



What We Heard in Washington and Recent Speaking Engagements

Members of our practice group recently attended the Georgetown University Law Center conference on “Representing & Managing Tax-Exempt Organizations.” The following bullet points address a few of the items that caught our attention.

- **Governance Issues:** Good governance leads to better tax law compliance and mitigates risk. This was one of the main messages from Sarah Hall Ingram, IRS Commissioner of Tax Exempt entities. While the IRS will not be preparing specific governance policies for organizations to follow, the IRS will be paying particular attention to specific governance issues from new registrants and existing tax-exempt organizations alike, such as the clarity of an organization’s mission statement, the composition of an organization’s board of directors, and the answers addressing an organization’s governance documents/policies on Schedule O of Form 990 (the annual return).

Many voices nationwide, including our own,¹ have been very critical of the IRS’s foray into governance. Nevertheless, the governance initiative is a compliance reality that the sector will have to deal with – as we are beginning to see with the many governance questions being asked in response to applications for approval of Section 501(c)(3) status we have on file with the IRS (Form 1023).

- **Form 990:** Beginning in 2010 those organizations that fail to file their Form 990 for three consecutive years will automatically lose their exempt status effective as of the due date of the annual filing. Beginning in January 2011, the list of revoked organizations will be published on the IRS website. If your organization has failed to file its past three annual Form 990s and loses its tax-exempt status, it will be required to reapply for tax-exempt status (Form 1023); if the application is approved, the organization will be exempt only from the date of the new application. Any income received between the date of revocation and the renewed exemption will be taxable. The law was actually effective in 2007 – hence 2010 is the first year in which non-filers will lose exemption.

It is not that uncommon for nonprofits to fall into the “failure to file” trap,² and it is hard to argue with revocation as the ultimate sanction (there are, in addition, failure to file monetary penalties). However, we would have preferred to have any renewal of exempt status of smaller organizations (re-applying after failing to file for three years) automatically be retroactive to the date it was lost – conditioned on the ability of the organization to demonstrate that it operated in an exempt fashion during the interim period. As it stands, the IRS has the discretion to apply the renewal

¹ The Winter 2010 edition of this report ([The IRS is your Big Brother \(and your Daddy too!!\)](#)) sets forth our critique of the governance initiative. It is available [here](#).

² Readers may be surprised to learn how often the failure to file problem arises. While we have seen it most often with small volunteer managed organizations, we have also encountered the problem with larger organizations with professional paid staff. It can be difficult to convince the IRS to waive monetary failure to file penalties.

retroactively to the date it was lost if it can be demonstrated there was reasonable cause for the failure to file. But the bottom line is, of course, to be sure you file your Form 990!

- **Charitable Spending Initiative:** The IRS will be focusing its attention on tax-exempt organizations with large amounts of fundraising expenses and unrelated business income relative to their exempt program related activities. This initiative is designed to ferret out persons who fraudulently abuse or take advantage of an organization's tax exemption. The classic example is the outside fundraiser who is paid a "fee" equal to a high percentage of the amount it raises – over 90% in the most abusive cases. The IRS argument in these cases is that the fundraiser is duping the contributing public by keeping 90% of what is being "contributed" – while simultaneously abusing the tax exemption of the charity by disguising as a "fee" money contributed for charitable purposes. In the worst cases the fundraisers could actually be behind the creation of the nonprofit that engages them.

In theory, a similar problem could arise in the context of unrelated business taxable income where, for example, the amounts of unrelated income are getting close on a percentage basis to the amount of exempt function income the organization takes in. We have seen unrelated business income cases in which operational anomalies skewed the percentages, making them look more unbalanced than they were. If you are worried about an issue like this in any given year, remember that you can use Schedule O of Form 990 to add a narrative explanation.

- **Political Expenditures:** In its well publicized decision in Citizens United v. Federal Election Commission, the United States Supreme Court held that all corporations (including nonprofit corporations) may make expenditures for independent communications which expressly advocate the election or defeat of a clearly identified candidate for public office. *However, this ruling does not change current law prohibiting Section 501(c)(3) tax-exempt organizations from participating in any political campaign on behalf of or against a candidate for public office.*
- **Speaking Engagements.** Nonprofit Practice Group chairman Jack Horak has two speaking engagements in June of this year on the Uniform Prudent Management of Institutional Funds Act and its effect on financial statement presentation of endowment assets in audited financial statements. The presentations will be before PKF North America in Chicago, and the American Institute of Certified Public Accountants in Washington, D.C. He also will be speaking on the topic of nonprofit mergers and affiliations at the annual meeting of the nonprofit section of the Connecticut Society of Certified Public Accountants. If readers have any interest in these topics please contact us for more information.

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This issue of the Nonprofit Organization Report was written by John M. (Jack) Horak, Chair of the Nonprofit Organizations Practice Group at Reid and Riege, P.C., which handles tax, corporate, fiduciary, financial, employment, and regulatory issues for nonprofit organizations. While this report provides readers with information on recent developments which may affect them, they are urged not to act on this report without consultation with their counsel. For information or additional copies of this newsletter, or to be placed on our mailing list, please contact Carrie L. Samperi at (860) 240-1008 or info@rrlawpc.com, or members of Reid and Riege, P.C., One Financial Plaza, Hartford, CT 06103. For other information regarding Reid and Riege, P.C., please visit our website at www.rrlawpc.com.