



# Philanthropic NEWS

FALL  
2006

TABLE OF  
CONTENTS

IRS 1023  
PROCESSING  
DELAYS  
Page 2

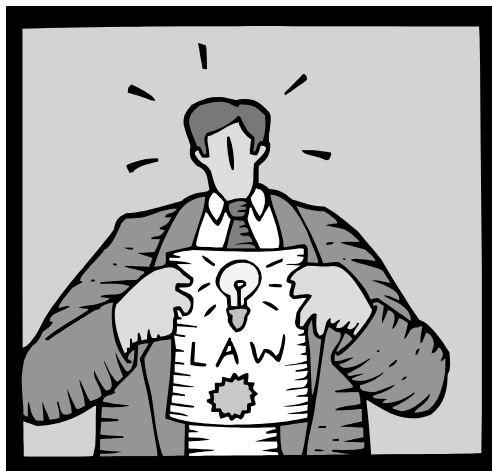
JOINT COST  
ALLOCATIONS  
Page 3

ANTI-TERRORISM  
GUIDELINES  
Page 3

PROFESSIONAL  
FUNDRAISING FEES  
Page 3

2006 NAAG/NASCO  
CONFERENCE  
Page 3

UPCOMING  
SPEAKING  
ENGAGEMENTS  
AND  
ANNOUNCEMENTS  
Page 4



## NEW LAW SUBJECTS DONOR ADVISED FUNDS TO STRICT NEW REGULATIONS

The Pension Protection Act of 2006 (also known as “HR4”) includes a number of provisions that will dramatically affect the way donor advised funds operate in this country.

Prior to the passage of HR4, the term “donor advised funds” was used generically to refer to charitable gifts where the donor retains some formal control over use of the gift. Unlike traditional “restricted gifts,” where the purpose and use of the gift is dictated by the donor at the time the gift is made and the donor thereafter has no involvement in approving specific expenditures, donor advised funds anticipate that the donor will play an active role in selecting recipients of the funds on an ongoing basis. Previously, the main advantage of a donor advised fund was that it allowed the donor to do this without the burdens or scrutiny that would apply if they used a private foundation as a vehicle for grant making. This feature has made these funds increasingly attractive to donors in the

*Continued on page 2, column 1*

## NEW LAW IMPOSES RESTRICTIONS ON SUPPORTING ORGANIZATIONS

The 2006 Pension Protection Act contains numerous provisions affecting supporting organizations. Some of the key provisions are as follows:

- Any grant, loan, compensation payment, or other similar payment from a supporting organization to a substantial contributor (or person related to the substantial contributor) will automatically be treated as an excess benefit transaction, subjecting the substantial contributor to an initial 25% tax on the amount of the payment. A substantial contributor is defined generally as any person who contributed in aggregate more than \$5,000 to the organization if such amount is more than two percent of the total contributions received by the supporting organization. Organization managers who knowingly participated in the making of the payment will be subject to a tax of ten percent of the payment amount.
- All supporting organizations are now required to file an annual information return (Form 990) with the IRS, regardless of the organization’s gross receipts, which must indicate whether it is a Type I, Type II, or Type III supporting organization and must identify its supported organizations. Supporting organizations must certify on the 990 that: (1) the organization is not controlled directly or indirectly by one or more disqualified persons (other than foundation managers and other

*Continued on page 2, column 2*

## DONOR ADVISED FUNDS

*Continued from page 1, column 1*

past 10 years.

The new law fundamentally changes all that by providing the first legal definition of a donor advised fund and imposing strict new rules on the way they operate. In the process, the advantages of a donor advised fund as opposed to a private foundation are dramatically reduced.

The new law defines a donor advised fund as: (1) a fund or account, (2) held by a public charity, (3) over which the donors (or persons designated by the donors) have advisory rights. All three characteristics must be present.

The new law defines a “taxable expenditure” as any payment to an individual, or any payment for an expense that is not directly charitable in nature, such as for general overhead or fund raising consultants (there is an exception for payments to the sponsoring charity for fund raising, administration, overhead and other costs). The fund may make grants to other entities only for directly charitable expenses, and the sponsoring charity must exercise expenditure responsibility (i.e., a higher standard of scrutiny) over grants that are made to any entity that is not a charity or a private foundation.

Virtually all payments from donor advised funds to donors or donor advisors and investment advisors are treated as “excess benefit transactions” and subject to strict penalties. No donor may receive more than an incidental benefit from the fund directly or indirectly. Also, as a general rule, the fund and its donors and donor advisors may not collectively own or control more than 20% of the voting stock of any company or enterprise without incurring penalties that apply to “excess business holdings.”

Penalties for taxable expenditures and excess benefit transactions include fines against the charity and the recipient of 20% of the amount of the prohibited transaction, with fines increasing to 200% of the amount of the improper expenditure if it is not corrected before the IRS gives the charity or the donor notice that they are in violation of the law. Violation of the excess business holdings rules can subject the fund to a tax of 5% of the excess holdings.

If you would like a copy of Perlman & Perlman’s detailed analysis of how the new law affects donor advised funds, please request a copy by email from [allen@perlmanandperlman.com](mailto:allen@perlmanandperlman.com).

## SUPPORTING ORGANIZATIONS

*Continued from page 1, column 2*

than one or more publicly supported organizations); and (2) the majority of the organization’s governing body is comprised of individuals who were selected based on their special knowledge or expertise in the particular field or discipline in which the supporting organization is operating, or because they represent the particular community that is served by the supported public charities.

The Act also imposes a number of specific new requirements on Type III supporting organizations.

- Type III supporting organizations, i.e., those “operated in connection with” one or more publicly supported organizations, as defined in the Treasury Guidelines, now have minimum payout requirements to ensure that a significant amount of the organization’s assets is paid to the supported organizations.
- A Type III supporting organization may not support an organization that is not organized in the United States.
- A Type III supporting organization organized as a trust must establish that it has a close and continuous relationship with the supported organization such that the trust is responsive to the needs or demands of the supported organization in addition to meeting existing legal requirements.

For more information, contact Cliff Perlman at [cliff@perlmanandperlman.com](mailto:cliff@perlmanandperlman.com).

## IRS EXPLAINS DELAY IN PROCESSING 1023s

The IRS announced in September that a backlog of 1023s has increased the time to process applications for tax exemption. The IRS usually responds within 60 days to applications that can be processed immediately based on the information submitted or those that need only minor additional information. However, applications requiring “additional development” (i.e., more complicated questions) are assigned to an Exempt Organization specialist.

The IRS has been receiving a high number of calls from practitioners and organizations about the increased delays, and therefore has begun providing updates on its website on the status of applications requiring additional development. Go to <http://www.irs.gov/charities/index.html> for more information.

## REGULATORS AND WATCHDOGS ARE SCRUTINIZING JOINT COST ALLOCATIONS

This firm has noticed increased scrutiny by state regulators and charity watchdog groups over charities' allocation of joint costs. Many charities that include non-fundraising purposes in their solicitation mailings, such as program or management functions, may allocate joint costs associated with those functions. Any joint cost allocations must be disclosed on the IRS Form 990.

Although the IRS has recognized that allocating joint costs fairly indicates how charities' expenses are used, many charity watchdogs perceive it as a vehicle for disguising fundraising expenses as program costs, and will only give a positive rating to a charity if the portion of the mailing cost allocated to program services is less than a certain percent of the total mailing cost.

Despite regulators' and watchdogs' increased scrutiny of joint cost allocations, many charities remain unfamiliar with the complex requirements for allocating joint costs. If your organization is currently allocating joint costs or is interested in doing so and would like further information, contact Karen Chang at [karen@perlmanandperlman.com](mailto:karen@perlmanandperlman.com).

## TREASURY RELEASES THIRD UPDATED ANTI-TERRORISM FINANCING GUIDELINES

The U.S. Department of Treasury released its third version of the *Anti-Terrorist Financing Guidelines: Voluntary Best Practices for U.S.-Based Charities* ("Updated Guidelines") in September. The Department reorganized sections relating to governance, financial practices and disclosures, and added an Annex describing the government's efforts to safeguard the charitable sector from terrorist abuse.

The Updated Guidelines stress that they are voluntary and that non-adherence to the Guidelines, in and of itself, does not constitute a violation of existing U.S. law. They also recognize that adherence to its recommendations does not guarantee protection from terrorist abuse, but that internal controls incorporating its principles and practices can help prevent such abuse. The Updated Guidelines are available at <http://www.ustreas.gov/offices/enforcement/key-issues/protecting/charities-intro.shtml>.

## REVISIONS TO "PROFESSIONAL FUNDRAISING FEE" DEFINITION ARE PLANNED FOR NEW 990

At the urging of state regulators, the IRS has agreed to expand and modify the instructions relative to the reporting of "professional fundraising fees" on line 30 of the Form 990. Consequently, many third party consultants whose fees were not previously reported as professional fundraising fees may now find their charges listed as such in the 990. An unintended consequence may be that consultants who had not previously thought to register as professional solicitors or fundraising consultants may now be required to do so. The changes will appear next year when the new 990 is issued with instructions.

## 2006 NAAG/NASCO CONFERENCE

The 2006 National Association of Attorneys General-National Association of State Charity Officials (NAAG-NASCO) held its annual Nonprofit Leaders Seminar in Nashville on October 16th. The seminar reviewed key regulatory changes and issues affecting charities today.

The IRS provided a summary of significant recent changes, which include:

- 501(c)(3) organizations must now make unrelated business income tax returns (Forms 990-T) available for public inspection;
- Beginning in 2008, exempt organizations with gross receipts under \$25,000 must file an annual notice; and
- The IRS is working on a protocol for limited information sharing with state charity regulators. Prior restrictions prevented the IRS from sending information about charities to state regulators.

A discussion on corporate accountability included a review of the continuing development of "best practices" for nonprofits and the influence of recent for-profit governance problems on nonprofit boards' conduct.

The keynote speech, given by Steve Gunderson, President of the Council on Foundations, focused on the Council's policy on sanctioning members for misconduct, which is a part of its overall effort to encourage high standards through self-regulation and thereby minimize the need for further state and federal oversight.

Further discussions were provided for in a face-to-face format with regulators on issues involving the application of the Charleston Principles, cause-related marketing, excessive compensation, and the functional definition of fundraising counsel.

## UPCOMING SPEAKING ENGAGEMENTS AND ANNOUNCEMENTS

Seth Perlman participated along with Karin Goldman of the New York Attorney General's Office in a panel discussion on cause marketing issues at the annual National Association of Attorneys General/National Association of State Charity Officials (NAAG/NASCO) conference in Nashville, Tennessee on October 16, 2006. Seth also gave a presentation on charitable solicitation at the Practising Law Institute's CLE entitled "Advising Nonprofit Organizations 2006."

Allen Bromberger presented a paper on hybrid legal structures at a meeting entitled "Social Enterprise, Alternative Business Forms" held at the Aspen Institute on September 29, 2006. Allen spoke about a particular type of structure that he calls a "Charitable LLC" and also about the potential for new types of business forms that would allow charitable and profit making activities to take place within a single entity in ways that are not currently permitted by U.S. law.

Allen Bromberger attended the Social Venture Network meeting in Tucson from October 12-15, 2006. The meeting, called "Pioneering a Just Economy," focused on the growing market for "value-driven" business enterprises that are also financially successful and profitable. Some of the markets in which these businesses are thriving include organic and natural foods, personal care and cosmetics, eco-tourism, alternative energy production and consumption, and environmentally sensitive products and services.

A Publication of:  
**Perlman & Perlman, LLP**  
Attorneys At Law  
41 Madison Avenue  
Suite 4000

New York, NY 10010  
<http://www.perlmanandperlman.com>  
(212) 889-0575  
(212) 743-8120 (fax)

Attorneys:  
Seth Perlman  
Clifford Perlman  
Allen R. Bromberger  
Karen I. Chang  
Catherine Oetgen

Registration Department and Paralegals:

Carol Ilsi  
Joyce Weyant  
Ryan Kominski  
Nicole Jones  
Cynthia Mercado  
Jodi Perlman  
James O'Meara  
Aimee Park  
Imelda Knudsen  
Marsha Forrester  
Roxanne Scher  
Holly Curtis

Philanthropic News is a quarterly publication published by Perlman & Perlman, LLP. The information provided in this publication does not constitute legal advice, and is not intended to substitute for legal counsel. For further information regarding the issues addressed in this publication, please contact us at [info@perlmanandperlman.com](mailto:info@perlmanandperlman.com).

**PHILANTHROPIC NEWS**  
**PERLMAN & PERLMAN, LLP**  
41 Madison Avenue, Suite 4000  
New York, NY 10010