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National Capital Region – Association of Corporate Counsel

ACC NCR Nonprofit Year in Review & 2024 Forecast

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Agenda

- Election year issues
- Key court cases
- Update on Foreign Agents Registration Act
- Application of Corporate Transparency Act to exempt organizations and their affiliates
- Delaware nonstock corporations vs. D.C. not-for-profit corporations
- Regulatory guidance on donor-advised funds

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Election Year Issues

What to Consider in 2024

- Basic restrictions on 501(c)(3) intervention
- Rules affecting 501(c)(4)s making federal independent expenditures
- Restrictions on foreign national activity
- Emerging issues: use of AI

A Refresh on the Basic Rules Governing 501(c)(3) Voter Mobilization Activities

- Two sources of law at federal level: IRS and FEC
- IRS standard: absolute prohibition on intervention
 - See, e.g., Rev. Rul. 2007-41, 2007-1-C.B. 1421
 - “Facts and circumstances” test looks for indicia of bias even in facially neutral activities
- FEC standard: no coordination with candidates, parties
- Common scenarios:
 - Providing registration, voting information
 - Officeholder appearances

Independent Expenditures by 501(c)(4)s, 501(c)(6)s

- Generally permissible after *Citizens United v. FEC*, but with some catches
 - Some source restrictions still apply: e.g., federal contractors, foreign nationals
 - Sponsor must comply with anti-coordination, reporting, disclaimer requirements
- Three big questions
 1. “Major purpose” – will the sponsor become a PAC?
 2. “Primary purpose” – when is exempt status jeopardized?
 3. When must the sponsor disclose its donors? (CREW v. FEC)

Restrictions on Foreign National Activity

- **Broad restrictions under FECA**
 - Applies to federal, state, and local elections
 - Dispute as to ballot initiatives
 - Prohibited activities include contributions, donations, “substantial assistance,” participation in decisions involving election-related activities
- **Disputes in a polarized political environment**
 - From the left: concerns about foreign government election interference
 - From the right: concerns about foreign national funding of U.S.-based nonprofits

Hot-Button Issue: Use of AI

- **Emerging State Restrictions**
 - California, Washington, Minnesota, Texas
- **Specific applications**
 - “Deep fakes”
 - New Hampshire Biden robocall:
<https://www.nbcnews.com/video/listen-fake-biden-robocall-tells-new-hampshire-not-to-vote-in-primary-202609733664>
 - Use of AI to provide voting, registration information

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Key Court Cases

Cases to Watch

- **Buckeye Institute v. IRS (S.D. Ohio)**
 - After *Bonta*, conservative 501(c)(3) challenges Schedule B donor disclosure on First Amendment grounds
- **American Alliance for Equal Rights v. Fearless Fund (11th Cir.)**
 - Plaintiff alleges 501(c)(3)'s use of race to award charitable aid violates Civil Rights Act of 1966
- **Moore v. United States (S. Ct.)**
 - Court weighs application of wealth tax to unrealized gains, with potential impact for philanthropy



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FARA Update

FARA – A Brief Refresher

- Passed in 1938 to compel disclosure on foreign influence operations in the U.S.
- Four main elements to FARA registration:
 - Foreign principal
 - Agency relationship
 - Registrable activities
 - Absence of exemption
- DOJ has boosted FARA enforcement, a trend likely to continue
- Potential impact for nonprofits

Recent FARA Developments

- Notice of proposed rulemaking likely to be published this spring
 - DOJ likely to propose a rollback of 22 U.S.C. § 613(d)(2)'s exemption for “other activities not predominantly serving a foreign interest”
- DOJ increasing staff, audits, letters of inquiry
- DOJ lobbying Congress for legislative changes
 - Repeal of LDA exemption
 - Authority for civil penalties, civil investigative demands



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Corporate Transparency Act – Application to Exempt Organizations

Overview

- The CTA became effective on January 1, 2024.
- Originally enacted as part of the Anti-Money Laundering Act of 2020, together with other legislation aimed at preventing money laundering and terrorism.
- The CTA requires companies to report their beneficial owners, with the intent of cracking down on anonymous shell companies used to facilitate criminal gain and other misconduct.

Overview

- Under the CTA, all new and existing U.S. entities must report their “beneficial owners” to a federal database maintained by FinCEN, unless qualifying under one of 23 exemptions.
 - “Beneficial owners” include individuals who own or control at least 25% of the entity’s ownership interests, or who exercise “substantial control” over the entity, which is very broadly defined under the CTA.
- New entities formed in 2024 have 90 days after formation to report; in future years, entities will have 30 days.
- Entities formed prior to 2024 have until January 1, 2025 to report.
- Any changes to reports filed must be updated within 30 days.

Application to Exempt Organizations

- Tax-exempt organizations are generally exempt from CTA requirements so long as they are:
 - Described in Section 501(c) of the Internal Revenue Code, without regard to Section 508(a) of the Code, and exempt from tax under Section 501(a).
 - e.g. 501(c)(3) public charities and private foundations, 501(c)(6) trade associations, 501(c)(4) social welfare organizations, etc.
 - Political organizations described in Section 527(e)(1) of the Code
 - i.e. a party, committee association, fund, or other organization primarily operated to accept donations and make expenditures for influencing an election for public office
 - Certain non-exempt charitable trusts

Application to Exempt Organizations

501(c)(3) organizations

- There is some disagreement among practitioners about whether the CTA exemption applies before the entity has applied for or received an IRS determination letter of 501(c)(3) status.
 - In our view, a reasonable interpretation of the CTA is that an entity that satisfies the requirements of Section 501(c)(3) is exempt from the CTA regardless of whether it has applied for tax exemption.
 - A more conservative approach may be to file an application for exemption (Form 1023) within the CTA reporting timeframe.
 - FinCEN has not provided guidance on this question.

Application to Exempt Organizations

501(c)(4) and 501(c)(6) organizations

- Tax-exempt organizations that can self-declare their exempt status (i.e. 501(c)(4) social welfare organizations, 501(c)(6) trade associations) should be considered exempt from CTA reporting without further action required.
 - For 501(c)(4) organizations, the CTA exemption is not contingent on the filing of a Form 8976 Notice of Intent to Operate.

Loss of Tax Exemption

- If an organization loses its tax-exempt status, it will still be treated as qualifying under the CTA exemption for a period of 180 days from its loss of exemption. After this period, a CTA reporting obligation may arise.
- It is unclear whether the organization must receive a new determination letter reinstating its exemption within 180 days (which may not be feasible given slow IRS timelines), or merely correct any issues causing the loss of tax exemption.

Affiliates of Tax-Exempt Organizations

- An entity is exempt from CTA reporting if it is **owned or controlled**, directly or indirectly, by one or more tax-exempt entities.
 - “Control” for this purpose is not well defined, and leaves some ambiguity as to how it would be determined.
- A wholly-owned subsidiary of a tax-exempt entity will fall under the above exemption and **will be exempt** from CTA reporting.
- A joint venture between a non-profit and a for-profit entity **may be exempt** from CTA reporting if either:
 - (1) the for-profit partner is also exempt under the CTA (and is not an MSB, Pooled Investment Vehicle, Inactive Entity or Entity Assisting a Tax-Exempt Entity, to whom the “subsidiary exemption” does not extend); or
 - (2) in the relatively rare circumstance where the tax-exempt entity can be said to “entirely control the ownership interest” in the JV (e.g. the non-exempt JV partner has only a profit interest but cannot transfer or otherwise dispose of its ownership interest without approval of the exempt entity)

Entities Assisting a Tax-Exempt Entity

- There is a separate CTA exemption for entities operated exclusively to provide financial assistance to, or hold governance rights over, a tax-exempt entity.
 - Further guidance is needed regarding the use of this exemption.
 - Notably, subsidiaries of such entities are not subject to exemption unless they separately qualify for exemption.



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Delaware Nonstock Corporations vs. D.C. Not- For-Profit Corporations: Pros and Cons

Delaware General Corporation Law

- Delaware has a single statute, the Delaware General Corporation Law (DGCL), that governs both for-profit and nonprofit (nonstock) corporations.
- Because it is a single statute, it is not always the best fit for nonprofit corporations.
 - For example, Delaware corporations must always have members. These can be the directors, if the corporation is not intended to operate as a membership corporation.
 - Delaware allows for as few as one director and one officer; this can simplify formation, but the IRS will want to see at least three directors.

Incorporating in Delaware

Advantages

- Efficient and knowledgeable Secretary of State's office helps ease process of filings and major transactions.
 - No state agency approval needed for formation, amendments, mergers, or other significant transactions.
 - No charitable registration needed with attorney general.

Incorporating in Delaware

Advantages cont.

- Statute is generally flexible and continuously updated.
- Robust body of Delaware case law provides predictability.
- Dedicated forum for dispute resolution (Delaware Court of Chancery).

Incorporating in Delaware

Disadvantages

- Must seek authorization to conduct business and/or register to conduct charitable solicitations in home state.
- Must maintain Delaware registered agent.
- Must pay fees and make annual filings in both Delaware and home state.
- Statute is not specific to nonprofits, and may not always be the best fit or provide necessary guidance on nonprofit-specific matters (e.g. charitable solicitations, property held for charitable purposes, etc.)

D.C. Nonprofit Corporation Act

- The D.C. Nonprofit Corporation Act of 2010 is the governing statute, and is specific to nonprofit corporations. The law substantially takes the form of the third Model Nonprofit Corporation Act.
- Although it is a nonprofit-specific statute, it is based heavily on general corporation law.
 - The Act is very protective of member rights, similar to a for-profit law's protection of shareholders. However, it sometimes may lose sight of the fact that most nonprofits are formed to serve specific purposes rather than the interests of their members.
 - This may be a better fit for 501(c)(6) trade associations or 501(c)(7) social clubs that are more member-focused.

Incorporating in D.C.

Advantages

- An organization conducting D.C.-based policy work may appreciate the optics of incorporation in D.C.
- No requirement to have members, like in Delaware.
- Although the statute isn't perfect, it is easier to understand its application to nonprofit corporations compared with the DGCL.

Incorporating in D.C.

Disadvantages

- The DC Department of Licensing and Consumer Protection (DLCP) is known for being inefficient and difficult to work with.

Key considerations in choice of jurisdiction

- Optics – what will be the purpose and activities of the organization?
- Related entities – is there an affiliated for-profit entity? If so, it may be simplest from an administrative perspective to incorporate and maintain the nonprofit in the same state.
- Administrative burden – Delaware is known for being knowledgeable and expedient; D.C. is known for the opposite.



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Donor-Advised Fund Proposed Regulations

Proposed Regulations

- The first of four expected pieces of guidance regarding donor-advised funds was published on November 13, 2023.
- This was proposed regulations under Section 4966, regarding excise taxes on taxable distributions from a DAF.
- The proposed regulations clarify definitions relevant to DAFs and what distributions may be made from a DAF without being subject to excise taxes.

Definitions

- **DAF**: a fund or account that is (1) **separately identified** by reference to contributions of a donor or donors, (2) **owned and controlled** by a sponsoring organization, and (3) with respect to which at least one donor or donor-advisor has **advisory privileges** with respect to the distribution or investment of funds in the account.
 - “Separately identified” can be determined by a formal record of contributions, or under the facts and circumstances.

Definitions

- **Advisory privileges** exist if:
 - (i) the donor or donor-advisor can provide nonbinding recommendations regarding **distributions or investments**;
 - (ii) there is a written agreement stating that such privileges exist;
 - (iii) a document or marketing material of the sponsoring organization indicates that a donor may provide advice; or
 - (iv) the sponsoring organization generally solicits such advice from a donor or donor-advisor.

Definitions

- **Donor:** any person or entity that makes a contribution to a fund or account of the sponsoring organization.
 - A “donor” does not include public charities or governmental units.

Definitions

- **Donor-advisor:** a person designated by a donor to have advisory privileges regarding the distribution or investment of assets held in a fund. Also includes:
 - (1) an investment advisor who provides advice regarding both the DAF assets and the donor's personal assets;
 - (2) a person who establishes the fund and acts as an advisor, but does not donate;
 - (3) a person recommended by the donor to serve on an advisory committee, unless certain criteria are met.
- This proposed definition is controversial; investment advisors treated as donor-advisors could no longer receive compensation from the DAF.

Taxable Distributions

- Any grant, payment, disbursement, or transfer from a DAF to any natural person, or to any other person if not for a charitable purpose or if the sponsoring organization does not exercise expenditure responsibility.
- The proposed regulations also expand taxable distributions to include “deemed distributions,” which includes any use of DAF assets that results in a more than incidental benefit to a donor, donor-advisor, or related person.

Excise Taxes

- Excise taxes for taxable distributions may be imposed on:
 - The sponsoring organization;
 - A fund manager who knowingly agrees to make a taxable distribution.
 - This includes an investment manager who has been delegated final authority to make investment decisions.
 - Actual knowledge is not necessary, so long as the manager had sufficient facts to determine that it would be a taxable distribution and negligently failed to do so.

Anti-abuse rule

- A planned series of distributions that results in what would otherwise be a taxable distribution if made directly from the DAF may be treated as a single distribution
 - e.g. Donor recommends a distribution from a DAF to a nonprofit; donor then arranges for the nonprofit to make distributions to certain individuals. The original DAF distribution will be treated as a taxable distribution from the sponsoring organization to individuals.

Exceptions

- Scholarship funds
 - Includes scholarship funds established by 501(c)(4) organizations, if six conditions are met:
 1. Sole purpose of fund is to make scholarship grants
 2. 501(c)(4) must nominate members of scholarship selection committee, who will choose the scholarship recipients
 3. Fund serves a charitable class
 4. Recipients selected on nondiscriminatory basis, pursuant to written procedure that is approved in advance by sponsoring organization
 5. No distributions to 501(c)(4) members or selection committee members, or their families
 6. Maintain adequate records

Exceptions

- Disaster relief funds
 - Includes employer-sponsored DRFs as well as non-employment based DRFs
 - Does not include emergency hardship funds
- Funds that grant to a single identified organization
 - Must be a public charity, qualifying supporting organization, or a governmental entity

Further guidance expected

- **Regulations under §4966 regarding donor advised funds, including excise taxes on sponsoring organizations and fund management.**
- Regulations under §4967 regarding prohibited benefits, including excise taxes on donors, donor advisors, related persons, and fund management.
- Regulations under §4958 regarding donor advised funds and supporting organizations.
- Guidance regarding the public-support computation with respect to distributions from donor advised funds.

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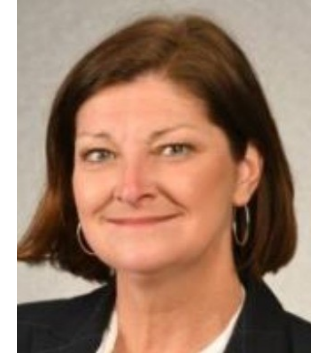


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