## **CONTENTS**

Preface to the Second Edition	xxv
Acknowledgments	xxix
1. INTRODUCTION TO THE LAW OF CHARITABLE ORGANIZATIONS	1
I. WHAT IS THE NONPROFIT SECTOR?  A. A Definition B. An Introduction to the Terminology C. Scope of the Sector Today: A Few Statistics 1. Number of Tax-Exempt Organizations 2. Information Forms Filed and Examined 3. Classification of Tax-Exempt Organizations 4. Employment in the Nonprofit Sector 5. Charitable Contributions Notes and Questions D. Historical Background	1 1 2 4 5 5 6 6 7 9
II. RATIONALES FOR THE NONPROFIT SECTOR  A. Economic Theory B. Political Theory C. Sociological Theory Notes	13 13 14 15 16
III. THE LIFE CYCLE OF A §501(C)(3) ORGANIZATION  IV. ANATOMY OF A NONPROFIT CASE  • Big Mama Rag, Inc. v. United States  Problem	16 18 18 27
UNIT I. STARTING THE NONPROFIT ORGANIZATION	29
2. STARTING THE ORGANIZATION AT THE STATE LEVEL I. INTRODUCTION	<i>31</i> 31
II. IS A NEW ORGANIZATION ADVISABLE?	32

III. CONSIDERATIONS OF FORM DURING THE	
STARTUP PHASE	33
A. Nonprofit or For-Profit Social Enterprise?	35
B. To Incorporate or Not?	39
C. Public Benefit or Mutual Benefit?	41
D. Membership or Nonmembership Organization?	42
E. Variations Among State Nonprofit Corporations Statutes	43
Note	44
IV. LEGITIMATE PURPOSES OF NONPROFIT	
CORPORATIONS	44
State v. Brown	44
• Association for the Preservation of Freedom of	
Choice, Inc. v. Shapiro	46
In re Sidney Gelb Chapter for Cancer Research	49
People v. Sinai Temple	50
Summary of Statutes	52
Note on Purposes of Nonprofit Corporations	53
Questions	53
	54
V. ARTICLES OF INCORPORATION	54 56
Queen of Angels Hospital v. Younger  Sample Articles of Incomparation	59
Sample Articles of Incorporation Note	59 61
	01
VI. ADDITIONAL CONSIDERATIONS IN STARTING A	
NONPROFIT	61
Problem	62
Drafting Problem: Forming the Nonprofit Corporation	62
3. THE BOARD OF DIRECTORS AND THE GOVERNANCE	
ROLE	63
I. INTRODUCTION	63
II. GENERAL CONCEPTS OF GOVERNANCE	64
A. What Is Nonprofit Governance?	64
B. Bylaws	65
American Center for Education, Inc. v. Cavnar	66
Sample Bylaws	73
Drafting Problem	77
C. Policies	78
Notes and Questions	80
III. FIDUCIARY DUTIES OF THE BOARD OF DIRECTORS	<b>82</b> 83
A. Fiduciary Duties of Care and Loyalty	03

<ul> <li>Model Nonprofit Corporation Act, 3d Ed. (2008), §§8.30, 8.32, 8.60, and 8.70</li> <li>Stern v. Lucy Webb Hayes National Training School for Deaconesses</li> <li>In re Lemington Home for the Aged</li> <li>B. Fiduciary Duty of Obedience</li> <li>Manhattan Eye, Ear, and Throat Hospital v. Spitzer</li> <li>C. Uniform Prudent Management of Investment Funds Act (UPMIFA)</li> <li>D. Fiduciary Duties to Others</li> <li>In re Milton Hershey Sch. Trust (Appeal of Milton</li> </ul>	83 85 90 95 95 98 100
Hershey School) Notes and Questions	100 105
<ul> <li>IV. CASE STUDIES</li> <li>A. The Smithsonian Institution</li> <li>Independent Review Committee, A Report to the Board of Regents of the Smithsonian Institution (June 18, 2007)</li> </ul>	106 106
Questions	110
<ul> <li>B. Central Asia Institute</li> <li>Office of Consumer Protection, Montana Attorney</li> <li>General's Investigative Report of Greg Mortenson</li> </ul>	111
(April 5, 2012)	111
Questions	114
C. The Donald J. Trump Foundation	114
<ul> <li>New York v. Trump, Verified Petition</li> <li>Problem</li> </ul>	114 117
4. TAX-EXEMPT PURPOSES OF §501(c)(3) ORGANIZATIONS	119
I. INTRODUCTION	119
<ul> <li>II. RATIONALES FOR CHARITABLE TAX EXEMPTION</li> <li>A. Subsidy Theory</li> <li>B. Income Definition Theory</li> <li>C. Capital Formation Analog</li> <li>D. Donative Theory</li> <li>• Walz v. Tax Commission of City of New York</li> <li>Notes and Questions</li> </ul>	120 121 121 122 122 122 127
III. INTRODUCTION TO SECTION 501(c)(3)	129
A. An Introduction to the Statute and Its Regulations	129
<ul> <li>Internal Revenue Code §501</li> </ul>	129
• Treasury Regulations §501(c)(3)-(2)	129
B. Organizational and Operational Tests	130

IV. "CHARITABLE" AND THE PUBLIC POLICY	
LIMITATION  Delta Longo Hairragita and Haita de States	131 133
<ul> <li>Bob Jones University v. United States</li> <li>Notes and Questions</li> </ul>	143
· ·	
V. SECTION 501(c)(3) PURPOSES: HEALTH CARE	145
<ul><li>A. Health Care as a Charitable Purpose</li><li>IHC Health Plans, Inc. v. Comm'r of Internal</li></ul>	146
Revenue	146
Internal Revenue Code §501(r)	154
B. State Pressures on Tax-Exempt Hospitals	155
C. Public Policy Concerns	158
Statement of John Colombo, Testimony Before the	
Full Committee of the House Committee on Ways	1.50
<ul><li>and Means</li><li>Jill R. Horowitz, Testimony Before the Committee</li></ul>	158
of the House Committee on Ways and Means	161
Notes and Questions	164
VI. SECTION 501(c)(3) PURPOSES: DISASTER RELIEF	166
<ul> <li>Internal Revenue Service, Disaster Relief, Providing Assistance Through Charitable Organizations</li> <li>Notes and Questions</li> </ul>	167 171
VII. SECTION 501(c)(3) PURPOSES: THE CONCEPT OF "CHARITABLE" Problems	1 <b>72</b> 173
VIII. SECTION 501(c)(3) PURPOSES: EDUCATIONAL	
ORGANIZATIONS	174
<ul> <li>American Campaign Academy v. Comm'r</li> </ul>	174
• Treasury Regulations §1.501(c)(3)-1(d)(3)	181
The Nationalist Movement v. Comm'r	182
Notes and Questions	191
IX. SECTION 501(c)(3) PURPOSES: RELIGIOUS	400
ORGANIZATIONS	193
<ul><li>Holy Spirit Association v. Tax Commission</li><li>Church of the Chosen People v. United States</li></ul>	194 198
<ul> <li>Foundation of Human Understanding v. United</li> </ul>	170
States States	202
Notes and Questions	206
X. OTHER SECTION 501(c)(3) PURPOSES	208
XI. STATE AND LOCAL CHARITABLE TAX	
EXEMPTIONS	209

<ul><li>A. State Income Tax</li><li>B. Sales and Use Taxes</li><li>C. Property Taxes and Pilots</li><li>1. Rationales for Property Tax Exemptions</li></ul>	210 210 210 211
<ul><li>2. Case Law Development</li><li>3. PILOTs (and SILOTs)</li></ul>	212 213
XII. APPLICATION FOR RECOGNITION OF SECTION 501(c)(3) STATUS  Problem: Completing Form 1023	<b>214</b> 216
UNIT II. RAISING MONEY	219
5. CHARITABLE SOLICITATIONS	221
I. INTRODUCTION	221
II. STATE LAW REQUIREMENTS  A. Charitable Registration Laws and Enforcement Difficulties B. Cause-Related Marketing Notes and Questions	223 223 225 226
<ul> <li>III. CHARITABLE SOLICITATION IN THE DIGITAL AGE</li> <li>The Charleston Principles: Guidelines on Charitable Solicitations Using the Internet</li> <li>Notes and Questions</li> </ul>	228 229 231
<ul> <li>IV. CONSTITUTIONAL ISSUES</li> <li>Village of Shaumburg v. Telemarketing Associates,</li> </ul>	231
Inc.	231
<ul> <li>Madigan v. Telemarketing Associates, Inc.</li> <li>Notes and Questions</li> </ul>	237 243
6. CHARITABLE CONTRIBUTIONS	245
I. POLICIES BEHIND THE CHARITABLE	
CONTRIBUTION DEDUCTION	245
A. How the Deduction Works	246
B. Why the Charitable Deduction Exists	247
C. Who Makes These Charitable Donations?	248
Benjamin Priday, Rich Folks Aren't That Stingy     After All	249
D. Is the Charitable Deduction Fair Policy?	252
E. Are There Better Ways to Incentivize Charitable Giving? Notes and Questions	253 254

Contents | xv

II. A BRIEF OVERVIEW OF FUNDAMENTAL	1
CHARITABLE DEDUCTION ISSUES A. §170(a)(1)(C)	2
Internal Revenue Code §170. Charitable, Etc.,     Contributions and Gifts     Notes and Questions     B. Other Issues Regarding Charitable Contributions	2 2 2 2
III. WHAT IS A CHARITABLE GIFT?	2
<ul> <li>United States v. American Bar Endowment</li> <li>Hernandez v. Commissioner of Internal Revenue</li> <li>Notes and Questions</li> <li>Problem</li> </ul>	2 2 2 2 2
<ul> <li>IV. USE OF FUNDS CONTRARY TO DONOR INTENT         <ul> <li>Tennessee Division of the United Daughters of the Confederacy v. Vanderbilt University</li> <li>Notes and Questions</li> <li>A Problem Based on Howard v. Administrators of the Tulane Educational Fund</li> </ul> </li> </ul>	2 2 2 2
7. PRIVATE FOUNDATIONS AND THEIR ALTERNATIVES I. INTRODUCTION	2
	2
II. HISTORY BEHIND THE CREATION OF THE PRIVATE FOUNDATION RULES	2
<ul> <li>III. OVERVIEW OF FEDERAL TAX TREATMENT OF PRIVATE FOUNDATIONS</li> <li>A. Special rules for Private Nonoperating Foundations, and Some Problems <ol> <li>Excise Tax on Investment Income (§4940)</li> <li>Self-Dealing (§4941)</li> <li>Minimum Distribution Requirements (§4942)</li> <li>Excess Business Holdings (§4943)</li> <li>Jeopardizing Investments (§4944)</li> <li>Taxable Expenditures (§4945)</li> <li>Charitable Contribution Deduction Rules (§170)</li> <li>Required Restrictions in a Foundation's Founding Documents (§508)</li> <li>Terminating a Private Foundation (§4507)</li> <li>Abuses</li> <li>Rick Cohen, Time to Stop Excusing the</li> </ol> </li></ul>	2 2 2 2 2 2 2 2 2 2 2 2 2 2 2 2 2 2 2
Inexcusable: Foundation Trustees Who Play by Their Own Rules	2
B. Private Operating Foundations and a Problem	3

	Problem Notes and Questions	303 304
IV.	PUBLIC POLICY CONSIDERATIONS WITH REGARD TO PRIVATE FOUNDATIONS	306
V.	DISTINCTION BETWEEN PUBLIC CHARITY AND PRIVATE FOUNDATION	309
	<ul> <li>A. Statutes Concerning Private Foundation/Public Charity</li> <li>Distinction</li> <li>Internal Revenue Code §509(A) Private Foundation</li> </ul>	310
	Defined	310
	<ul> <li>Internal Revenue Code §170(B)(1)-A</li> </ul>	311
	B. Summary of §509(a)(1) and §509(a)(2) Tests	312
	1. §509(a)(1) Traditional Charities	312
	<ul><li>2. §509(a)(2) Gross Receipts Charities</li><li>C. Discussion and Examples of §509(a)(1) Traditional Public</li></ul>	313
	Charities	313
	1. Inherently Public Organizations	313
	2. Testing Period	314
	3. Mechanical Test	315
	4. Facts and Circumstances Test	318
	D. Discussion and Examples of §509(a)(2) Gross Receipts	210
	Charities	319 320
	<ol> <li>Positive Support Test</li> <li>Negative Investment Income Test</li> </ol>	321
	3. Calculating the Positive Support Test	321
	4. Calculating the Negative Investment Income Test	322
	Notes and Questions	323
VI.	ALTERNATIVES TO FOUNDATIONS	323
	A. Introduction to Supporting Organizations	324
	1. Tests All SOs Must Meet	326
	2. Type I SOs	326
	3. Type II SOs	328
	4. Type III SOs Note	330
	Problem	333 333
	B. Donor-Advised Funds and Sponsoring Organizations	334
	1. Donor-Advised Funds	334
	2. Sponsoring Organizations	338
	3. Donor-Advised Funds in Action	340
	Alan Cantor, Strings on Donor-Advised Funds Are	2.0
	Making Charity Supporters Angry	345
	Notes and Questions	342

C. Policy Issues Remaining with Supporting Organizations and	
Donor-Advised Funds	342
D. Comparing the Options	344
Problem	346
Notes and Questions	346
8. RAISING FUNDS FROM COMMERCIAL ACTIVITIES	349
I. INTRODUCTION	351
II. SECTION 501(c)(3) CONSIDERATIONS ABOUT	
COMMERCIAL ACTIVITY	351
A. Statutes and Regulations	351
• Internal Revenue Code §501(c)(3)	351
• Treasury Regulations §501(c)(3)-1(c)(1)	352
• Treasury Regulations §501(c)(3)-1(E)	352
B. Is the Activity So Commercial There Is No Exempt Purpose?	352
• Zagfly, Inc. v. Commissioner of Internal Revenue	352
C. Commerciality Doctrine	353
Better Business Bureau of Washington, D.C., Inc. v.	
United States	353
• Presbyterian and Reformed Publishing Co. v.	
Commissioner of Revenue	356
Airlie Foundation v. IRS	363
D. Commensurate in Scope Doctrine	369
• Rev. Rule. 64-182, 19640-2, C.B. 186-187	369
• IRS Gen. Couns. Mem. 34682 (Nov. 17, 1971) Notes and Questions	369 370
III. UNRELATED BUSINESS INCOME	373
<ul><li>A. UBIT Statutes</li><li>Internal Revenue Code §511 Imposition of Tax on</li></ul>	374
Unrelated Business Income of Charitable, Etc.,	
Organizations	374
Internal Revenue Code §512	375
• Internal Revenue Code §513. Unrelated Trade or	0,0
Business	376
B. Trade or Business	378
<ul> <li>United States v. American Bar Endowment</li> </ul>	378
C. Regularly Carried On	382
• National Collegiate Athletic Ass'n v. Comm'r of	
Internal Revenue	382
D. Substantially Related to Charitable Purpose	388
United States v. American College of Physicians     Property 1072 1 CP 2044	388
• Revenue Ruling 73-105, 1973-1 C.B. 264	393

E. Exceptions and Modifications	394
1. Rental and Royalty Payments	395
• Sierra Club, Inc. v. Commissioner	395
2. IRC §513(i): Corporate Sponsorship Payments	399
Notes and Questions	401
Problem	404
UNIT III. ISSUES WHILE RUNNING THE ORGANIZATION	405
9. INUREMENT, PRIVATE BENEFIT, AND EXCESS BENEFIT TRANSACTIONS	407
I. INTRODUCTION	407
II. INUREMENT	408
Internal Revenue Code §501(c)(3)	408 409
<ul> <li>Treasury Regulations §§1.501(a)-1(c) and</li> </ul>	409
1.501(c)(3)-1(c)(2)	409
• United Cancer Council, Inc. v. Comm'r	409
Church of Scientology of California v. Comm'r	416
Notes	423
III. PRIVATE BENEFIT	424
• Treasury Regulations §1.501(c)(3)-1(D)(1)(II)-(III)	424
American Campaign Academy v. Comm'r	426
Notes	427
IV. INTERMEDIATE SANCTIONS AND EXCESS BENEFIT	
TRANSACTION	428
<ul> <li>Internal Revenue Code §4958</li> </ul>	429
• Steven Miller, Easier Compliance Is Goal of New	
Intermediate Sanction Regulations	431
• Internal Revenue Service, TE/GE Technical Advice	
Memorandum 200243057 (2002)	441
V. RELATIONSHIP BETWEEN INUREMENT AND	
INTERMEDIATE SANCTIONS	447
• Treasury Regulations §1.501(c)(3)-1(F)(2)	447
Notes and Questions	448
VI. ISSUES REGARDING NONPROFIT COMPENSATION Problem: Applying Inurement, Private Benefit, and Excess	451
Benefit Concepts	453
10. COMPLEX COMMERCIAL TRANSACTIONS	455
I. INTRODUCTION	455

Contents | xix

II. SUBSIDIARIES OF §501(c)(3) TAX-EXEMPT	
ORGANIZATIONS	456
A. Why Subsidiaries Exist and How They Work	456
B. Choice of Entity for the Subsidiary	458
1. The Subsidiary is Organized as a §501(c)(3)	459
2. The Integral-Part Doctrine	459
• IHC Health Plans, Inc. v. Comm'r	
	459
3. LLCs	462
C. Is the Subsidiary a Separate Organization?	463
• Network for Good v. United Way of the Bay Area,	4.63
Findings of Fact and Conclusions of Law	463
D. Potential Inurement Issues	466
Technical Advice Memorandum 200437040  E. H. L.	466
E. Unrelated Business Income Issues	469
1. Typical UBIT Issues with Subsidiaries	469
• Priv. Ltr. Rul. 201503018	469
2. Special Circumstances with Controlled Organizations:	470
§512(b)(13)	472
Notes and Questions	472
III. JOINT VENTURES	473
A. Background	473
B. Whole Hospital Joint Ventures	477
• St. David's Health Care System v. United States of	
America	477
C. Ancillary Joint Ventures	485
• Revenue Ruling 2004-51, 2004-22 I.R.B.	485
Notes and Questions	489
IV. SOCIAL ENTERPRISE REVISITED	491
Notes and Questions	495
Problems	496
11001011	., 0
11. LOBBYING AND POLITICAL CAMPAIGN ACTIVITIES	499
I. INTRODUCTION	500
II. LOBBYING	501
A. Constitutionality of Lobbying Restrictions	501
• Christian Echoes National Ministry, Inc. v. United	
States	501
• Regan v. Taxation With Representation of	
Washington	505
Notes and Questions	511
B. No Substantial Part Test	511
• IRC §501(c)(3)	511

• Treasury Regulations §1.501(c)(3)-1(c)(3)	
• IRC §504. Status After Organization Ceases to	512
Qualify for Exemption Under Section 501(c)(3) [26	
USCS §501(c)(3)] Because of Substantial Lobbying or Because of Political Activities	512
• IRC §4912. Tax on Disqualifying Lobbying	312
Expenditures of Certain Organizations	513
<ul> <li>Christian Echoes National Ministry, Inc. v. United</li> </ul>	313
States	514
Note: Thoughts on the "Substantial Part" Test	516
C. §501(h) Expenditure Test	518
1. The Elements of the Test	518
• IRC §501(h). Expenditures by Public Charities to	
Influence Legislation	520
• IRC §4911. Tax on Excess Expenditures to	
Influence Legislation	521
• Treasury Regulations §1.501(h)-3(b)	524
2. Example: How to Calculate Excess Lobbying Under	
§501(h)	524
Problems	526
III. POLITICAL CAMPAIGN ACTIVITY	527
• IRC §501(c)(3)	528
• Treasury Regulation §1.501(c)(3)-1(c)(3)(iii)	528
• IRC §4955. Taxes on Political Expenditures of	
Section 501(c)(3) Organizations	529
• Revenue Ruling 2007-41. Exempt Organizations;	
Political Campaigns	530
<ul> <li>Branch Ministries, Inc. v. Rossotti</li> </ul>	538
Notes and Questions	544
Problems	546
IV. OTHER TAX-EXEMPT ORGANIZATIONS THAT	
ENGAGE IN POLITICAL ACTIVITY	547
A. Noncharitable Tax-Exempt Organizations That Can Engage	
in Political Activity	548
1. Section 501(c) Organizations, Particularly §501(c)(4)	548
2. §527 Organizations	550
3. PACs and Super PACs	551
B. Tax and Policy Issues	553
1. Determining the Primary Purpose of a §501(c)(4)	553
Gregory Colvin, Treasury/IRS Regulations on  Political Activity: A Much Needed and	
Political Activity: A Much-Needed and Constructive Process. Testimony to Senate	553
Constitutive process, resultions to Senate	223

Judiciary Subcommittee on Oversight, Agency	
Action, Federal Rights, and Federal Courts	
2. Do Large Amounts of "Dark Money" Allow Secretive	
Donors to Buy Elections?	556
3. Can and Should the IRS Enforce Election Rules?	559
C. The State Law Response	560
D. The Effect of This Activity on §501(c)(3)s	561
Notes and Questions	563
12. ACCOUNTABILITY	565
I. WHAT IS "NONPROFIT ACCOUNTABILITY"?	565
Notes and Questions	567
II. FEDERAL ACCOUNTABILITY RULES	568
A. The Form 990 Information Return	569
• Tax Exempt and Government Entities, Advisory	
Committee on Tax-Exempt and Government	
Entities (ACT), 2015 Report of Recommendations	
(June 2015)	570
• Elizabeth Schmidt, Nonprofit Board Members—	
Don't Let the New Form 990 Catch You Flat-Footed	574
Notes and Questions	576
B. The IRS's Review Process	578
Notes and Questions	579
III. STATE ACCOUNTABILITY MEASURES	581
A. The Attorney General's Role	581
Marion Fremont-Smith, Attorney General	201
Oversight of Charities	581
B. Enforcement of Directors' Duties	582
Stern v. Lucy Webb Hayes National Training	
School for Deaconesses	583
• Model Nonprofit Corporation Act, 3d Ed. (2008),	
§§8.33, 8.51, 8.52, AND 8.57	585
<ul> <li>California Corporations Code §5142</li> </ul>	586
<ul> <li>In re Milton Hershey School</li> </ul>	587
Notes and Questions	590
C. Concerns Among State Charity Regulators	591
Notes and Questions	593
IV. SELF-REGULATION AS A FORM OF	
ACCOUNTABILITY	593
A. Umbrella Groups	594
B. Charity Information Websites	594
C. The Nonprofit's Own Board	595
D. Impact Assessment and Performance Measurement	596

	Contents   xxiii
Form 990 Exercise	597
UNIT IV. ENDING THE ORGANIZATION	603
13. ENDING THE ORGANIZATION: DISSOLUTION, ME AND CONVERSION	RGER, 605
I. INTRODUCTION	605
<ul> <li>II. CY PRES AND DEVIATION</li> <li>United States v. Cerio</li> <li>In re The Barnes Foundation</li> <li>Notes and Questions</li> </ul>	<b>606</b> 607 612 614
III. BANKRUPTCY PROTECTION  A. City of Detroit's Institute of Arts B. Bankruptcy Protection for Catholic Dioceses C. August Wilson Center	<b>615 616</b> 616 616
<ul> <li>IV. DISSOLUTION</li> <li>Treasury Regulations §1.501(c)(3)-1(b)(4)</li> <li>Model Nonprofit Corporation Act, 3d Ed. (2)</li> </ul>	616 619 (008) 619

Shorter College v. Baptist Convention of Georgia

Organization of New York, Inc.

David La Piana's First Merger

VI. CONVERSION TO FOR-PROFIT ORGANIZATIONS

B. Considering Previous Cases as Conversion Cases

1. Queen of Angels Hospital v. Younger

2. Caracci v. Commissioner

Notes and Questions

Model Nonprofit Corporation Act, 3d Ed.

Model Nonprofit Corporation Act, 3d Ed.

New York v. Trump

Notes and Questions

Notes and Questions

V. MERGER

A. Introduction

Problem

Table of Cases

Index

Table of Statutes

In re Matter of Multiple Sclerosis Service

622

626

634

636

637

637

640

642

641

641

644

646

646

648

649

651

653

657

663