receipt to support multiple charities
- Planning benefit of irrevocably earmarking money just for charitable purposes

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Alternate Structures for Charitable Giving: Fraudulent transfers

Fraudulent Transactions: The Basics

Bankruptcy trustees have the power to “clawback” or void fraudulent payments made by the debtor in the two years prior to filing bankruptcy so the funds can be distributed among creditors.

Theories of Fraud:

- **Actual →** debtor intended to delay, hinder, or defraud creditors by making the payment
- **Constructive →** debtor received less than a reasonably equivalent value for the payment *and* insolvent at the time of, or rendered insolvent by, the payment
  - *Intent behind the transaction is irrelevant*

Exception for Charitable Contributions

- Defined by §170 of Internal Revenue Code
- Contribution must be made by a natural person and consist of a financial instrument or cash
- Alternative theories for pursuit may nonetheless exist

Fraudulent Transactions: Common Elements

1. **Transfer of Property**
   - *Anything* decreasing the debtor's estate
   - Includes promises or loans, gifts or donations, business transactions, etc.
2. **Two-year Look-back Period**
   - Transfer must occur within two years immediately before bankruptcy filing – anything before or after is not included
   - State Law: trustees may also use look-back period of applicable state law (typically longer than 2 years)
3. **Two-year Statute of Limitations**
   - Trustee has exclusive right to claims within 2 years of filing
   - May be possible for individual creditors to bring state claims if the state statute of limitations has not expired

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Advocacy Communications

Advocacy Communications: TCPA

- Telephone Consumer Protection Act (“TCPA”) prohibits use of autodialers to text cell phones without prior, express consent
- TCPA provides a private right of action, with potential class action certification and possibility of significant fines
- Plaintiffs’ lawyers, ideological adversaries, pro se litigants all have used the TCPA against nonprofits
- Despite Supreme Court decision in Facebook, Inc. v. Duguid, 141 S. Ct. 1163 (2021), TCPA cases continue to proliferate

Advocacy Communications: TCPA

- Tips for Nonprofits:
  - Know your vendor practices
    - Are they TCPA-compliant?
    - Do they comply with relevant state laws?
  - Look at your contracts
    - Do they bind the vendor to TCPA compliance?
    - Do they contain robust indemnification language?
    - Does the vendor have sufficient insurance, resources to meet potential downsides?
  - Think intelligently about how to resolve disputes
    - Vendor obligations
    - Weighing costs of settlement versus other downsides

Advocacy Communications: Platform Policies

- Internet platforms continue to grapple with political, issue-based advertising
- Considerations weighing toward caution:
  - Audience alienation
  - Public exposure over foreign election interference, fraud, other issues
  - State regulation (e.g., political file requirements)
- But 2024 will likely bring greater opportunities
  - Growth relative to other media, attractiveness to advertisers
  - Potential economic demand
  - Ability to leverage audience data

Advocacy Communications: Platform Policies

- Issues to be aware of:
  - Disclosure policies:
    - Sponsor identification
    - Ad archives, etc.
  - Scope of policies: distinctions between campaign, issue-based, public service communications, etc.
  - Terms and conditions: community standards, platform discretion, etc.
  - Reliance on industry voluntary standards

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State Controversies

State Controversies: Aftermath of *Bonta*

- In our last episode …
  - California required 501(c)'s to file IRS Form 990 Schedule B, as part of state solicitation requirements
  - Americans for Prosperity Foundation and Thomas More Law Center sue the state
  - Supreme Court, on 6-3 vote across multiple opinions, strikes down the California requirement
  - States began to grapple with the Supreme Court's decision

State Controversies: Aftermath of *Bonta*

- Since then …
  - Buckeye Institute sues to strike down Schedule B disclosure in S.D. Ohio
  - Conservative groups attack leak of donor information from New York for nonprofit associated with Nikki Haley (https://www.politico.com/news/2022/08/26/donors-secretly-funded-nikki-haleys-nonprofit-00053963)
  - IRS issues revised regulations on disclosure of tax records to state, local authorities (87 Fed. Reg. 50242)
  - At least 14 states, including Missouri, Kansas, Virginia, New Hampshire, enact laws to protect donor privacy
- Takeaway: Disclosure fight will continue to unfold

State Controversies: Washington v. GMA

In our last episode …

- Washington Supreme Court upheld campaign-finance penalty levied against Grocery Manufacturers Associations
- Issue: whether a 501(c)(6)’s fundraising in connection with a state ballot issue triggered political committee registration, anti-concealment laws
- $18 million penalty may have been the largest in history of campaign finance

State Controversies: Washington v. GMA

Since then …

- GMA litigated over the penalty and went back up to the Washington Supreme Court, which affirmed the penalty.

  State v. GMA, 198 Wash. 2d 888 (2022)

- GMA and the state settled the case for a $6 million civil penalty and $3 million in donations to charities, mooting a potential appeal to the U.S. Supreme Court

  (https://agportal-s3bucket.s3.amazonaws.com/uploadedfiles/Another/News/Press_Releases/StipJudgment.pdf)

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Application of Foreign Agents Registration Act

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Foreign Agents Registration Act: Overview

- Enacted in 1938, FARA was written to track German activities on the eve of World War II
- Controversies in the 1960s over the sugar industry shifted FARA's focus toward lobbying
- After 9/11 and the 2016 election controversies, DOJ uses FARA as a tool to promote national security interests and transparency
- Efforts to amend FARA regulations are now underway in DOJ

Foreign Agents Registration Act: "What Has This Got to Do with Me?"

- FARA's archaic origins, sweeping language, and vague terms make its application uncertain
- News accounts, DOJ actions have raised questions of when charities receiving grants from foreign governments can become "agents of foreign principals"
- Controversies have led counsel, charities to look more searchingly at foreign-sourced grants

Foreign Agents Registration Act: Definitions

- **Foreign principal:**
  - Foreign government
  - Foreign political party
  - Foreign individual
  - Organization having its principal place of business in a foreign country or organized under laws of foreign country

Foreign Agents Registration Act: Definitions

Agent of a foreign principal:

- Acts at the order, request, or under the direction or control of a foreign principal

AND

- Engages in **political activities** for the foreign principal in the US; or
- Acts as a **public relations counsel**, publicity agent, or **political consultant** for the foreign principal in the US; or
- Solicits or dispenses money for the foreign principal in the US; or
- Represents the foreign principal before any US agency or official

Foreign Agents Registration Act: Definitions

- **Political activities:**
  - Any activities intended to influence any US government agency or official or any section of the US public with respect to formulating, adopting, or changing US policies or with respect to the political or public interests or policies of a foreign government or foreign political party

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Foreign Agents Registration Act: Reporting

- File Exhibits A and B for each new foreign principal, including:
  - Description of proposed activities
  - Copies of any written agreements between agent and foreign principal
- File Semiannual Supplemental Statements, including:
  - Detailed description of activities (e.g., date, participants, and brief description of contacts with media, government employees, and other outside organizations)
  - Statement of funds received from or disbursed for foreign principal
- File and label “Informational Materials”

Foreign Agents Registration Act: Nexus to Charities

- 2014: N.Y. Times spotlights foreign government grants to U.S.-based "think tanks" (https://www.nytimes.com/2014/09/07/us/politics/foreign-powers-buy-influence-at-think-tanks.html)
- 2015: DOJ tells foundation receiving foreign government grant that it would not contest exception for "scholastic, academic, scientific pursuits"

  (https://www.justice.gov/nsd-fara/page/file/1038206/download)
- 2020: DOJ tells environmental nonprofit receiving foreign government grant that it was engaged in "political activities" and must register (https://www.justice.gov/nsd-fara/page/file/1287616/download)

Foreign Agents Registration Act: Takeaways for Charities

- Have a playbook for foreign grants – be on the lookout for a nexus to foreign government, foreign political party interests
- Review grant agreement closely, for indicia of FARA-registrable activity
  - Language diminishing nonprofit's autonomy
  - Language suggesting agency between grantor, grantee
  - Language suggesting FARA-defined "political activity"

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Updates

Donations of Cryptocurrency

CCM 202302012

- In new guidance, the IRS confirmed that a qualified appraisal is required for donations of cryptocurrency for which a charitable contribution deduction of more than $5,000 is claimed.
- The “reasonable cause exception” to the appraisal requirement will not apply if the taxpayer determines the value of the donated cryptocurrency based on the value reported by a cryptocurrency exchange, rather than by obtaining an appraisal.
- Third-party services can accept donations of cryptocurrency on your behalf, convert it to dollars, and issue an appraisal with the help of a third-party provider.

Compensation Reporting

IRS Announcement 2021-18

- Revoked Announcement 2001-33, which permitted exempt organizations to report on their Form 990s compensation paid to a management company, rather than compensation paid to individuals providing services on behalf of the management company.
- Now, organizations must follow the instructions on the Form 990.
- Applies for tax years beginning on or after January 1, 2022.