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Philanthropic NEWS

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SUSPECT DONOR-ADVISED FUND IS DENIED TAX-EXEMPTION

The U.S. Court of Federal Claims recently affirmed the IRS's determination that a nonprofit corporation that advertises that donors can "warehouse wealth" in donor-advised funds and pay themselves "administrative expenses" does not qualify for tax exemption.

The New Dynamics Foundation, formed in 1996 as a spin-off of the National Heritage Foundation, administered a donor advised fund program that charged a $2,500 set-up fee and a 0.625 percent quarterly management fee. The Foundation advertised that the donor and his family could pay themselves administrative expenses from the donor advised fund, including travel expenses, meeting costs and consultant's fees. Robert Henkell, the Foundation's founder, was quoted as suggesting that up to 95% of the funds could be used for these administration expenses.

The Foundation's marketing materials stated that the donor advised funds can be used as a "very powerful long range planning device to establish, tax-free, a nest

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CONGRESSIONAL COMMITTEE ON TAXATION RELEASES NEW REPORT

The Joint Committee on Taxation of the U.S. Congress has released a report calling for changes in tax laws that apply to charities. The report is scheduled to be reviewed by the Senate Finance Committee this summer. The following five proposals are of particular significance to charities.

Proposal One applies to organizations that don't file 990's: Tax exempt organizations that are not required to file Form 990 because their gross receipts are normally under $25,000 would have to submit a Notice to the IRS each year that includes evidence of the organization's continuing basis for its exemption from filing Form 990. Failure to provide the information would result in revocation of the organization's tax-exemption. There is a "reasonable cause" exception, but it must be approved by the IRS. The proposal also requires that each Notice be made available to the public under the same rules that apply to Form 990.

Proposal Two applies to charities that fail to file Form 990 for 3 consecutive years: Failure to file Form 990 for three consecutive years by any organization that is required to file will result in revocation of the organization's tax exempt status.

Proposal Three applies to charities that provide estimated values for donated property: Present law requires taxpayers to obtain a qualified appraisal for donated property with a value of more than $5,000, and to attach an appraisal summary to the tax return. Misstatements of value can

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IRS DENIES TAX-EXEMPTION

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egg that can provide retirement benefits" and a place to "warehouse income for long range planning and wealth accumulation."

The Court stated that distributions from the funds "bore the distinct mark of personal expenditures" and that the Foundation was not "operated exclusively for exempt purposes." The efforts to "warehouse wealth" and provide an alternative to other retirement plans were obviously for the personal benefit of the donors. Personal expenses paid out included scholarships to children of donors. In one case, a donor purchased a $147,000 motor home using funds contributed to a donor-advised fund and in his travels occasionally provided medical services to needy individuals. The court determined that the organization "failed to operate exclusively for exempt purposes."

Many donor-advised funds are appropriately being administered by community foundations and other charities. The Court's decision establishes certain boundaries that are necessary to minimize abuse of donor-advised funds.

For more information, contact Cliff Perlman at cliff@perlmanandperlman.com.

CFC REVOKES UNIQUE EIN REQUIREMENT

On June 12, 2006, the federal Office of Personnel Management (OPM) issued CFC Memorandum 2006-15, which stated that the application and eligibility process for the 2006 Combined Federal Campaign (CFC) will not be changed to require each participating charity to have a unique Employment Identification Number (EIN), as would have been required according to two earlier published CFC Memoranda.

Prior CFC Memoranda stated that a new rule would be imposed as part of its effort to assign unique codes for all charities participating in CFC, requiring each charity participating in either local or national campaigns to have a unique EIN. This rule would have had a significant impact on national organizations that have local chapters that participate in local CFC campaigns across the country. Many of these local chapters are exempt under a group 501(c)(3) ruling, but do not have their own unique EIN. The OPM was advised by a number of stakeholders that that the requirement would cause "operational and accounting problems" that it had not anticipated.

RECENTLY ENACTED STATE BILLS

Illinois House Bill 4315, adopted on May 9, 2006, amends the Solicitation for Charity Act by broadening the definition of "professional fundraiser" to include any person who, for compensation, receives or collects contributions, in addition to soliciting contributions. The bill also adds detailed schedules along with the required financial report of professional fundraisers whose campaign involves the collection or resale of automobiles, motorcycles, other motor vehicles, or water crafts in the state. This bill becomes effective January 1, 2007.

Hawaii has adopted a new bill, effective June 5, 2006, which makes the following changes to the Solicitation of Funds for Charitable Purposes Act:

- requires professional solicitors to make certain disclosures to donors;
- amends the definition of "contribution" to include a subsidy from any 501(c)(3) organization;
- amends the definitions of professional fund-raising counsel and professional solicitors; and
- allows the attorney general to suspend or revoke any registration where the registrant has failed to file, or filed an incomplete financial report as required.

New Jersey has adopted a new bill, effective July 9, 2006, which makes significant changes to the Charitable Registration and Investigation Act affecting charities, professional fundraisers, fund raising counsels, and commercial co-venturers. The following summarizes the most important changes:

- expressly includes within the scope of the law all assignees, subcontractors and independent contractors of fund raising counsels, independent paid fundraisers and commercial co-venturers;
- increases the threshold amounts a charity must raise before it is required to register or file financial statements;
- requires that all relationships between charities and fundraising counsels or independent paid fundraisers must be in written contracts;
- requires fund raising counsels and independent paid fundraisers to disclose in their contracts the fixed fee or rate at which they will be compensated;
- requires independent paid fundraisers to register the individual solicitors they control;

- requires commercial co-venturers to certify the amount of funds raised during a charitable sales promotion, and make certain disclosures in their promotional materials;

- permits the state to bring an action against an entity required to be registered based upon proof of criminal convictions or findings of violations of charitable solicitation laws involving theft, fraud, or deceptive business practices in other jurisdictions committed by the entity, or its officers, directors or principal employees;

- modifies the disclosure statement that must be printed on every written charitable solicitation; and

- prohibits anyone soliciting contributions from blocking the caller identification information when calling anyone in the state.

Please note that disclosures in charitable solicitation materials prepared by charities and professional fundraisers should be updated to conform with these new laws. Perlman & Perlman's updated disclosure summaries and sample disclosure paragraphs can be downloaded at http://www.perlmanandperlman.com.

For questions regarding the new laws, contact Karen Chang at Karen@perlmanandperlman.com.

PENDING STATE LEGISLATION

New York Assembly Bill 9061 and Senate Bill 4745-C would require the full-time, salaried employees of charitable organizations, whose primary responsibilities are fund raising, professional fundraisers and professional solicitors, to complete an acceptable course of instruction in the law and ethics of fundraising and philanthropy, and would provide for a one-time reimbursement of a portion of the registration fee. Both bills were amended in June and remain under committee review.

District of Columbia Legislative Bill 759 would provide additional measures to facilitate investigation of possible violations of laws governing nonprofit corporations and charitable solicitations. The bill would expressly authorize alternatives to corporate dissolution when nonprofit corporations act contrary to their nonprofit purposes (e.g., placing the corporation in receivership, and imposing a constructive trust on compensation paid to directors, officers or managers, or grant other equitable relief). The bill would also statutorily subject nonprofit corporations to the Consumer Protection Procedures Act. This bill was introduced on May 4, 2006.

JOINT COMMITTEE ON TAXATION

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result in substantial financial penalties. Under the proposal, a penalty is imposed on a person – including a charity -- who: (1) aids or assists in or advises with respect to a tax return or other document; (2) knows (or has reason to believe) that such document will be used in connection with a material tax matter; and (3) knows that this would result in an understatement of tax of another person. In general, the amount of the penalty is $1,000. If the document relates to the tax return of a corporation, the amount of the penalty is $10,000.

Proposal Four doubles the excise taxes that charities must pay in certain circumstances: Excise taxes imposed on public charities and private foundations—and their managers -- for self-dealing, excess benefit transactions, political and lobbying expenditures, failure to distribute income, excess business holdings, jeopardizing investments, and taxable expenditures would double under the proposal.

Proposal Five would permit the IRS to provide greater information to state officials: Current law restricts the kinds of information that the IRS may provide to state officials. The proposal would expand the kinds of information that the IRS may disclose, and would require the IRS to disclose much of the information currently restricted upon written request by a state official. State regulators have long sought these changes.

For more information, contact Allen Bromberger at allen@perlmanandperlman.com.

CHARITY WINS JUDGMENT AGAINST GROUP WITH SIMILAR TRADE NAME

A charity represented by this firm recently obtained a judgment in federal court against an organization with a similar name involving a testamentary gift mistakenly sent to the other organization. Unfortunately, this type of problem has become a more common occurrence.

It is becoming increasingly important that charities make every effort to protect the trade names, words, phrases and logos that they use in communicating with the public.

Please contact Cliff Perlman or Karen Chang at 212-889-0575 if you want to find out how to better protect your important intellectual property assets.

UPCOMING SPEAKING ENGAGMENTS AND ANNOUNCEMENTS

Perlman & Perlman is proud to announce that its Arizona office is moving into new office space this summer. The new Arizona address is:

1855 West Baseline Road, Suite 160
Mesa, AZ 85202-9000
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Seth Perlman will be speaking on commercial co-ventures at the National Association of Attorney Generals/ National Association of State Charity Officials (NAAG/ NASCO) annual conference on October 16, 2006 in Nashville, Tennessee. He will also be giving a presentation on charitable solicitation law at the Practicing Law Institute's continuing legal education program, "Advising Nonprofit Organizations," in New York City on October 18, 2006.

Seth Perlman and Karen Chang have written a two-part article entitled, "Fundraising in Cyberspace: The Current State of the Law of Internet Fundraising and Revenue Generation" which was published in the June and July editions of the **Nonprofit Times**.

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